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Index

Residential Cost Approach Part 2 - Reconciliation, obsolescence, sample comments By Denis DeSaix, MAI, SRA

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Editor's note: In Part 1, in the March, 2017 issue of Appraisal Today, Denis discussed USPAP, basic components, land value, data sources, depreciation, how to report depreciation on appraisal forms, and other issues.

In Part 2, Denis includes sample reconciliation statements for your appraisals and why the Cost Approach does not have to "match" the Sales Comparison Approach.

Summary of important issues (repeated from Part 1)

* 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

Functional obsolescence

Functional obsolescence is created when some aspect of the improvement does not meet the market standards. Usually it is caused by a design flaw or due to a component becoming obsolete.

The classic example of functional obsolescence due to floor plan design is a bedroom that is accessed through another bedroom.

Another example (less obvious) might be this: In a community of 2-story homes, the market expectations (the market standard) might be that a half-bath is located on the ground floor (or full bath if a bedroom is on the ground floor). If the subject's
design does not include this market expectation, its price will likely be negatively impacted.

In both examples, the market is likely to pay less for the subject with the design flaws than it would a substitute without design flaws.

Since the Cost Approach is using Replacement Cost calculation that doesn't reproduce the subject's functional impairments, the adjustment in the sales grid (the loss in value) is the functional obsolescence adjustment to be applied in the Cost Approach.

External obsolescence

External obsolescence is defined as a loss of value due to influences outside the property (and outside of the control of the owner). External obsolescence is a form of depreciation that appraisers routinely calculate, even when the Cost Approach is not completed. Busy streets, railroad tracks, proximity to non-residential influences may result in a negative market reaction (a "loss in value") vs. non-impaired properties.

Another type of external obsolescence is caused by market conditions (and referred to as "Economic Obsolescence"). Many of us saw the results of economic obsolescence in the recent housing crash: homes were selling for less than their depreciated value.

The adjustment for external obsolescence in the Cost Approach should be related to the location adjustment applied in the sales comparison grid. An important item to remember is sometimes part or all of the externality affects the value of the land; in that case, the site value would reflect that condition already, and the amount attributable to the improvements would reflect the balance.

Summary of important factors

These are just some general examples of how appraisers estimate depreciation. The key take-away is this:

* Depreciation is a loss in value.
* The basic Cost Approach formula is Value = Cost - Depreciation. This formula also proves that Depreciation = Cost - Value.
* Many times, adjustments applied in the sales comparison approach have a corresponding adjustment in the Cost Approach.
* Appraisers are already calculating depreciation adjustments in their typical assignments, but they are not called "depreciation" adjustments; they are called sales comparison adjustments.
* When completing the Cost Approach, an appraiser should ask him/herself, "I adjusted for X in the sales grid… is there a corresponding adjustment to make in the Cost Approach?"

The Reconciliation

The vast majority of residential appraisals (and almost all residential mortgage appraisals) rely on the sales comparison approach to value as the primary valuation method. This is as it should be, since the sales comparison approach best mimics the market dynamics of buyers and sellers… especially owner-user buyers and sellers of single-family homes. Consequently, many of us are very good at reconciling the sales comparison approach, but sometimes we don't adequately reconcile the other approaches.

The reconciliation (or "Final Reconciliation") is where the appraiser provides his or her evaluation of each approach used (or not used), states its strengths and weaknesses, and then synthesizes all valuation analyses into a final opinion of value. It is the persuasive argument the appraiser should make that states: "I relied upon A, B, and C for reasons 1, 2 and 3 to conclude $X as my opinion of value."

Recall that FAQ #290 stated that an appraiser who completes a Cost Approach, but finds the results not meaningful, should address this in the reconciliation. Correctly addressing the strengths and weaknesses of the Cost Approach in the reconciliation ensures that the client understands the Cost Approach results, and understands how the appraiser considered them in the final value opinion.

Summary

Below are some of the main points we discuss in the Cost Approach class I teach.

* The Cost Approach is always applicable for an improved property. By definition, if a property is improved, its value can be expressed by the formula Value = Cost - Depreciation. Consequently, a Cost Approach is always applicable (can be applied) to value an improved property.

Many appraisal reports state that the Cost Approach is not applicable. I recommend that they state the Cost Approach is not necessary for credible results, but don't say it isn't applicable (if it isn't applicable, how can the appraiser apply it credibly?).

* The Cost Approach methodology is always credible. Some reports state that no consideration is given to the Cost Approach because the Cost Approach is not a credible valuation analysis.

Recall the Competency Rule requires appraisers to complete competently any analysis that is necessary. All appraisers who complete the Cost Approach must be competent to do so; otherwise, they need to become competent (and disclose the steps they took to achieve competency) or withdraw from the assignment. I would never want to make a statement in my appraisal report that effectively said, "I completed this analysis, but despite my best efforts, the results cannot be relied upon, because the analysis isn't credible."

The weakness is the data, not the methodology

The weakness in the Cost Approach is not the methodology, but the data. If we had high confidence inputs for cost and depreciation estimates, then we can solve for value. "Value = Cost - Depreciation" is sound methodology. The weakness isn't in the model, it is in the data.

This is true for any approach: When we have exact-matches for use in the sales comparison approach, we have a very high confidence level of the result. But, sometimes when our subject is atypical and no model match exists, we are forced to try to find the next best substitutes, which can be significantly different from our subject.

No one would say that the sales comparison approach isn't credible. Most would say, "These are the best comps that exist, and the value indication is credible based on the best available data".

In the atypical house with few comparable sales, the problem is poor or weak data, not the approach. In the Cost Approach, when estimating depreciation on a 40- (or 75-) year old home, the problem is uncertainty about the data (the accuracy of the estimate), not the approach.

When relying on recognized building-cost services that are based on some rather simple parameters (size, configuration, quality) to estimate the costs an actual "boots on the ground" contractor might bid off of specific plans, the problem is the quality of data, not the approach.

When relying on extraction or allocation rather than actual land sales to determine the value of the subject's site, there is an inherent imprecision to the calculation, the problem is the quality of data, not the approach.

When the Cost Approach is most relevant

Consider when most of the recognized texts or knowledgeable peers recommend the Cost Approach might be necessary for credible results.

Most of the time, the Cost Approach is recommended in two scenarios: (a) newly constructed improvements, or (b) special, atypical, or unusual improvements.

In the newly constructed improvement scenario, the Cost Approach makes a lot of sense; primarily, because depreciation is easy to estimate, and actual cost figures may be available for consideration. In this case, the Cost Approach is recommended because the data is thought to be good quality.

In the atypical improvement scenario, the Cost Approach data is probably no better than the 40-year old home scenario (and could be worse). Nevertheless, the Cost Approach is recommended because the other approaches (sales and income) likely have similar, poor quality data issues. Here, even though the Cost Approach's data is low quality, relatively speaking, its data quality is similar in quality to the other approaches, therefore, it is recommended and may even be necessary for credible results.

Sample Cost Approach Reconciliation statements for your appraisals

Here are three examples of Cost Approach reconciliation statements that communicate to the client/intended user how the appraiser evaluated the Cost Approach's value indication in the final value opinion. Note that each one addresses if the appraiser considers the approach necessary or not.

