

APPRAISAL TODAY

Residential Cost Approach: complying with USPAP when lenders require the Cost Approach - Part 1

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Editor's notes: This is Part 1. Part 2, in next month's newsletter, includes external and functional obsolescence, reconciliation, and sample comments.

When I started appraising in 1976 at a California Assessor's office, the Cost Approach had been the primary method of valuation for many, many years. Assessors were transitioning away from the Cost Approach, which was not considered to be a very good valuation method. In many other countries, it is still the primary valuation method and is typically done by engineers.

I very seldom do a Cost Approach, unless it is new construction. When I worked for lenders in the past, I was required to do them and was never comfortable doing it on older homes and few, if any, land sales.

This article is an excellent explanation of how to do the Cost Approach, when it works well, and what to do if you are not comfortable doing it.

This article is very, very useful if your client requires a Cost Approach on an older home.

Many residential mortgage lenders are requiring a cost approach to value as part of their assignment conditions.

In some markets, the cost approach is a very reliable value analysis. Such markets usually have an active and steady level of building activity. These markets not only exist in rural areas, but also exist in suburban and urban areas where expansion is occurring (at the outer boundaries of the suburbs), or where new in-fill construction and gentrification is occurring (in the city).

In areas that are mostly built-up, when a new subdivision is created, the quantity of data for new home sales is usually sufficient and land values can be easily extracted from the sales. Physical depreciation is minimal and not difficult to estimate. Most appraisers are comfortable applying the Cost Approach in these scenarios.

Summary of important issues

- * The Cost Approach is being required by more and more clients; even in cases where it isn't necessary for credible assignment results
- * The USPAP requires appraisers to complete each analysis in a competent manner
- * The Cost Approach, even in cases where not necessary and not given any consideration in the final value reconciliation, can be completed and reported without creating a "misleading" report (See USPAP FAQ #290)
- * The reconciliation is the section where the appraiser should communicate to the client his/her evaluation and ultimately the consideration given to the Cost Approach in concluding the final opinion of value
- * The quality of data (absolute and relative to the other approaches) should be discussed in the reconciliation; the quality of data determines how much consideration the Cost Approach should be given

IN THIS ISSUE

- How to get started in commercial appraising: 5+ unit apts. Higher fees, no AMCsPage 6**
- Appraiser surveys: blacklisting, regs/enforcement, background checks, pressure, etc Page 10**
- Loan application graph from 2013 to todayPage 12**

Cost Approach challenges - old homes and few (or no) land sales

The challenge exists, however, when a lender requires a cost approach analysis on a property with a 40-year old improvement in an area that is nearly 100% built-up, and where the typical buyer would not consider building new vs. purchasing an existing home.

Many appraisers wonder if they can accept such an assignment and complete the Cost Approach when:

- (a) they don't believe the approach is applicable,
- (b) they don't consider the results meaningful, and
- (c) they are concerned about producing a misleading report by including an approach they otherwise would not include.

I teach a continuing education class (approved in California) that deals with the practical application of the Cost Approach for residential assignments. In the class, we discuss these and other issues, as well as complete a Cost Approach analysis on a single-family residence located in a 40-year old neighborhood where there are no vacant land sales. By the end of the presentation, most participants are convinced the Cost Approach can be credibly completed for any single-family residence.

The mechanics of the application are best presented in a class or textbook, but this article summarizes some of the major themes of providing a credible and USPAP compliant Cost Approach analysis.

What does the USPAP say?

When an appraisal assignment requires the Cost Approach as part of the assignment conditions, that requirement becomes part of the assignment's Scope of Work (see SOW Rule), and it must be developed and reported. Some appraisers are concerned that completing and reporting an approach to value they consider not appropriate can result in

a "misleading" report.

FAQ #290 in the USPAP (2014-2015) deals directly with this concern.

Question: I have a client requesting that the Cost Approach be included in every appraisal assignment, including those where I feel the Cost Approach may not yield meaningful results.

I am concerned that by complying with the client's request I may be providing a misleading appraisal report. How can I comply with USPAP and satisfy the client at the same time?

Answer: Performing a Cost Approach that may not yield a meaningful indication of value does not result in a misleading appraisal report if the appraiser properly addresses the applicability and suitability of the approach in the report. Many appraisers address this in the reconciliation by including statements such as, "The Cost Approach was included solely at the request of the client; it has been given no weight in arriving at the final opinion of value because"

The appraiser can complete the Cost Approach, even when the appraiser believes the results are not meaningful. The approach is completed, but the final value opinion is not dependent on the results of that approach. The report is not misleading since the opinion of value is not relying on the Cost Approach. Further, the appraiser explains why the Cost Approach is included (client requirement) and why the results are not given any consideration in the final value reconciliation (more on this to follow).

However, just because the Cost Approach results can be effectively and appropriately excluded from consideration, does not excuse the appraiser from completing the Cost Approach in less than a competent manner.

The USPAP is very clear on compe-

tency (Competency Rule, my bold for emphasis):

An appraiser must: (1) be competent to perform the assignment; (2) acquire the necessary competency to perform the assignment; or (3) decline or withdraw from the assignment. In all cases, the appraiser must perform competently when completing the assignment.

