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Issue 4

FHA APPRAISER

Welcome to the fourth issue of the Federal Housing Administration Appraiser Roster Newsletter. We hope you will find it informative.

UNIFORM APPRAISAL DATASET (UAD)

In the last issue, we highlighted the Uniform Appraisal Dataset (UAD) and announced FHA's intention to adopt two of the UAD compliant appraisal reporting forms (the URAR and the condo form). Since the software vendors are about to roll out UAD compliant reports in a MISMO 2.6 format, a review of some of the changes to the data fields in the reporting forms may be useful. In rating the condition of the property in a UAD compliant report, the appraiser must choose between six ratings, ranging from C1 (recently constructed, not previously occupied home where all the components are new) to C6 (improvements have substantial damage or deferred maintenance). No longer will an appraiser be able to characterize a home's condition as good, average, or poor, which have no universally recognized definitions. The appraiser will, however, be able to provide additional explanatory text in the comments section or the addendum. In rating the quality of construction of a home (sales grid section of the report), the appraiser must choose between six ratings, ranging from Q1 (unique homes designed by an architect and featuring high-grade materials) to Q6 (low cost homes of

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FHA SPOTLIGHT – SALES CONCESSIONS AND VERIFICATION OF SALES

Judging from the number of different ways FHA Roster appraisers are handling sales concessions, which range from being characterized as "typical for the market" to "unknown", it is important to revisit the guidance on sales concessions that was released in Mortgagee Letter (ML) 2005-02. The continued prevalence of sales concessions is underscored by the frequency with which a concession is given by a party to the sale (builder, seller, lender, etc.). In many housing markets throughout the country which are continuing to experience declines due to job losses and increased foreclosures, sales concessions are frequently relied upon to make a sale at a price that is not reflective of the "true sale price". Sales concessions can influence the price paid for real estate and are not always straightforward. Sales concessions can be in the form of loan discount points, loan origination fees, interest rate buy downs, closing cost assistance, payment of condominium fees, builder incentives, down payment assistance, monetary gifts or personal property given by the seller or any other party to the transaction. ML 2005-02 reiterates FHA requirements for both lenders and appraisers in reporting sales concessions. First and foremost, lenders must ensure that the appraiser

Always report sales concessions associated with the subject property and the comparable sales.

Sales Concessions and Verification of Sales, cont'd

is provided with a complete copy of the ratified sales contract, including all addenda, for the subject property that is to be appraised. Secondly, the lender must provide the appraiser with all financing data and/or sales concessions for the subject property granted by anyone associated with the transaction. If the lender does not provide a complete and ratified contract of sale and/or financing data, the appraiser must record this fact within the appraisal and note the steps taken in an attempt to secure the information.

The appraiser must report the total dollar amount of the loan charges and/or concessions paid on behalf of the borrower and identify which party provided the concession in the contract section of the appraisal reporting form. The appraiser must verify all sales transactions for seller concessions and report those findings in the appraisal. Many MLS systems do not record sale concessions and a verification process, if properly carried out, can reveal concessions where none appeared to be. If the sale cannot be verified with someone who has first-hand knowledge of the transaction (i.e., buyer, seller or their representatives), the appraiser must clearly state how the sale was verified and explain to what extent.

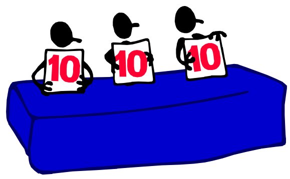
In the Sales Comparison Approach section of the appraisal, appraisers must report the type and the amount of sales or financing concessions for each comparable sale listed. If no concessions exist, the appraiser must note none. Appraisers are required to make market-based adjustments to comparable sales for any sales or financing concession that may have impacted the sale price. These adjustments should be expressed in terms of cash or cash equivalency. The adjustment for each comparable sale must reflect the difference between the sales price with the sales concession and what the property would have sold for without the sales concession.

It is possible that a sales concession may not have influenced the sale price. For example, improvements made to a home in the form of specialty furnishing or extensive gardens and/or landscaping whose additional cost is not included in the pricing of the home as an inducement to purchase, may or may not have influenced the buyer's decision to buy or the price paid. On the other hand, there have been numerous reports of buyers of condominiums located within projects with slow sales receiving concessions of pre-paid condo fees for 6 to 8 or more months. It is difficult to make a case that such a concession (often providing a savings to the borrower of several hundred dollars per month) did not influence the price paid.

In some housing markets, ignoring sales concessions and failing to recognize the impact they can have on the price paid for a home can easily lead to overvaluation when some or all of the comparable sales relied upon in an appraisal had a sales concession which was not adequately addressed in the appraisal.