Example #1: Cost Approach is not meaningful or necessary, but is required and is given no consideration in the final reconciliation.

The Cost Approach is not necessary for credible results; however, it is required by the client and is therefore completed. The subject is an older improvement (actual age 75-years) with excessive wear and tear and some identified repair items; depreciation is difficult to estimate with accuracy.

Within this market, there were no land sales available for a site value estimate. The extraction method is used, but the data are similar, older properties, and depreciation (as with the subject) is difficult to estimate.

Compared to the sales comparison approach, the quality and quantity of data is significantly inferior; given these weaknesses, the Cost Approach is given no consideration in the final value reconciliation.

Example #2: Cost Approach is not necessary, but the result merits some consideration and the client requires the approach.

The Cost Approach is not necessary for credible results; however, it is required by the client and is therefore completed.

The actual age of the improvement is 60-years, but the subject has been well maintained, updated and modernized; its effective age is 20-years and depreciation is estimated with some degree of confidence.

In this market, while there are no current land sales, there are some newer homes (3-5 years old), and a site extraction analysis was completed using these sales. Due to the limited depreciation, the site value indication is considered a good quality data point.

The weakness of this approach is the lack of independent land sales to provide additional validation for the site value estimate. Further, the cost data, while credible, is based on the average for a multi-city area (defined by the first 3-digits of the zip code); this lowers the confidence level of the replacement cost calculation.

Compared to the sales comparison approach, the quality of data for the Cost Approach is inferior; therefore, the sales comparison approach is given most consideration in the final value opinion. However, despite the weaknesses, the Cost Approach value indication is overall consistent with the sales comparison, and provides additional market support for the final opinion of value.

Example #3: Cost Approach is necessary, and it merits significant consideration

The subject is a proposed-construction, single-family residence, with the owner planning to develop and occupy the home. For this assignment, the Cost Approach is necessary for credible results; further, my client has requested its completion.

Within this market, there is new construction activity and a buyer of the subject would consider the option of building new vs. purchasing a newly built home.

The cost data for this assignment is high quality: in addition to the plans and cost-bid documents for the subject's construction, I've also retained in my files costing data from 3-similar homes built within this market and within the last 18-months.

Lastly, I have been able to validate the cost estimates using Marshall & Swift costing service.

Based on its relevance, and the quality and quantity of the data, I've given it equal consideration in my final value analysis as the sales comparison approach.

In Summary

* 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
* While not always necessary, the Cost Approach is applicable (can be applied) to any improved property
* 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 Cost Approach can be expressed by the simple formula:
Value = Cost - Depreciation
* The weakness of the Cost Approach is not the methodology (the model works!), it is usually the quality of data
* National costing sources are recognized and appropriate data sources for almost all residential mortgage finance appraisals
* Site values can be arrived at, even in 100% built-up markets, by such tools as extraction, or if competing markets have land sales, then allocation
* Depreciation results in a "loss in value". Deterioration (physical) or obsolescence (functional or external) result in depreciation
* Most appraisers in every assignment complete the fundamentals of estimating depreciation. Estimating total economic life and remaining economic life is part of estimating physical deterioration. Location adjustments in the sales grid many times equate to external obsolescence. Impaired floor plans that require an adjustment in the sales grid usually correlate to the functional obsolescence adjustment in the Cost Approach
* 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

Cost Approach does not have to "match" the other approaches

Finally, some clients (and appraisers) believe that the Cost Approach must "match" or even be higher than the sales comparison approach.

In my classes, participants have told me that clients/reviewers have said to them, "Your Cost Approach is too different from your sales comparison approach; you need to change it and make it come more in-line." Putting aside the fact that such an instruction is a violation of the Appraiser Independence Rule, the request itself is fundamentally flawed if the appraiser has competently completed the Cost Approach and appropriately discussed the results in the reconciliation.

Consider the following: In the reconciliation examples, we have two extreme situations: Example #1 where the data is poor and Example #3 where the data is excellent. In these two examples, how close to the sales comparison approach (and final value opinion) would one expect Example #1 to be? If the data is of poor quality, would the expectation be that the value indication should be similar? If the data is of poor quality, other than coincidence, why would the value be similar? Indeed, if the data is of poor quality, the expectation should be that the value indication will be different, and may be significantly different. This is why, in the case of Example #1, the indicated value by Cost Approach warrants little (if any) consideration in the final value reconciliation. Alternatively, in the case of Example #3, where the data is good (and assuming the sales comparable data is equally good), the expectation should be that the two approaches provide a similar value indication.

I advise appraisers to resist the temptation or instruction to try to make the Cost Approach "fit" with the sales comparison approach. As long as the methodology is applied correctly, it is the data, not the expectation (or desire) that should drive the results. A comprehensive statement in the reconciliation can be used as a reference point for such requests:

"I've explained in the report that the data available for the Cost Approach is poor quality, and that's why I did not give it any consideration in concluding my final value opinion. Given the difference in the quality of data, the expectation should be that the results would be different from the sales comparison approach. What you are asking me to do is to massage the data to fit an expectation that isn't consistent with the data. This, I cannot do."

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 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.

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How to get a FREE Google listing - near the top of Google searches!! No web site required!!

Put your appraisal business near the top of google searches by signing up for Google business listings! You don't need a web site. For info, google "free google business listing" or go to www.google.com/business/

Check out my listing by googling: Alameda California appraisal. An Alameda map comes up on top with info on my business just under the map. I set it up quite a while ago. About half my business comes from the Internet. See what happens when you do a search in your city.

Search terms can vary. Try, for example, alameda ca appraisers.
It is easiest to set up if you have a physical location. It is okay to use a mobile phone number.

What if you don't want to advertise your location because you have a home office? Search for google service area businesses and get the instructions. You can set your service area based on the zip codes or cities that you serve, or on a given area around your location.

Google verifies that you are a legitimate business before you are listed, so it can take up to a week to get it set up.

What city should you be listed in? Most people, when looking for an appraiser, search by city. You can also include other cities or zip codes in your google listing, if your city is very small or you work a wider geographic area.

Get started in attorney work by doing divorce appraisals - much higher fees, no UAD, no underwriters, no AMCs

AMC work pays better now as many appraisers are busy, but that will change as soon as lender work slows down, as it inevitably will. Do you want to go back to those really low fees of less than two years ago?

There is a lot of divorce work available for residential appraisers. Often commercial appraisers do them, but lack the expertise you obtain when you specialize in residential appraisal work.

Remember when you had regular mortgage broker clients that you worked with and knew personally? Tired of working with anonymous people by phone and email.

Also, you won't be competing with desperate lender appraisers who bid $350, when the typical divorce appraisal fee is $1,000 plus $200 per hour for testimony, etc.

Say no to AMC work. Say yes to divorce work.

I quit doing divorce appraisals awhile ago, as I prefer estate/trust work. I did not mind doing court testimony or depositions. I did not like the "hurry up and wait" of testimony, but most appraisers doing litigation support say it is okay with them.

Why are non-lender appraisals needed?

Mostly death, divorce, and taxes. For residential appraisers, most nonlender work comes from estate/trust and divorce work. After you have some experience, you can get litigation such as construction defects or defects that were not disclosed before close of escrow, which pays very well. This article focuses on getting started by doing divorce appraisals.