Comment: Competency may apply to factors such as, but not limited to, an appraiser's familiarity with a specific type of property or asset, a market, a geographic area, an intended use, specific laws and regulations, or an analytical method. If such a factor is necessary for an appraiser to develop credible assignment results, the appraiser is responsible for having the competency to address that factor or for following the steps outlined below to satisfy this COMPETENCY RULE.

Therefore, even though the appraiser concludes the Cost Approach does not yield meaningful results and does not rely on it, it must be completed in a competent manner. This requires the appraiser to use the correct methodology, regardless if the appraiser believes the results to be meaningful or not.

Cost Approach Methodology & Cost Approach Data

Many appraisers in my class ask this question:

How is it possible for a competent appraiser to complete an approach to value using the correct methodology, and yet arrive at a value indication that he or she considers not meaningful?

The answer is simple: The Cost Approach methodology is sound. The typical weakness is not the methodology (which is tried and true), but rather the data. Nelson Bowles, MAI, in his book "In Defense of the Cost Approach: A Journey into Commercial Depreciation" (published

by the Appraisal Institute) sums up the Cost Approach formula succinctly:

$$\text{Value} = \text{Cost} - \text{Depreciation}$$

The value of a property equals its cost (land/site, construction, and all related costs including entrepreneurial profit) less depreciation (all forms: physical, functional, and external). The equation is so simple as to be elegant. The methodology used in the Cost Approach solves for the above equation. If given the correct inputs, anyone with the most basic math skills can solve the problem.

I emphasize in my classes that it isn't the Cost Approach methodology that has shortfalls; it is the data available for consideration. Understanding this difference (methodology vs. data quality) will ensure that the appraiser (a) completes the Cost Approach credibly and (b) uses the correct rationale and logic in determining how much consideration (if any) the Cost Approach should be given in the final value reconciliation.

Basic Components of the Cost Approach

There are three basic components of the Cost Approach: (1) Site value, (2) improvement costs, and (3) depreciation. I've listed some of the major topics that are discussed in my class that seem to get the most feedback from the participants.

SITE VALUE

* Land is always valued at its highest and best use. Land sales or land extraction comparables should be similar to the subject in zoning and likely use. It is better to match R-20 (residential, single-family, 20,000sf min. lot) with another R-20 vs. R-40. Similarly, it is always better to match a site that is single-family use only vs. a site that may allow for multiple/competing uses. Try to match like

for like with the subject.

* The site value in the Cost Approach reflects the value of a site that is "ready for development." "Ready for development" is relative depending on the location. A rural setting may reflect a "raw land" condition (little if any infrastructure). An urban or suburban setting would reflect more of a "finished land" condition (some grading and drainage, and street/utility infrastructure present). If the improvements on the subject's site were removed, what kind of land (raw or finished) would best match it?

* Sales Comparison approach is the best if vacant land sales exist that are similar to the subject's site. If there are no vacant land sales, then two other methods are commonly used: Extraction and Allocation (there are two other methods for obtaining land values: Land Capitalization and Subdivision Analysis; but they are seldom used or necessary for a residential mortgage appraisal assignment).

* Extraction is the process of taking a recently sold improved property, and then extracting its site value from the total sale price. This method has many advantages; most notable is the improved sales can be from the subject's neighborhood (and can be comparables used in the sales grid). The disadvantage is that the same challenges in a regular Cost Approach (namely, building cost data and estimating depreciation) are also present in this method. Despite the challenges, this is the method I prefer if land sales are unavailable and I must complete the Cost Approach.

* Allocation uses land-to-value ratios from properties located in competing markets, and applies them to the improved properties within the subject's market. This approach works well when there is an identified competing market with similar properties and vacant land sales, and the demographic profile is the same or very

similar to the subject's demographic.

The process is to compare the land sale price to the improved sale price, and conclude a ratio (land sells for \$100k, improved property sells for \$500k, land-to-value ratio is 20%). With enough such sales, a reliable ratio can be extracted and then applied to the subject. The strength of this approach is that there are land sales to support the analysis. The weakness is similar to what exists in the subject's market: it relies on vacant land sales.

* What about Assessor Land-to-Value Ratios? Assessors typically rely on mass appraisal techniques that can be very good in the aggregate, but might not be ideal in a specific. Some assessor models use the same Land-to-Value ratios for different property types or apply the same ratio to different quality/condition/age properties; consequently, the ratio is not subject-specific.

In California, due to Proposition 13, the assessed values may have little relationship to market value. Also, if questioned, I could not explain exactly how and what data an assessor used in its site value/Land-to-Value ratio calculations. For these reasons, I do not recommend relying on assessor calculations for site value estimates unless the appraiser can verify the ratio is market-based and applicable to a subject-like property.

Editor's note: relatively few states have this restriction. See if the land to value ratios are reliable in your area.

Support for your opinion is required

Whatever method an appraiser selects, if the assignment is for residential mortgage lending and is completed in compliance with the GSE guidelines, then the requirement is to provide "Support for the opinion of site value (summary of comparable land sales or other methods for estimating site value)." A simple state-

ment of "site value by X method" does not meet this requirement. If land sales are used, then they should be itemized (summarized). If allocation or extraction techniques are used, I recommend that the table/worksheet used to calculate the results be included, or at a minimum, the properties used be listed. The GSE form also states:

"Provide adequate information for the lender/client to replicate your cost figures and calculations."