UAD Cont'd from 1

basic quality). Again, the appraiser will no longer be able to rate the quality of construction based upon a rating such as average which has no universally recognized definition. Two other data fields of the current reporting forms (within the sales grid) also require the appraiser to make subjective judgment calls: location and view. In the UAD compliant reports, appraisers will be required to rate location and view as falling in one of three choices: neutral, beneficial and adverse. Once the location rating is selected from the three choices, the appraiser will have a drop down list of 11 location factors (ranging from adjacent to power lines to other) from which to choose to further describe the location in terms of positive, neutral or negative attributes. Similarly, once the appraiser has determined which of the three ratings apply to the subject property's view, the appraiser will have a choice of 13 view factors (ranging from industrial to water view) from which to choose to further describe the view in terms of positive, neutral or adverse attributes. A required data field in the new UAD compliant report format which may cause consternation among appraisers is the field in the sales grid which calls for information on the basement and finished rooms below grade. In the UAD compliant reports, appraisers will be required to input room count and square footage for the basement as well as separately input square footage of any finished area of the basement for the subject and each of the comparable sales. Percentage estimates are not acceptable and appraisers are required to input a room count and square footages regardless of ability to access this information. FHA will be issuing guidance via a Mortgagee Letter regarding the use of UAD complaint appraisal reporting forms.



STIGMATIZED PROPERTIES

A property may be affected by a stigma. What steps should an appraiser take to ensure that this fact is disclosed to the underwriter? The Fifth Edition of The Dictionary of Real Estate Appraisal, published by the Appraisal Institute, defines a stigma as "an adverse public perception regarding a property; the identification of a property with a condition (e.g., environmental contamination, a grisly crime) that exacts a penalty on the marketability of the property and may also result in a diminution of value." Stigmas typically are either social or environmental in nature. In cases of an environmental stigma, the potential stigma may be caused by proximity to a site that has been officially determined to be contaminated due to the presence of hazardous materials or toxic substances. The property being appraised may not be contaminated but it's proximity to a contaminated site (such as Love Canal in NY State) may have negatively impacted public perception and caused such properties within a certain distance of the known contamination to experience longer marketing periods and/or sell for less than what a similar property not so impacted would sell for. In cases where the property being appraised may be contaminated but where there has been no definitive determination of such, the appraiser must condition the appraisal on an inspection by a qualified 3rd party. In cases of social stigma (such as a grisly crime having been committed at the property being appraised), it is incumbent upon the appraiser to be geographically competent and know if any state or local jurisdiction laws prevent disclosure of such information. In all cases, the appraiser should be guided by the state or local laws governing disclosure and, where appropriate, notify the lender immediately if a property may suffer from an environmental or social stigma whose impact upon the value of the property may or may not be easily quantifiable but nonetheless exists.

FINDINGS FROM ACTUAL FHA APPRAISAL REVIEWS

The following sanctions/actions are the results of actual appraisal reviews conducted by the Atlanta Homeownership Center (HOC).

Failure to Perform an Accurate Appraisal, Failure to Accurately Analyze market conditions, Failure to report property defects and other FHA reporting requirement errors

In FHA Case No. xxx-xxxxxxx, the appraisal made reference to declining property values in the neighborhood section of the appraisal report but failed to include negative time adjustments to the comparable sales (which were 3 to 6 months old in terms of sale date) to reflect locations within a declining market which experienced an approximately 18% decline for the preceding 12 month period). Other reporting omissions include failure to report flaking and chipping paint on a pre-1978 home; failure to report significant degree of deteriorating wood fascia and a broken window which had been covered with plywood. In spite of these and other deficiencies, the subject property was rated as being in average condition. Two of the three comparable sales were also rated as being in average condition despite the fact (as confirmed by the subsequent field reviewer and MLS data) that both these comparable sales underwent significant renovations prior to their sale and were in significantly superior condition as compared to the subject property. Analysis by the HOC review staff found that the appraisal over estimated the value of the subject property by nearly 50%. The Atlanta HOC recommended removal of the FHA Roster appraiser for a period of 12 months and required completion of 14 hours of continuing education: 7 hours of USPAP and 7 hours of FHA appraisal reporting requirements and guidelines. The proposed removal is currently pending an appeal by the appraiser.

Failure to Perform an Accurate Appraisal Report, Failure to report property defects, Failure to Select Suitable Comparable Sales failure to comply with other FHA reporting requirements.

In three FHA cases reviewed, all performed by the same appraiser, the appraisals did not reflect readily observable property deficiencies and/or inaccurately reported defective conditions. This resulted in the properties' not meeting FHA Minimum Property Requirements (MPR) as the appraisals were not conditioned upon repair of defective conditions nor did the appraisals provide a cost to cure for the required repairs. The three appraisals were reviewed in the field and the field reviewer confirmed that none of the properties met MPR. Additionally, the field reviewer determined that the appraisals relied upon less than suitable comparable sales and, specific data related to the comparable sales selected was not accurate. Individual adjustments made to the comparable sales were not reasonable or well supported, leading to an overvaluation of the properties. The Atlanta HOC required the appraiser to complete 7 hours of continuing education and recommended removal from the Roster for a period of one year. The appraiser did not appeal the removal sanction and is currently off the FHA Roster.