Court testimony is relatively rare for estate/trust work and other types of non-lender work, but is more common for divorce appraisals. If you don't want to ever testify in court, don't do divorce appraisals.

If you want a long term career in residential appraising, and not totally dependent on very cyclical lender work, divorce appraising is a good option that pays very well.

Lender vs. non-lender volume of work

When you work for lenders, work is much steadier than for non-lender work. Every residential appraiser I know does both lender and nonlender work.

You may get one-time clients, especially when you are starting out, so marketing is critical. But, attorneys tend to be loyal to appraisers they have worked with and remain loyal for many years.

Also, your name gets "passed around" among attorneys as a very knowledgable appraiser, experienced with divorce appraisals. I have not done divorce work for quite a while, but still regularly get calls from divorce attorneys.

Divorce vs. lender appraisals

Although they are both appraisals, using the same appraisal procedures, the scope of work is typically different.

You will be calling on all the sales and listings, will take as much time at the property as you can, ask questions, and may have a copy of other appraisals that have been done.

The most significant difference is possible court testimony and another appraiser working for the other side. Of course, no current Fannie forms are used, no UADs, and no 1004MCs.

Effective date of the appraisal

Be sure to ask about the effective date of the appraisal. It can be the day you inspect, the day of separation, or another date.

If the date is in the past you will need information on changes (if any) to the home such as plumbing, paint, etc. Try to get copies of checks, bids, etc. Be sure to go over any changes while doing the inspection.

Emotions are high

Everything is personal with a divorce, including the family home. Be polite and professional. I consider myself as an "appraiser-listener". I listened to complaints about the other spouse or whatever they want to talk about. The time was built into my fee.

Inspecting the house

Find out who will be present - wife, husband, which attorneys, etc. Never inspect by yourself.

Take many, many photos. Ask your client what are the special features of the home. Clients on the "high" side will often say how great the home is and fail to mention any bad features. If you see anything, ask them about it.

If they're on the "low" side, they will let you know about all the defects, including the neighbor's noisy dog.

Who can do divorce appraisals?

In my area, the San Francisco Bay Area, some are done by real estate agents, who will also testify in court. They do them in hopes of getting the listing if the home is sold. If you're in a mandatory state, real estate agents may not do divorce appraisals/BPOs.

See who does them in your area. Ask a few local divorce attorneys at a Chamber of Commerce or law association meeting. If you have limited (under a few years) of appraisal experience and/or are not certified, it can be tough to break in, but keep trying.

You will need to be able to go way beyond what is required for a typical lender form-filling assignment. The skills can be learned. Take a few classes from the Appraisal Institute.

Reviewing reports

You can offer to review the appraisal reports done by the other side. I always ask for the reports even if my client doesn't want a review. Then I can see how the other appraiser approached the assignment, or at least check the building drawing and square footage.

If you are doing a forensic review (for litigation purposes) it is best to do them the same as you do a lender review, so you are not accused of advocacy. May be appropriate if you are not doing an appraisal, but are hired as a consultant to look for weaknesses in the other appraisal. But, this role can be controversial and tricky, looking at USPAP.

Working with attorneys - they want to win

Attorneys are advocates and try to get the best "deal" for their clients. In contrast, appraisers are experts and only advocate their value opinions. Some attorneys "shop" for appraisers who will give them a high or low number, depending on what helps their clients. Just like in lender work, there are some appraisers who are willing to do this.

When interviewing a prospect, I always try to find out which side they are on and let them know that my appraisal will be in the middle. I tell them if neither spouse likes my appraisal, the appraisal is probably okay.

Every appraiser is different. It's your choice.

Fees

Don't underbid unless you're trying to break into the business or trying to get business from a prime new client.

Do your appraisals "as if" they will be scrutinized by attorney, judges, both spouses, other appraisers, etc.

Charge much higher than for a standard lender appraisal. How much higher depends on what other appraisers do in your area, how well known you are as an expert witness, etc.

I used to charge 3 times what a lender would pay for the appraisal. Court testimony rates depend on your experience and expertise. $200 per hour is not high in my area.

Be upfront about your hourly rate for testimony, preparation, and deposition and include it in your engagement letter. Some appraisers charge from portal to portal (your office to the courtroom), some don't. You should be paid for waiting outside the courtroom.

Some appraisers also charge for "waiting" time, when you set aside time for the testimony, but are not called. In my area, typical rates are from $150 per hour to over $250 per hour, depending on your testimony experience. If the appraisal is not straightforward and requires additional research, set an hourly rate. If you are paid on a hourly basis, be sure to keep very good track of your time.

Always get paid in advance

I always get an advance retainer fee to cover the appraisal and sometimes testimony time.

If you are deposed, in my area the standard is that your client brings a check for the expected time (or a blank check for the actual time) and pays when you deposition is over. If you are having problems getting an attorney to pay, mention it to the judge, who usually is sympathetic.

Collecting from attorneys

Collecting from attorneys can be difficult. If your client loses the case, they will be less likely to pay. Get as much upfront as possible. If it is a complicated case, get regular partial payments.

What type of reporting format to use - NO Fannie forms

Do NOT use any Fannie Mae forms. The primary problem with using the form is the adjustment grid. How many of the adjustments do you have fully supported? Attorneys can attack adjustments and use of the forms, intended for mortgage lender work.

Most appraisers use short narrative reports or GPAR forms, there you select the pages to use.

I never put dollar adjustments in my appraisals, unless it was critical to the valuation, such as a view. I quit doing any dollar adjustments in my non-lender appraisals several years ago.

How to get started

Divorce appraisals can be difficult to break into. On the plus side, most residential appraisers won't do them because they don't want to testify in court.

A good way to get started is to bid low. You won't make a lot of money, but will get experience. Some attorneys are price-sensitive.

Another, much more risky, way is to take an assignment that must be completed very quickly. These are risky because you must plan on possible testimony. I regularly receive calls from panicked attorneys who need an appraisal completed in a few days.

Joining your local bar association as an associate member and attending meetings and/or classes of the family law group can really help. Offer to do registrations. You will meet lots of prospects.

Testifying in court

Even if you do many divorce appraisals, you don't typically testify very often. But you should plan on testifying on every appraisal, even if the client says you won't be testifying.

Sometimes divorce attorneys will say "this will never go to court". Do not believe them. No one really knows what will happen.

Appraisers who specialize in litigation support often look at it the same way attorneys do. They like the give and take in the courtroom and like to win.

It's hard to know if you will like (or not mind) testifying until you do it. If you can stay calm when being reviewed by an appraiser or answering stupid underwriter questions you should do okay.

I don't mind testifying, even if the opposing attorney tries to make me look like a fool in court. I figure they are paying me for my testimony. The job of the opposing attorney is to try to "shred" it. I do not specialize in litigation work as I prefer doing just the appraisal and don't really like working for attorneys. Just my opinion.

Fortunately, few attorneys know much about USPAP or appraising, so questions are often not relevant and can be strange, particularly for divorce appraisals.

In my area, divorce is handled in family court with just the judge and no jury. The judge keeps the attorneys "on track."