This applies to all of the elements (site, cost, and depreciation) of the Cost Approach. In order to "replicate" the cost figures and calculations, it makes sense that enough information must be provided so that the lender/client can check the data and do the math.

Sources for Improvement Costs

Obtaining improvement and building-cost estimates from valid sources is not difficult. There are national vendors of such information (Marshall & Swift, AppraiserBase), and there is a free source that is available on the web by Craftsman Publications (www.building-cost.net/CornersType.asp). I've used all three, and compared them to one another and with local building costs.

While there is some discrepancy (5-10% +/-), overall I have found them to be reliable for most basic improvement-types within my markets.

The best data is actual contractor cost/bid sheets from local builders. In markets where there is a lot of new construction activity and an appraiser has access to recent and relevant contractor prices, the quality of this data is excellent. However, these are the same markets where the Cost Approach is not a challenge.

In markets where there is not that level of activity, then the next best method would be a national cost service. The three sources I referenced modify for location (AppraiserBase

modifies based a 5-number zip code, Building-cost.net to the first 3 numbers of the zip code).

The advantages of using these types of services are:

- * They are recognized as reliable sources and used by one's peers
- * They provide varying degrees of detailed cost information that can be easily imported into the report
- * Their results are replicable

Some argue that these cost services are not reliable because they are based on surveys. Marshall & Swift has been a recognized source for many years, and its residential cost sheet is incorporated into many appraisal software programs. Bluebook International, a leading provider of construction costs for the insurance industry, developed AppraiserBase. Craftsman publishes cost-estimator books and software designed for contractors. All three are recognized as valid sources, used regularly in the appraisal profession, and are appropriately reliable given the intended use of the typical mortgage-finance appraisal assignment.

Other improvement cost considerations:

- * Replacement Cost is the typical standard for residential appraisal assignments. Replacement cost replaces the existing improvement using modern building techniques and materials, and modern design-standards. When using replacement cost, functional obsolescence (due to poor floor plan design) is eliminated.
- * Reproduction Cost is not typically used for mortgage finance appraisals. Reproduction cost effectively rebuilds the improvement as is, using similar building materials and the same design, which would include any functional obsolescence due to floor plan layout.
- * As-Is Value of the Site Improvements are the contributory value of site-improvements not included in the building costs. The

important item to remember is that "as is" means "as is"; the value is not cost of the item, but its contributory value. In effect, they have already been depreciated (Value = Cost - Depreciation. Contributory value = cost - depreciation).

An example I use to demonstrate the difference is this: Assume a pool costs \$45,000 new, and adds \$25,000 to value. Some appraisers put the cost of a new pool above the depreciation line, and then depreciate it; this is fine (as long as one makes sure the depreciation includes physical and functional). Another, equally valid, and in my opinion, easier method would be to add \$25,000 to the as-is value of the site improvements. The result, if done correctly, is the same.

But if put above the depreciation line, most form software will calculate physical depreciation of the pool based on the age/life calculation for the home; if there is additional depreciation (functional), then this has to be calculated separately and added into the "functional depreciation" category. I find it easier to lump sum the contributory value (which is the same adjustment used in the sales grid).

Referencing "Appraiser Files".

In my role as a reviewer, I read many reports that gave their construction cost source as the "appraiser files". As I said earlier, relevant and current contractor bids, kept in the appraiser's files, is probably the best data available. But, the requirement in the GSE forms is more than just citing the source; it requires the appraiser to provide adequate information so the lender/client can replicate the steps. In California, our regulators, if auditing an appraisal report, will ask for the support of the cost estimates if "appraiser files" are referenced. In other words, if the file is cited as containing the data, the data better be there.

If you cite appraiser files, then I

recommend a more robust commentary/citation. In my class, I use an example like this:

I have completed 5 appraisals of newly constructed homes in the subject's neighborhood within the last 18-months. These homes are located on Vine, Mary, Elm, Cherry, and Walnut Streets. For these assignments, I have contractor bids and price lists. The subject is similar in quality and configuration to these homes, and I have relied upon this contractor cost data to conclude my \$/SF replacement cost. I have retained this data in the work file.

Depreciation is not easy

Easy to define, but sometimes difficult to calculate, many find estimating depreciation as the most challenging part of completing a Cost Approach.

Depreciation, in its basic form, is nothing more than "a loss in value".

Again, the basic Cost Approach formula states:

Value = Cost - Depreciation

Many use the term "depreciation" interchangeably with "obsolescence". Technically speaking, depreciation is the loss in value. Obsolescence (functional or external) can cause depreciation. Physical deterioration (wear and tear that comes with aging) also causes depreciation.

A new home, built to the ideal market standards (the "ideal improvement") having no deterioration or obsolescence, is worth what it costs to create (that cost includes both contractor and entrepreneurial profit).

There is no free lunch: the builder and developer need to be paid for the roles they play and risks they take in developing the property. As the home ages (physical), market (external) and location (external) factors change, a property begins to depreciate.

Appraisers (including myself) like to remind other stakeholders "Cost does not equal value". For the ideal improvement (the new home described above), cost actually does equal value; in most other cases, the cost of an item experiences some form of depreciation (even if it is new).

Ways to calculate depreciation

There are a number of ways to calculate depreciation, with market-extraction being the best. Again, if sufficient data exists to do so, it is likely that new construction activity is steady and there is sufficient data for the other elements (site value and building costs). This is cost-approach paradise!

For the rest of the markets, the data isn't so readily available.

In my class, we discuss the typical ways appraisers estimate depreciation. * Physical deterioration can be estimated using a modified age-life method. The age-life method relies on an improvement's (a) total economic and (b) the effective age. The calculation is simple: If an improvement is estimated to have a total economic life of 70 years, and the appraiser estimates it is about half-way through its life-cycle, then its effective age is 35 years, and its remaining economic life is 35 years. The depreciation is $35/70 = 50\%$.

In its purest form, the age-life method does not differentiate among the different types of obsolescence (physical, functional, or external). Most appraisers use a modified age-life method, which separates those elements; the result of the modified age-life method is the amount allocated to physical depreciation (wear and tear/age).

Estimating total economic life and remaining economic life is something appraisers do in every 1004 form appraisal, with or without completing

the Cost Approach.

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How to get started in commercial appraising: 5+ unit apartments. Higher fees, steadier work, no AMCs, etc.

What will you do when the residential lending market slows way down again and fees drop? Tired of working for AMCs?

In the article in this newsletter about appraiser survey results, "Appraiser surveys - blacklisting, regs/enforcement, background checks, pressure, liability issues, etc.", there are some increases in the number appraisers doing commercial appraising or both residential and commercial appraising.

Residential lender appraising is very cyclical, but commercial appraising is much steadier with lots of non-lender options. How can you break into this business?

If you have ever filled out an income and operating statement for a 2-4 unit property, the financial analysis required for 5+ unit properties is very similar.

There are no adjustment grids, no AMCs, and much higher fees. I use the old 4-page 71A old Fannie form and update it for USPAP, certification and limiting conditions, etc.

Get started by doing 5-10 unit apartments

Many commercial appraisers don't like to appraise apartments because of the relatively low fees and the use of form appraisals.

If you can appraise a 2-4 unit property, you can learn to appraise apartment buildings with 5+ units. For many appraisers, including myself, 5+ units are easier to appraise than 2-4 units as they are purchased on their income producing capability. In contrast, 2-4 units are often not purchased by sophisticated investors, so appraising them has issues somewhat similar to homes, such as changing buyer motivations, etc.

2-4 units vs. 5+ unit appraisals

Appraising 2-4 unit properties is often much more difficult than 5+ unit properties. The form is similar to a URAR, with adjustments and much less emphasis on income.

In contrast, 5+ unit properties are purchased on income.

2-4 unit appraisals are complicated with lack of sales in many areas, rent comps can be hard to find, the differences in the market among 2,3, and 4 unit properties, relatively low fees, owner occupants, etc.

Depending on the market, units of comparison such as price per unit, per bedroom, and per sq.ft. are also used as "rule of thumb" factors by investors. The primary indicators of value are based on income: gross income multipliers and cap rates.

The differences between commercial and residential appraising

Learning how to appraise commercial property takes a long time (3-5 years++) because you appraise so many different property types (hotels, warehouses, retail, etc.) Commercial properties often have issues such as highest and best use and zoning conflicts.

You must be able to analyze leases, use a spreadsheet program, write narratives, and have good financial and math skills.

Commercial appraising is not for everyone, but I really like it.

What I miss the most doing commercial appraisals is working in the field. I spend most of my time researching and writing reports. In residential, I spend much more time in the field.

However, I prefer residential, as they are much easier due to good data, and I spend much less time per appraisal. When non-lender residential volume is low, I do more commercial appraisals. Also, very few residential appraisers can make it financially doing only non-lender work.

Does residential experience help?

This is a very controversial topic. When I started appraising in the 1970s, you started in residential. The better residential appraisers were allowed to move into commercial appraising.

Since then there has been fairly strict "tracking". When you start in residential or commercial, you stay there. It is hard to move to the other field.

Personally, I find my residential skills very helpful in understanding the commercial market. Residential focuses much more on buyer motivation. You are only appraising two types of properties: single family and 2-4 unit properties so you really become an expert. The MLS data is much better than for other property types.

In contrast, commercial appraisers work on a wide variety of properties, such as apartments, industrial single and multiple tenants, retail stores and strip malls, etc. There are fewer transactions and finding out about them can be tough. Highest and best use is often a big issue. Almost every commercial appraisal I have done has something about it that was unique.

However, many commercial appraisers say it is difficult to train a residential appraiser to do commercial appraisals. They prefer to train someone with no appraisal experience. That is one of the main reasons I recommend starting in 5+ apartments.

Do you like appraising 2-4 unit properties?

If you don't like doing them, you won't like appraising 5+ unit apartments. If you like doing them they can really help you get started doing 5+ apartment properties.

Appraising in a market where most properties are purchased by investors is most similar to appraising 5+ unit properties. They are concerned about the income and cash flow potential.

If you have never appraised a 2-4 unit property in an investor market, you can offer to do one for free for the owner just to see what it is like. Or, take one of your previous 3-4 appraisals and analyze it "as if" it was in an investor market and no adjustment grid is used.