If you are unable to do this, just remember the Primary Rule: Say Yes or No, and just answer the questions. Watching legal TV series can help, but they tend to be overly dramatic.

My advice is to try testifying and see if you like it or don't mind doing it. It pays very well.

Taking classes, seminars, or workshops in expert testimony can really help.

Engagement letters

Always have a signed engagement letter that specifies exactly what you will be doing, your rates, and other issues. There are many different engagement letters.

Link to Appraisal Institute sample engagement letters:
www.appraisalinstitute.org/
professional-practice/professional-practice-documents/sample-agreements-

for-services/

Most appraisers start with samples and make up their own. I have several templates and customize them for every assignment.

Subpoenas

If you are subpoenaed, call the attorney ASAP to let him or her know that you are only testifying as to fact, and you are not testifying as a witness. Judges do not like this in their courts.

Fortunately, often the attorney who sent the subpoena is just trying to get a very cheap expert witness. But, he/she may only want to get the appraisal entered into evidence without an expert witness.

If you do an appraisal and are subpoenaed, you must appear by law. However, you are not testifying as an expert with opinions. Of course, your fee is whatever is typical in the court, such as a nominal fee of $50.

You are testifying as to fact, such as "Yes, I did this appraisal." Or, "Yes I did an appraisal on 123 Smith St. I looked at home on July 3, 2006." If you are asked anything else say "I am not testifying as an expert and don't have any comments". Contribute nothing except fact - what your appraisal says. Nothing else.

Depositions

In contrast with court testimony where the judge runs the courtroom, attorneys can ask whatever they want. Depositions tend to be long. They are typically used in other types of litigation, not divorce.

Depositions are usually held in a room with a court reporter, plus attorneys. Others, such as defendant and plaintiff, may be there.

In my area, appraisers always get paid at the end of your deposition. The attorney should bring a blank check.

What about pressure?

As with almost any type of appraising, somebody is "looking for" or "hoping for" a certain value. The pressure is much, much less than when your worked for mortgage brokers.

How to market divorce appraisals

Usually you are contacted by an attorney, but sometimes one of the owners, if the attorney asks the owners to get an appraisal. If contacted by an owner, be sure to contact the attorney.

As with any other type of marketing, face to face works best. You also get referrals from real estate agents.

To connect with attorneys go where you can meet them. Attend local bar association meetings, Chamber of Commerce meeting, etc. Anywhere you can network with attorneys.

Advertising in a local bar association newsletter or magazine can help. Owners get referrals from real estate agents and sometimes look for "divorce" on the Internet or in the Yellow Page advertising.

Building up the business can take awhile, but can really pay off. Once you start to testify and the attorneys like you, they will give your name to other attorneys. Becoming an expert in a local market can really help.

Where to get more information

Liability Insurance Administrators has a good intro to litigation appraising at www.liability.com/claim-alerts/10-Tips-for-Landing-and-performing-work-as-an-expert-witness-appraiser.aspx.

The Appraisal Institute is the best source for litigation support. It has books, seminars, and classes on litigation appraising. Go to www.appraisalinstitute.org. It can be tricky to navigate the site, but go to Education for the classes. You can search for litigation and find the books.

The classes focus on court testimony. Attendees are typically very experienced. I have taken workshops and seminars and learned a lot.

The Appraisal Institute seminars and classes:

• Litigation appraising: specialized topics and applications. 2 days
• Litigation skills for the appraiser - an overview. 1 day.
• The Appraiser as an Expert Witness: Preparation and Testimony

Short workshops are sometimes offered. Check with your association's chapter office. The Appraisal Institute is most likely to offer them.

The Appraisal Institute has books:

• Applications in Litigation Valuation: A Pragmatist's Guide
• Appraising Conservation and Historic Preservation Easements
• Real Estate Damages: Applied Economics and Detrimental Conditions

You don't have to attend a special classes on how to complete most residential non-lender appraisals (divorce, estate, bankruptcy). You already know how to do appraisals. The classes focus on court testimony.

What geographic area should you advertise?

Many lender appraisers work a wide geographic area.

But, when almost anyone (except AMCs) looks for an appraiser, they first look for an appraiser located in the city where the property is located.

The larger your city, the more work is available. However, you can market by county or by a nearby larger city.

I have always advertised myself as a specialist in my city of Alameda, about 78,000 population. However I have worked in nearby cities and worked Alameda County for many years with a much larger population, especially for lender work.

What about other types of litigation support appraisals?

Many disputes are about property lines, views, defects, failure to disclose, encroachments, etc.

I have done them, but they can be tricky, especially if you have only done residential lender work.

I suggest doing divorce to get started, as they are usually just value disputes between the husband and wife. Then you can expand to the more difficult appraisals.

Which appraisers tend to really like litigation support?

Appraisers who want to win by having their opinion of value selected seem to like it the best.

One appraiser I know tries to only work for the winning side in a dispute.

How many appraisers do litigation support?

I don't have any data, but most appraisers have MAI designations due to the designation being well established over many years.

However, very few MAIs specialize in residential appraisals. Also, they usually work a wide geographic area.

A local experienced, knowledgable appraiser would have an advantage in a divorce appraisal, which is less complicated that loss in value, such as from a creek, rezoning, etc.

Should you do divorce appraisals?

If you are a knowledgeable, experienced appraiser (or can take classes to upgrade your skills) you will be able to do the appraisals.

Court testimony is the main reason appraisers don't want to do divorce work. It is your decision. However, you don't typically testify very often.

Most of the residential appraisers in my area who have lots of nonlender business are doing divorce appraisals.

Why not try it and see if you like it!!

Why Does Regression Not Work?

By George Dell MAI, SRA, ASA

Regression is just a math formula. The regression line itself is middle-school.
Y = a + bX, where

- Y is predicted (let's say the sale price)
- a is a constant (where the line crosses the vertical axis)
- b is a slope of the line (how price changes with size, let's say SqFt)

The right regression line is the one that best fits the data points. The custom is to find the line which minimizes the squared distances from that line to each data point. (Other ways are possible).

Simple vs. multiple regression

Usually, all appraisers care about is the slope of the line. This is simple regression. Multiple regression just looks at several X's at the same time. For example, besides building size, it may consider the site size, and whether it is next to a highway or not. Building size and site size are measure (continuous) variables, while the highway variable is a yes/no (category/discrete) variable. The formula still looks the same.

Y = a + b1X1+ b2X2+ b3X3

where the Xi's are building size, site size, and yes/no (0/1) numbers. The bi's are the "coefficient" number. (Each b is multiplied times its X).

The bi are similar, but not equal to what appraisers use as an adjustment.

This difference between adjustment amounts and regression coefficients (the bi's), is **problem #2** in why regression does not work, given the thinking-training appraisers have received. (We will get to **problem #1** another day, another blog. Hint -- it has to do with how we pick the data . . . ;).

But what is the problem we are trying to solve? Regression can be used to solve for Y, or it can also be used to help us to determine, estimate, or approach the right adjustment in traditional comparison. This is a modeling decision! It is important to not pick up a hammer every time, even if we just want to cut the board in half . . . Regression itself can sometimes be a hammer, and sometimes a saw, and sometimes just a tape measure.