Fannie Mae form 216 - Operating Statement for 1-4 unit properties

Have you ever done these? If not try filling it out for 2-4 unit appraisals you have done. It is very similar to the 71A form's income and expense form.

What about math skills for apartments?

Have you ever done an income approach on a 2-4 unit property? For small apartments you need the same math skills as a 2-4 unit property - add, subtract, multiply, divide. If you can calculate a GRM, you can calculate a GIM and an OAR.

Have you ever filled out an Fannie Mae form 216, operating statement for a 1-4 unit rental property, which are for lending purposes and are not financial statements? They are very similar to filling out a current and projected financial statement for 5+ unit properties.

More complicated math, such as discounted cash flow analysis is not typical for most small apartment markets.

What about listings and sales?

Depending on the local market, some apartment properties are listed on MLSs. There are relatively expensive commercial data sources as Costar in some larger markets.

Apartment appraisal forms - 71A and 71B

I prefer the 4-page 71B form. Print it out from your forms software and see what it requires.

You will be using GIM - Gross Rent Multiplier (annual gross rent) and Capitalization Rates, which are very easy to calculate (net operating income divided by sales price). You can calculate them for the listings and sales.

For small apartments, typically under 20 units, a 4-page appraisal form, 71B, is used in many areas. Sometimes the 10-page 71A form is used. See which form is preferred in your area.

The forms are available in most residential appraisal forms software. The forms are old so you will need to include additional material now required by USPAP. You can do it yourself using the form 1025 (2-4 units) as a guideline. However, do not include some of the Fannie statements in that form. It will be a very good exercise in understanding USPAP.

The 71B form states that it is to be used only for apartments where the "loan request does not exceed \$750,000." Few, if any, clients care about the limit.

How to get started writing narrative reports

Most commercial appraisals are in narrative format. In some markets narrative reports are used for apartments. If so, it is time for you to practice producing narratives. If you've written a term paper in college, you can do a narrative.

The best way to get started is to complete a residential appraisal you have done on a form and convert it into a narrative report. Just follow the form. Instead of checking boxes, write out your description and analysis. The chapters are the same as the form.

What classes should you take for certified general?

Check the requirements for certified general in your state. Be sure to take your classes from the Appraisal Institute as they are preferred by most commercial appraisers.

If you already have a bachelor's degree, I strongly recommend taking finance and accounting classes as they will give you the foundation for commercial appraising. When I started appraising I came from a science background, so my math skills were strong. But I knew I lacked basic business education, so I got an MBA which dramatically improved my appraisal skills.

If you are licensed or certified you probably already have basic appraisal principles, procedures, statistics, and USPAP. You will need to take an additional 210 hours of six 30 hour classes: Market Analysis, Site Valuation and Cost Approach, Income Approach part 1 and 2, and Report Writing. Check www.appraisalinstitute.com to see when and where classes are offered.

Taking online classes is NOT recommended.

What about a college degree?

A bachelor's degree is required for certified general. It is very unlikely the AQB will change this requirement.

A college degree in finance, accounting, English, or real estate is preferred to get someone to train you.

What if you don't have a 4-year degree and have a certified residential license?

Check your state appraisal regulations. You can work for a commercial appraiser who will co-sign for you, if needed.

What if you only want to appraise 5+ unit apartments?

To get a Certified General license, you need experience in a variety of commercial properties and a college degree.

A good option is to do apartment appraisals for commercial appraisers who get appraisal requests for apartments but don't want to do them. You can continue doing 2-4 unit properties.

Take a basic live commercial appraisal class from the Appraisal Institute. Do not take it from a proprietary school. Do not take an online class. This will demonstrate that you are serious about learning.

What about working for lenders?

Most apartment appraisers work for lenders. There are few, if any, lenders who use AMCs for apartment appraisals.

In many areas, commercial appraisals are done on a bid basis online, which depresses fees. But, not all lenders use online bidding.

There is also non-lender work available. For example, I do a lot of appraisals for 5+ unit properties for

estates.

What about getting an MAI designation?

If you want to make a good, steady income in commercial appraising, an MAI designation, is very, very helpful.

Tips on finding a mentor

Many commercial appraisers in my area don't like to do apartments, particularly small 5+ unit properties.

As a licensed or certified residential appraiser, you will need to have a certified general review your work and "sign off" on your commercial appraisal experience if you are doing them for lenders.

For non-lender work, check your state requirements. You may not need a co-signature for non-lender work. However, you do need someone to advise you per USPAP's competency rule.

Offer to "tag along" with a commercial appraiser on a small apartment assignment to see how the inspection is done. Then offer to do a parallel report and have him/her review it. You can offer to pay a review fee, if necessary. Try working for a very low fee split.

If you can't find anyone to tag along with, try doing one yourself on the 71A form. They are not very difficult.

If you really want to do commercial appraising, I strongly recommend taking basic commercial appraisal classes from the Appraisal Institute, to show that you are motivated and serious about becoming a commercial appraiser. They are diffi-

cult and you will need good math skills and know how to use Word and Excel for commercial narrative appraisal reports.

The best place to network is at Appraisal Institute chapter meetings, seminars and classes.

What about fees for small apartment properties?

They are relatively high in my area, as many certified generals don't do them. Mine are twice as high as 2-4 unit appraisals and take about the same amount of time. Call around and ask local commercial appraisers what they charge.