To go further, we need to reconsider what we are after. It is important to know that regression can be used to help hunt down adjustments, as well as the value estimate!

1. We can use multiple regression alone, to directly estimate our Y, the predicted variable.

2. We can use multiple regression to help us determine or estimate adjustments.

In the second use, it is possible to use regression results in conjunction with traditional comparison. (Note that comparison is in all three approaches: cost, income, direct comparison). **Problem #2** requires we have to first make a modeling decision. Are we trying to hammer a nail, or saw a board?

The 'regression' model for determining, estimating, or approaching adjustments is a separate, but important topic. For now, what is important is that we have identified the problem (predict Y); we have decided that a useful model might be regression. The solution to this problem #2 has a number of sub-problems.

First, the analyst must decide what data to include in the formula (Problem #1).

Second, the analyst must decide what X's to include in the formula. Oh darn - another modeling decision! Can we just use the three predictors (XI) building size (X1), site size (X2), and highway yes/no (X3). Or should we also add other predictors, like distance to the city, age, quality . . . ? There are two ways to determine what predictor variables belong in a multiple regression. One is that the experienced appraiser chooses, based on being an expert in the area and in the property type.

A second method is to use (computational) classifying tools. This second method is what is used by AVMs. It does not work so well, but works well enough to provide big competition for appraisers, who could otherwise be getting this work. (I can run a regression better than you can!)

So this raises another question: How can appraisers pick comps better than automated systems? The answer is that human judgment is quite good in certain things, like seeing patterns. Yet computer systems can pick comps. Is it possible that human appraiser expertise combined with computation tools and visualization methods could do better than either one alone?

If you believe as I do - that humans armed with the right tools, hammers, saws, and power tools can do a better job than either one alone, then you are in the right place. Is current appraiser education focused on helping the appraiser choose the right tool? Are most software vendors focused on helping the appraiser choose the right data, the right tool - or are they just selling "my regression is better than your regression"?

Regression does not work? It works every time! INPUT -> REGRESS -> OUTPUT. No matter what you put in, REGRESS regresses. It just does the "minimize the squared deviations" thing. It does it well. It does it fast. And it does it perfectly. OUTPUT outputs. So why does regression not work? There is only one thing left in this algorithm. The INPUT. But this was Problem #1.

For now we are dealing with problem #2 - Is regression the right model for the problem at hand? So far, we have a short list of modeling decisions an appraiser must make:

1. What data should I include?
2. What predictors should I include?
3. Should I be using regression on this problem?
4. If yes, should it be simple regression or multivariate regression?
5. How should I explain my use of regression and graphs in my report?

The above questions are basic. Actually, they are not all that hard. Appraisers make similar decisions on each and every appraisal assignment performed. The wording is different, and the problem has changed. The wording is, in order: What comps can I get? What rates/ratios and elements of comparison should I use? Should I use one of the methods suggested in

The Appraisal of Real Estate? (Such as: paired comparison, grouped comparison, secondary data analysis, statistical analysis, including graphic analysis and scenario analysis, cost-related adjustments or capitalization of income differences). Note that "regression" is not in this list. Perhaps it is considered a sub-method of statistical analysis, taught in several courses and seminars.

What is not taught, are the real issues about the use of regression, the tool. The tool is easy. You do not need to memorize the formula. You do not need understand how it is derived. You do not need to know how it is mathematically 'proved.' You do not even need to be able to explain it in a report. You do not need to explain the calculus involved in 'minimizing' the least squares. What you do need to do is know when to use it, what form of regression to use (simple or multivariate), what data you put in, what predictors to leave in and which to take out. And you need to be able to explain your competent appraiser judgment in each of these things.

There is no magic.

So why does regression not work? But wait, there's more. Number 2 above, about using the right predictor variables (elements of comparison), needs another look. What if a critical feature/predictor is not measured or provided in the data source? What if it is noted, but not measured, like "spectacular view." How about predictor variables that interact with each other? And finally, how about those things which are non-linear? And in particular those predictors which are ordinal in nature? (You can tell better or worse, but no measure is possible). This post cannot cover each of these here. Yet they can be the weakest part of reliance on regression.

On the other hand, once an analyst understands about things such as missing variables, interaction variables, correlated variables, and ordinal variables - the appraiser brain can be put to excellent use.

The appraisal profession suffers from two things: over-simplification and over-complication. Over-simplifying is due to the idea that you can just throw in a bunch of data, push the button, and get a good answer. If it were that simple, you would be obsolete. The computation is simple. The modeling is not. A machine does the computation. A human is needed for modeling decisions. It need not be very complicated. It just needs to be explained simply. Appraisers are smart enough to make some difficult things work. Doing it a better way maybe easier than trying to explain the "too easy."

Over-complication is the terror inflicted by some statistical methods, imposed by those who may have never used them in practice. Or worse, used by those who wish to win through the clever appearance of sophisticated competence, rather than by simple truth and understandability.

Much of the over-complication we see today is brought to us via "advanced methods" in appraiser education. The education jumps right to complex theoretical tools -- mostly inferential statistics. What has been neglected is the modeling and using the right tool for the right problem. The 'new' basics.

This last thought brings us right back to the original question. Regression works. Using it in the wrong model to solve the wrong problem is what causes issues.

The appraisal problem requires a predictive solution, not sample statistics. Inferential statistics is designed to help describe large populations of data by drawing random samples. A complex, difficult, but clever-looking "solution" to the wrong question. To learn or teach obsolete (and never needed) inferential statistics for appraisal work is a waste of time.

Calling it an "advanced" method sells, and impresses some. But whatever happened to "beginning" and "intermediate" statistical modeling?

The modeling must come first. Then learn and teach and use the tools. Like regression.

Where to get more information

Go to www.GeorgeDell.com. Join a community of appraisers who care. Help act on our future, not react and be pushed around.

About the author

George Dell MAI, SRA, ASA, is a recognized authority on applications of predictive methods to asset valuation and risk/reliability issues. He has authored numerous articles, seminars, and is a co-author of the Appraisal Institute book "Appraisal Valuation Modeling".

George is CEO and chief instructor for Valuemetrics, Inc., which provides a curriculum of hands-on workshops for appraisers and lenders.

For more information, go to
www.valuemetrics.info and www.georgedell.com

Is there really an appraiser shortage today?

At a March 28, 2017 webinar, "What is going to happen to appraisers in 2017?" with Fannie Mae and others speaking, there were some very interesting graphs, which I had never seen before. These graphs indicated that there is no appraiser shortage.

The reason for the webinar was Fannie's recent re-stating that they have no policy against use of trainees. FHA requires certified appraisers. This article discusses the webinar topics and includes several of the graphs. Of course, I have included some of my opinions, prefaced with: "My comment".

The speakers were:
- Zachary Dawson, Director Collateral Strategy & Policy, Fannie Mae,
- Matt Simmons - Partner, Maxwell, Hendry & Simmons, LLC, former Chair of Florida Real Estate Appraisal Board
- Brian Coester - CEO, CoesterVMS
- Alan Hummel - Chief Appraiser, First American Mortgage Solutions.

Dawson and Simmons had some very interesting graphs. Coester and Hummel had some interesting comments.

ASC data is often used, but it includes all appraisers in multiple states and does not break down by type of license. Also, the shortage is in mortgage lending, not other types of appraisals.

What I read about is mostly AMCs complaining about an appraiser shortage. I guess that most reporters just call them for quotes. Of course, there is a shortage for AMCs as they are very price sensitive. Their fees are based on supply and demand. More appraisers means lower fees.

In response, the AQB is reducing requirements, such as allowing college degree alternatives and fewer experience hours. Of course, as we all know, it is low AMC fees and lenders not allowing trainees to sign that are the problems.

Prior to 2008, changes in demand had always been done by hiring and firing trainees. Now, that is not an option.

If there are no new appraisers, lenders will push to allow the use of various "alternate valuation products" so somehow this problem needs to be solved.

There are others who complain, of course, such as local lenders in rural locations, but they always have fewer appraisers than in urban areas.

I had expected the webinar to be the usual whining about appraiser shortages, but it was mostly that there is not a shortage.

Fannie Mae - graphed data on appraisal volume and number of appraisers submitting appraisals to Fannie since March 2012 (below)

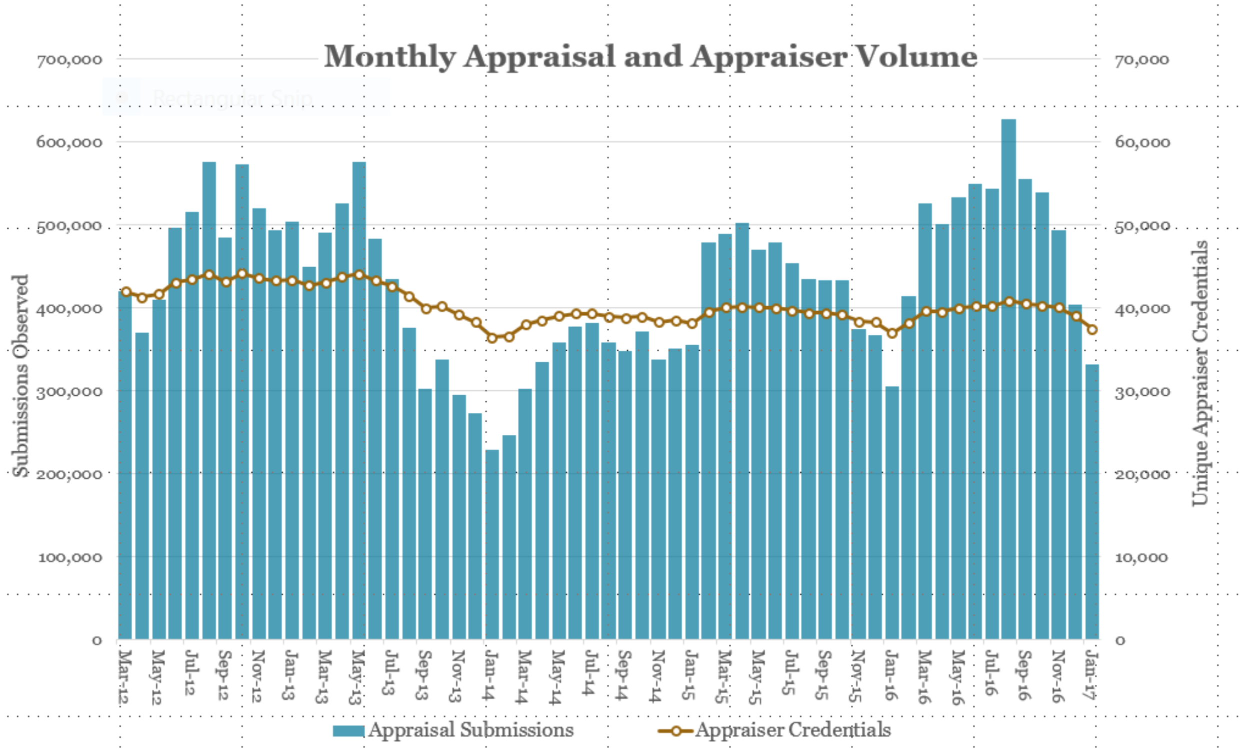
Dawson regularly speaks at appraisal conferences and is a former appraiser, who had a company with trainees. He is the Director - Collateral Strategy & Policy, Fannie Mae. Dawson is responsible for Fannie Mae's Single Family collateral strategy as a whole, covering both Selling Guide policy and use of collateral technology tools including Collateral Underwriter ®. He oversees the Appraisal Quantity Monitoring initiative, collateral analytics & reporting, and other strategic appraisal initiatives.

The graph below uses data of appraisals submitted to UCDP since March, 2012 to current and the number of appraisers with unique appraiser credentials (no duplicates) who submit appraisals to Fannie. It shows a steady number of appraisers at about 40,000 with about 10% variation (right side of graph). The number of appraisals submitted(demand) is volatile (left side of graph). For example 2/16 was about 300,000, 8/16 about 630,000 and 1/17 about 300,000.

Ever since Fannie starting purchasing loans in the 1970s, demand for appraisers has gone up and down significantly, dependent on mortgage interest rates.

Until licensing, this appraiser demand was handled by lenders hiring armies of trainees when demand was strong and then laying them off when no longer needed. During the last big crash in the early 1980s, some staff appraisers stayed on as bank tellers, but most left appraising. I knew a local appraiser who started working for a big lender in the 1970s. He regularly got laid off and re-hired over decades.

Fee appraisers hired armies of trainees in the 2000 boom, then let them go in 2008. Since then, few lenders will accept trainees signing appraisals, so very few are hired. There is no way to get the new appraisers needed during boom times.



Fannie's Conclusions

Analysis suggests that recent challenges with costs and turn times are more a result of high volume over a prolonged period than they are a sharp decline or "shortage" of appraisers.

- However, a decreasing number of licensed appraisers overall and fewer new licenses being issued are problems that should not be ignored.
- The underlying issue is that demand for appraisal services is highly variable and the capacity of appraisers - collectively as an industry and on an individual level - is inelastic.
- This leads to unpredictable earning potential for appraisers and volatility in costs and turn-times for their clients - neither of which supports a stable housing finance system.

A successful long-term solution must include the following components:

- a viable plan to attract and retain new valuation professionals to the field,
- a more efficient appraisal process to increase the capacity of each individual appraiser,
- use of data, analytics and technology to produce more credible and transparent valuations, and
- alternative means of valuation that responsibly reduce demand for traditional appraisals in certain cases.

Fannie Mae graph comments

When showing the graph below at conferences attendees, had expected to see much larger changes in the number of appraisers. Fannie is just a part of mortgage originations. (My comment: This eliminates commercial and duplicate licensees, making it more accurate). This graph dramatically illustrates volume changes in mortgage lending.

However, the volume capacity of appraisers individually and as an industry seems to be relatively fixed. Dawson does not see a significant shortage problem now, but could be in the future due to aging population and lack of new appraisers.

Even with technology and data changes, most appraisers don't think they are more productive than in the past. (My comment: I suspect this is due to increased client requirements. My non-lender appraisal productivity has not changed much.)