Also, ask if they use forms or narrative reports for the smaller properties. Forms take much less time to complete than narrative reports.

Useful book: "The Valuation of Apartment Properties"

The Appraisal Institute published the second edition of "The Valuation of Apartment Properties" in 2008. The book uses two examples: a 12 unit building and a 150 unit property.

This book is "textbook" style and is written similar to basic appraisal books.

Since the book includes both the small apartment and the large apartment complex, some of the material is an over-kill for small apartments.

But the book has some practical information such as a sample pro-forma statement and how to calculate and use an Overall Capitalization Rate.

Most appraisals in my area for small apartment properties are done on the 71A or 71B form. In some areas, narrative appraisals are done. The book does not go through the form.

If you're new to Income property appraising, buy this book.

To order the book, go to

www.appraisalinstitute.com

Useful book: "Using the Small Residential Income Property Appraisal Report"

The Appraisal Institute published this very practical book on appraising 2-4 unit properties using the 1025 form.

The book does not include a "sample" report, but goes through the report line by line explaining what is needed.

The Appendix includes an analysis of the Form 216, Operating Income Statement. This is used for lending purposes, not appraisal purposes, but requires most of the data needed for the 71A and 71B forms.

To order the book, go to www.appraisalinstitute.com

Should you do commercial (non-apartment) appraising?

If you're an experienced residential appraiser, you already know what you like about appraising.

Differences between commercial (non-apartment) appraising and residential appraising include:

- Much fewer comps and listings available.
- Expensive data.
- Time on the phone trying to get information from people on the sales and listings.
- Working with numbers and spreadsheets.
- Spending lots more time on each appraisal.
- Lots of learning in classes and individual training.
- Good writing skills for narrative reports.
- Spending most of your time in the office, instead of in the field.
- Need a network of other appraisers for advice, comparable rents, etc.

Appraiser surveys - blacklisting, regs/enforcement, background checks, pressure, liability issues, etc.

I have combined two national appraiser surveys from Valuation Review and Alterra Group (Appraisal Buzz). They do not have exactly the same questions, but it is good to have more than one survey.

When available, and relevant, I have included data from previous years.

Last month I wrote about surveys that included such topics as fees and turn times plus AMC/lender surveys. This month I write about the other survey results.

Data on appraisers - type of appraisals, how long appraising, etc. Residential, commercial or both?

Source: Voice of the Appraiser, Valuation Review

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Res.	66.2%	65.2%		
Comml.	8.9%	11.2%		
Both	24.9%	23.5%		
Comm/ both	33.7%	34.7%	22.2%	18.5%

What type of appraisal work do you perform?

Source: National Appraiser Survey 2016, Alterra Group

	<u>2016</u>	<u>2015</u>
Residential	78.2%	80.2%
Commercial	4.5%	4.0%
Both	15.4%	14.6%
Other	1.9%	1.2%

Comment: The Alterra survey had mostly residential appraisers and the Valuation Review survey had more commercial appraisers. However, both indicate that the number of appraisers who do commercial or both has been increasing. This month I write about how to get started in commercial appraising by doing 5+ unit apartments, which are easier, and more profitable, than 2-4 unit appraisals.

What type of appraiser are you?

Source: National Appraiser Survey

2016, Alterra Group

	<u>2016</u>	<u>2015</u>
Sole Proprietor	64.6%	66.1%
Staff Appraiser of Appraisal Firm	10.0%	9.0%
Owner or Principal of Appraisal Firm	23.9%	24.9%
Staff for Multiple Appraisal Firms.	1.6%	n/a

In what year did you begin conducting real estate appraisals?

Source: National Appraiser Survey

2016, Alterra Group

	<u>2016</u>
Earliest	1951
Most recent	2014
Mean	1991
Mode	1986

Comment: previous years were very similar.

Business diversification

What other types of work assignments do you routinely accept?

Source: Voice of the Appraiser, Valuation Review

	<u>2016</u>	<u>2015</u>
Estate	75.0%	80.4%
Divorce	66.5%	66.6%
Review	64.5%	64.5%
Probate	47.4%	
Litigation	47.4%	
Bankruptcy	38.8%	
Taxation	36.8%	
Forensic	26.8%	
Eminent domain	19.0%	
Right of way	16.3%	
Personal prop	8.5%	

Comment: No data was available on how many appraisals were done in each type, but does indicate that

estate, divorce and review are high. Probate could be included also, as it sometimes would include estate. Eminent domain, right of way, etc. is probably from commercial appraisers.

What real estate valuation services do you provide?

Source: Voice of the Appraiser, Valuation Review

Full appraisals	99.1%
Drive-by appraisals	71.1%
Property condition inspections	28.0%
Alternative Valuations such as CVRs, STATS, RERs, etc	12.4%
Broker price opinions	4.8%

Comment: Although many appraisers don't like drivebys, the results indicate that lots of appraisers do them.

Marketing methods

Source: Voice of the Appraiser, Valuation Review

	<u>2016</u>
Word of mouth	80.0%
Internet	44.3%

Comment: Because residential appraisers are so busy, and most work is from AMCs, there is little more "traditional" types of marketing such as Chamber of Commerce meetings, networking at appraisal meetings, etc. I only use the methods above myself.