Matt Simmons - ASC and MBA loan data and graphs below and next page - Appraiser Supply

(source: ASC National Registry & MBA Forecast Model)

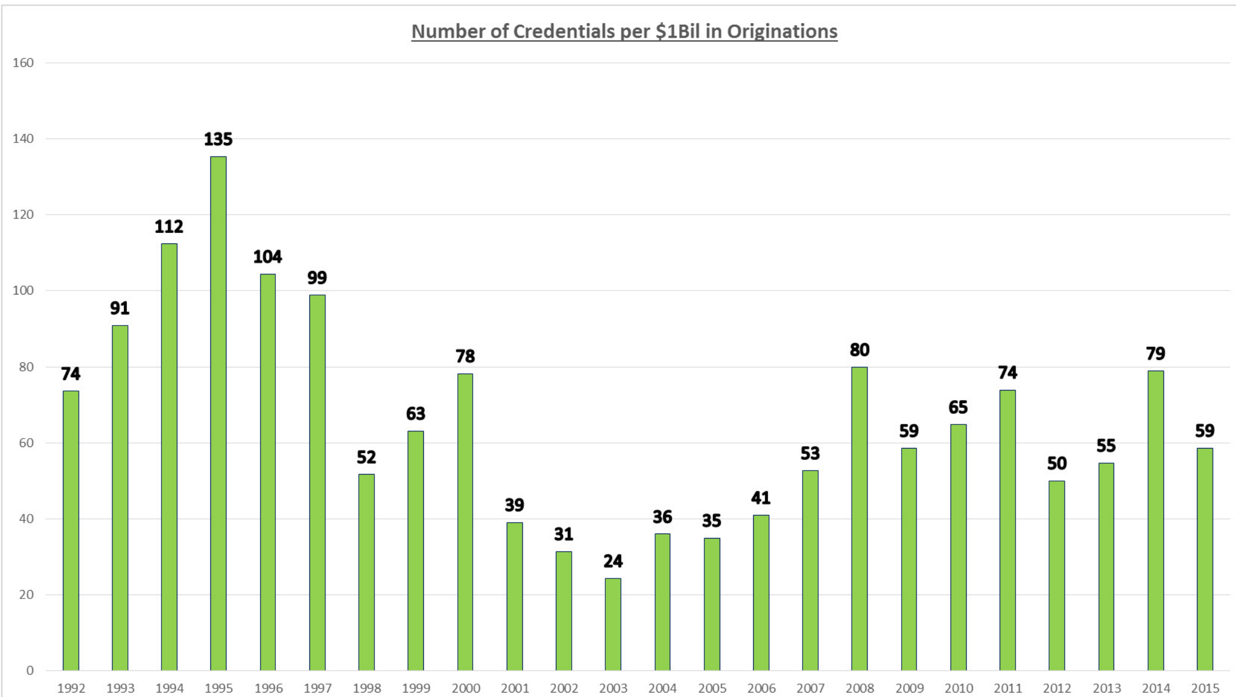
Note: Most recent available ASC data is from 2015.

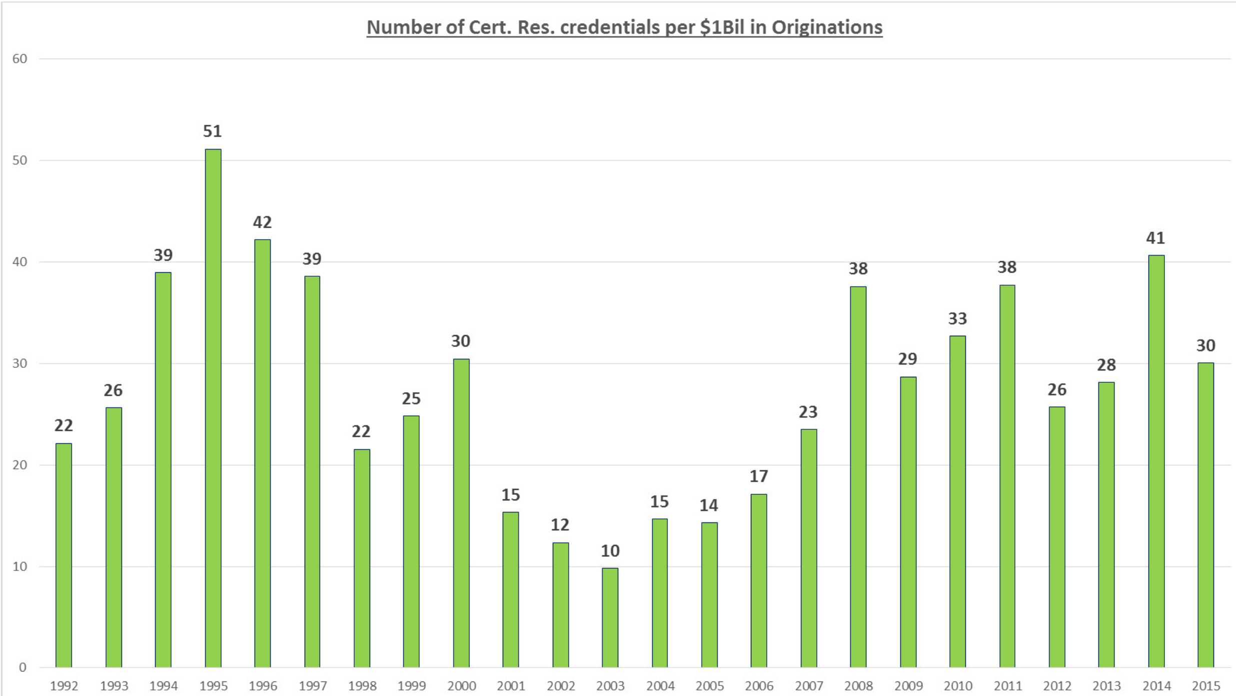
The graph on the next page shows number of credentials per $1 billion in originations. In 1992, there were 74 per $1 billion and in 2014 there were 79 and in 2015 it was 59. The lowest point, with fewer appraisers was in 2003. However, the ASC does not track trainees, which greatly increased during the mortgage boom. If trainees were allowed now, there would be more appraisers per $1 billion.

The graph on the next page shows number of Certified Residential per $1 billion in loan originations, with similar trends as the graph above with all credentialed appraisers. However, this does not include the large numbers of trainees during the last boom, the first one after full licensing in all states. This shows much lower numbers of appraisers than the graph below.

Appraiser Supply

(source: ASC National Registry & MBA Forecast Model)





Attendee Q&As

Will technology "one day" replace appraisers now or in the future? Is that "one day" coming soon? A frequently asked question.

Dawson: No, but analytics, data and technology will change the appraisal profession just like everywhere is changing. It may change the process, scope of work, when a "traditional" appraisal, as we know it today, is needed. Fannie's Property Inspection Waiver program was being studied in 1997 and has finally been able to work because of data and analytics.

Hummel said that we went from typewriters to computers. Coester sees 2 classes of appraisers: tech/data savvy appraisers vs. the others that don't understand data analysis. Physical inspections cannot be automated.

Simmons added that some appraisers have been doing business for 20-25 years and don't want to change. But, Legalzoom did not replace attorneys. Local expertise will always be needed. Appraisers need to learn to use new tools.

How fair and reasonable are AMC fees? How is public trust affected by fast and cheap fees?

Hummel: In the past it was very simple to set fees: URAR. "Uniform" RAR assumes all properties are the same, requiring the same scope of work and the same fee. But all appraisers know this is not correct. But, some lenders and AMCs assume all properties are Uniform with the same fee. Also, with TRID, etc. requirements on appraisal fee disclosure, it can be difficult to change a fee later when the appraiser finds out it is more complex.

Coester: National and online lenders tend to work with a fixed fee schedule.

Simmons: Dependent on supply. State boards and fees - regulations were not set up until 2014-2015 where state boards could set C/R fees.

Are turn times realistic?

Coester: Constant conflict between appraisers and lenders. The market takes what appraisers give them, but tries to get them ½ to 1 day shorter. Lenders compete with each other to get borrowers. Lenders want to get the appraiser physically to the property ASAP. 85-90% of borrowers go with the lender that gets the appraiser to contact the borrower faster and inspect their property quicker. Then they have less "fall out" (borrowers going to another lender).

Appraiser turn times are definitely regional. For example, Washington State with 3 months and $3,000 to get it faster. In contrast, Colorado is 3-4 weeks but FL and CA are 5-7 days (probably for Southern CA, with lots of tract homes).

If a lender is competing with a 7-10 day close, their data shows that the the appraiser must call the borrower within 24 hours. (My comment: lenders have always wanted appraisal turn times as low as possible. They are much less sensitive to fees. If $50 more for an appraisal can get a loan closed quicker, that is a cheap price. AMCs, of course, are very fee sensitive.) Appraisers would like to see less status requests.

Hummel: If AMCs/lenders provide the appraiser with more information than an address, it can resolve many issues before the appraiser accepts the fee and turn time. Factual data from their own databases such as previous sale, lot size, zoning, etc. could save time for the appraiser. (My comment: I know a local lender whose loan officers fill out a form, written by an appraiser, with questions on bedrooms/baths/remodeling, etc.)

Simmons: In Florida, the state regulator set up requirements for AMCs and lenders to provide certain information to the appraiser. Turn times are definitely a factor in fee. For example, placing an order on Friday, completed by Monday requires a very high fee.

The ways in which AMCs broadcast assignments.

Coester: sends to just one appraiser and gives time to respond. Or, send to 3 top qualified appraiser. Does not think broadcasting to 500 appraisers is a good business practice. Appraisers are in the field most of the day. Text messages are faster. The appraiser can call borrower and schedule.

Hummel: AMCs are different. Broadcast to thousands of appraiser would not be effective. His example: St. Louis Park has 9 appraisers in his database that work that area, 6 are good, but only 1 qualified to do a particular assignment. Or, sending to a short list of qualified appraisers. Sending to a big list and taking 2 days to place an order is too much time.
Simmons: Section 129 of TILA has been referenced regarding broadcasting. One method that some AMCs use is to make the appraiser in his or her response to "kinda" certify that he or she is competent to perform the appraisal. There has been a lot of chatter from the state regulatory perspective about broadcasting. But, there is no standard of practice for AMCs.

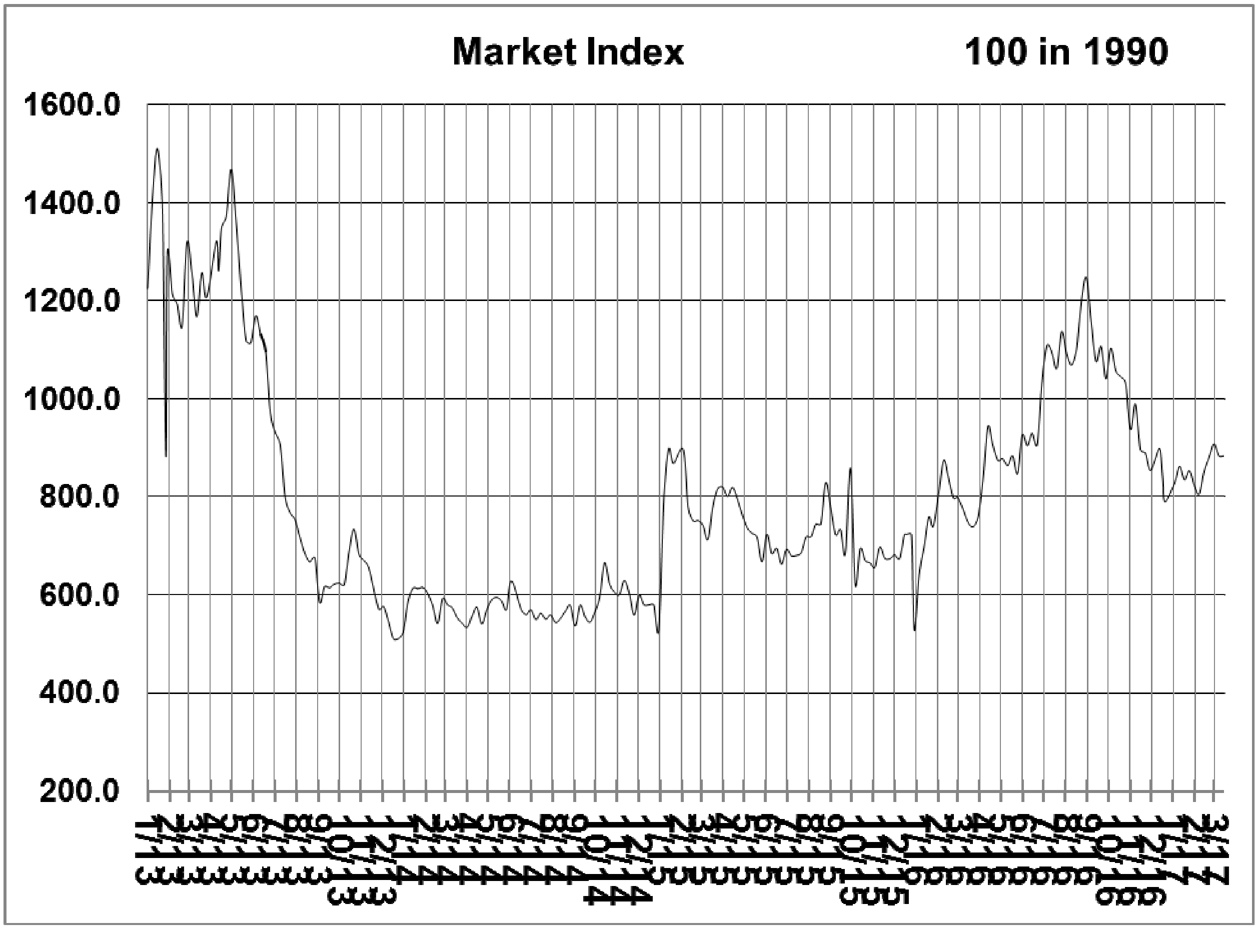
How to listen to the 1 hour webinar and get all the handouts

Go to www.housingwire.com/webinar and look for "What is going to happen to appraisers in 2017?"

The organizer, Housing Wire, plans to redo the webinar in the next quarter or so, to answer many of the questions.

MBA Loan Volume Application Index 1/13 to 3/17

Volume has been going up and down in 2017 and some AMCs are offering lower fees. But, it has



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

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