The Future of appraising

How do you feel about your business right now?

Source: Voice of the Appraiser, Valuation Review (5 choices)

<i>Extremely pessimistic</i>	7.6%
	14.8%
<i>It's OK</i>	47.1%
	23.5%
<i>Extremely optimistic</i>	7.0%

Comment: Most appraisers say it is "OK" or are somewhat optimistic.

Are you optimistic about the future of appraising?

Source: National Appraiser Survey 2016, Alterra Group

Yes	18.7%
No	64.7%
Don't know	16.6%

Comment: Most appraisers answering the survey were residential.

Professional appraisal association membership

Do you belong to a professional organization?

Source: National Appraiser Survey 2016, Alterra Group

Yes	46.0%
No	52.3%
N/A	1.7%

If yes, which one(s)? (Check all that apply)

(Percent estimated from graph)

Source: National Appraiser Survey 2016, Alterra Group

Appraisal Institute	40%
NAA	8%
ASA	2%
IAAO	3%
NAR	20%
ASFMRA	2%
NAMA	2%
NAIFA	7%
State Coalition	27%
Other	25%

If you do not belong, why not? (Check all that apply)

(Percent estimated from graph)

Source: National Appraiser Survey

2016, Alterra Group

No perceived benefits	75%
I know nothing about them	10%
Dues are too high	30%

Comment: Not much change on these question from 2015. Looks like the Appraisal Institute is the most dominant, with NAR second. But, state coalitions and "other" also were selected I am not sure what "other" means (Facebook, etc.?), but the results indicate that many appraisers are members of groups. Although, many appraiser mention that they seldom communicate with other appraisers.

What are you concerned about?

As an appraiser, rank the following from major concern to no concern:

Source: Voice of the Appraiser, Valuation Review 2016

(Note: 5 choice ranking, from Major to Not a concern)

	Major		Not a concern	
<i>Low fees</i>	44.4%	15.0%	5.8%	6.2%
<i>Lack of loyalty/Work to us</i>	25.9%	18.2%	8.7%	9.8%
<i>Scheduling conflicts</i>	17.6%	18.9%	8.3%	6.9%
<i>Blacklisting</i>	22.8%	12.6%	13.6%	22.3%
<i>Appraisal reviews/Conflicts</i>	11.4%	12.0%	13.3%	15.6%
<i>Don't know who to talk to about problem</i>	11.8%	12.2%	13.0%	23.5%
<i>Send orders then cancels frequently</i>	5.8%	5.2%	22.3%	30.0%

Comment: Low fees is the top concern, although many appraisers were getting significantly higher fees in 2016. Of course, once volume drops, fees will drop also. Fortunately cancelling is not a big problem.

What do you consider to be the most pressing issues facing appraisers today?

Scale: 0.0 to 2.5

(Percent estimated from graph)

Source: National Appraiser Survey 2016, Alterra Group

Appraiser independence	1.5
Appraisal fraud	2.0
Appraiser competence	1.3
AMCs	1.5
AVMs	1.8
Appraiser license oversight and enforcement	1.9
C&R	1.7
Appraisal volume diminishing	1.8
Data harvesting	1.6
Scope Creep	1.4
Blacklisting	1.7

Blacklisting

Comment: The survey above indicates that appraisers are concerned about blacklisting. The results below indicate that some appraisers have been blacklisted, but many are not sure. Also, few were notified

Since HVCC/AIR have you been placed on a blacklist?

Source: National Appraiser Survey 2016, Alterra Group

Yes	8.3%
No	58.5%
Not Sure	29.9%
N/A	4.0%

If you answered yes to the previous question, were you notified when placed on a blacklist?

Source: National Appraiser Survey 2016, Alterra Group

Yes 3.3%
 No 14.6%
 N/A 82.0%

Liability issues

What do you feel are the biggest What are the liability issues facing appraisers today?

Source: Voice of the Appraiser, Valuation Review (Note: 5 choices)

Most important - - - Least important

Excessive or Unattainable demands from AMCs

35.6% 27.8% 18.5% 8.6% 9.5%

Confusing Regulations (USPAP, UAD, etc.)

18.7% 28.1% 27.5% 13.6% 12.1%

Pressure from lenders and real estate agents

19.4% 24.9% 22.6% 17.2% 15.9%

Aggressive states and local disciplinary boards

13.2% 15.4% 25.0% 24.7% 21.7%

Actions brought against appraisers by the FDIC or other federal regulatory body

19.5% 24.7% 22.7% 17.2% 15.9%

Note: In 2015, AMC demands and Pressure were also No. 1 and 2.

Comment: Although AMC demands do not seem to be a liability issue, appraisers worry that they will get into trouble. There are few appraisers affected by FDIC or federal regulators now, but appraisers see it as an issue. State boards are seen as the lowest lia-

bility, but many complaints are made to state boards.

Condition and value pressures

Do you experience pressure to change the condition of the subject property?

Source: National Appraiser Survey 2016, Alterra Group

Yes 4.7%
 No 74.9%
 Sometimes 18.5%
 N/A 1.9%

Do you experience appraisal independence pressure today to inflate values?

Source: National Appraiser Survey 2016, Alterra Group Yes = 8.9

No 63.5%
 Sometimes 26.3%
 N/A 1.4%

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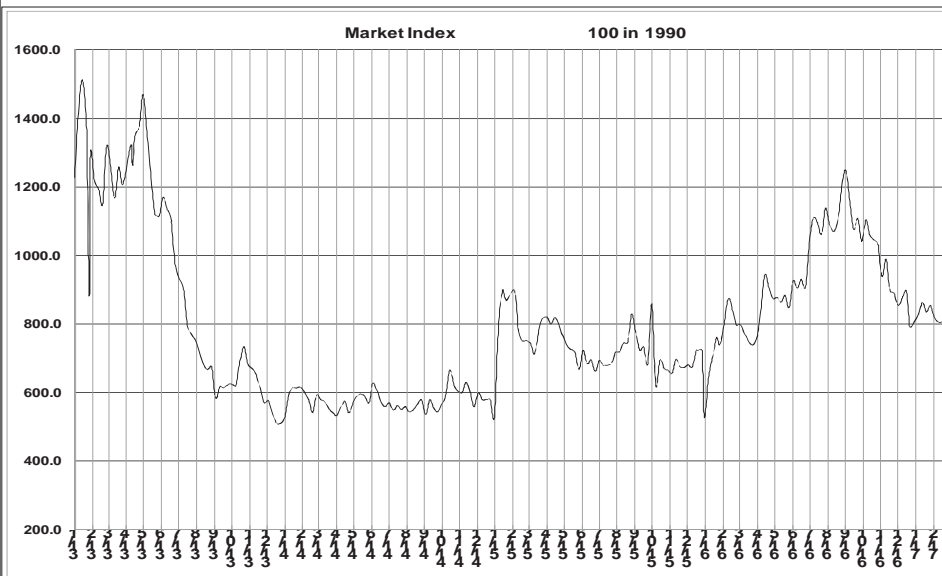
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MBA Loan Volume Application Index – 1/13 to 2/17



If you answered Yes to either of the previous questions, from whom do you receive pressure? (Choose all that apply)

(Percent estimated from graph)

Source: National Appraiser Survey 2016, Alterra Group

Consumer/Homeowner	20%
Real Estate Agent	22%
Mortgage broker/ /loan officer	14%
Underwriter	8%
AMC	17%

Comment: A big change from the mortgage broker days with considerable pressure on values. I had been hearing about AMC pressure. These results indicate that there is value pressure sometimes and from AMCs, whose primary job is to protect appraisers from pressure.

Background checks

Source: Voice of the Appraiser, Valuation Review

Per the report "In 2017, the requirement by lenders and AMCs to have appraisers do a complete background check will become mandatory. Just as in 2015, 60 percent of the appraisers polled said they had been required to do a background check, while 40 percent of appraisers soon will be getting those."

Has your lender/AMC required you to complete a background check?

	<u>2014</u>	<u>2015</u>	<u>2016</u>
Yes	58.1%	61.2%	59.9%
No	41.7%	38.8%	40.1%

How do you feel about background checks?

(Percent estimated from graph)

Source: National Appraiser Survey 2016, Alterra Group

I think it weeds out the bad appraisers	11%
I don't think it is anyone's business	18%
I am tired of getting a new one for each client	38%
I am uncomfortable but Understand the need	12%
Don't care really	21%
N/A	4%

Comment: Overall negative opinion of background checks, primarily because of getting them for each client. Not all appraisers are asked for background checks by lenders. Not much change since 2014. Commercial lender appraisers are seldom asked for background checks.

Technology/Data/Appraisal forms

Do you use a mobile device to enhance your on-site appraisal assignments?

Source: Voice of the Appraiser, Valuation Review

	<u>2016</u>	<u>2015</u>
Yes	31.1%	20.6%
No	68.9%	79.4%

Comment: Increase in use of mobile devices.

What functions do you perform on your mobile device?

Source: Voice of the Appraiser, Valuation Review

	<u>2016</u>	<u>2015</u>
Photos	73.4%	78%

Comment: Other uses were for maps, sketches, workflow management and forms. I use an inexpensive camera as it is a lot cheaper to replace when dropped and damaged, than my iphone or tablets.

What technology do you desire that is currently not available to you? (Choose all that apply)

(Percent estimated from graph)

Source: National Appraiser Survey 2016, Alterra Group

Better 1004 MC tools	32%
Interactive Valuation Models	24%
More robust data sources	51%
Advanced Field Collection Devices	25%
Web based forms	11%
Other	13%

Comment: Very interesting that appraisers are still looking for better 1004 MC tools. Of course, we all want more robust data sources. Not sure what Interactive Valuation Models are used for. Many of us, including myself, are looking for field connection devices that integrate with our forms software.

Do you think new appraisal forms would be helpful?

Source: National Appraiser Survey 2016, Alterra Group

Yes	49.9%
No	46.2%
N/A	4.4%

Comment: Several appraisers mentioned 1004MC forms.

Would you contribute to a shared property database if you were compensated for the data?

Source: National Appraiser Survey 2016, Alterra Group

Yes	62.3%
No	31.0%
N/A	6.7%

Comment: Interesting results. There are a few appraiser shared databases today. In the past, before appraisers got MLS access, there were more. Before licensing, I used CMDC, an appraisers' cooperative database and contributed the first page of my appraisal reports. Not paid.