EXCESS OR SURPLUS LAND

The Fifth Edition of The Dictionary of Real Estate Appraisal, published by the Appraisal Institute, defines excess land as "land that is not needed to serve or support the existing improvement. The highest and best use of the excess land may or may not be the same as the highest and best use of the improved parcel. Excess land may have the potential to be sold separately and is valued separately." Surplus land is defined as "land that is not currently needed to support the existing improvements but cannot be separated from the property and sold off. Surplus land does not have an independent highest and best use and may or may not contribute value to the improved parcel."

Excess land can be in the form of an additional lot or parcel, adjoining or part of the improved subject lot and in the same ownership as the subject, which may or may not be a legal lot of record and/or represents a large acreage parcel of ground which is of sufficient size to be buildable and capable of a separate use. Surplus land can be found in older subdivisions and/or communities where it is not uncommon to find a single family property composed of several contiguous lots in which an adjoining unimproved subject lot, due to changes in zoning and land use over time, may be considered a substandard sized lot not capable of being independently built on.

FHA, whose mission it is to promote homeownership through affordable housing, will accept homes with excess or surplus land as security for FHA-insured financing but has some strict rules regarding the valuation of such properties. FHA defines excess land as being the area by which the subject land supporting the home improvement is considered to be larger than typical improved lots in the subject neighborhood.

Generally, the defining characteristic of excess land, according to FHA standards, is its ability to be subdivided and marketed as an individual lot or parcel of record. This excess land could also be incapable of subdivision and independent use but represents additional or surplus land that, when combined with the typical amount of land necessary to support the home improvements, is larger than the area of a readily marketable single family improved property. This scenario is common in rural areas where zoning can be nonexistent and where supporting land sizes for single family homes range from several acres to many acres in size.

In cases where the land supporting a single family home is significantly larger in size than the supporting land area for a typical and readily marketable single family property, FHA instructs the appraiser to place no value on the excess or surplus land by assuming the size of the land supporting the improvements is in keeping with the average of the subject marketplace. For example, if the subject property is composed of a 15 acre parcel of land supporting a single family home and the subject marketplace is characterized by sales of single family properties situated on 2 to 3 acre parcels, the appraiser must hypothetically condition the appraisal on the assumption that the subject property is composed of 2 to 3 acres of land, thereby giving no value to the excess or surplus land. The appraiser must, however, describe and note the actual area of the land supporting the subject improvements within the appraisal report.

ANSWERS TO THE SPRING TUNE UP – BASIC MATH QUIZ FOR 2-4 UNIT PROPERTIES

In recent months FHA reviewers have noted the poor quality of 2-4 unit appraisals, including an appraisal with the following reconciliation of the income approach: *"The appraiser used the current rent of the subject property and the indicated value by the sales comparison approach to calculate the gross rent multiplier. The gross rent multiplier times the current rent of the subject property establishes the indicated value by the income approach, which supports the final value conclusion."* **Scary, isn't it?**

Following are a few refresher exercises to assist appraisers in completing the income approach on 2-4 unit appraisals. Try these and see how you do.

1. An appraiser's research on a 2 unit small residential income property revealed only 2 sales which were rented at the time of the sale. Comparable number one is a 3 unit property that sold for $345,000 and was rented at the time of sale for $1,800 Comparable number two is a 2 unit property that sold for $265,000 and was rented at the time of sale for $1,200

   What is the GRM for each comparable sale? _____
   Comp #1: $345,000/$1,800=191.67
   Comp #2: $265,000/$1,200=220.83
   What GRM is best indicated by the market? _____
   A GRM between 192 and 221 is indicated. Since the information the problem provides indicates that the subject property is more similar to comparable #2, the appraiser should use this information to reconcile the GRM to be closer to the 200-215 range. A conclusion of say 205 is better supported than a conclusion of 190.

   If the subject property has an indicated market rent of $1,350, what is the indicated value of the subject by the income approach? _________
   205x$1,350=$276,750
   The appraiser must select a number as a GRM in order to calculate the value of the property using the income approach. Given that there are only 2 sales available the appraiser will probably not give substantial weight to the income approach, however it is not appropriate to claim that "there is insufficient rental data to utilize the Income Approach".

2. An appraiser's research on a 3 unit small residential income property revealed 9 sales that were rented at the time of the inspection.

   What is the GRM for each sale?

   2 unit property sold for $175,000, one unit rented for $800, market rent for the second is $900
   $175,000/(800+900)= 102.94
   3 unit property sold for $750,000 and was rented for $3,200 $750,000/3,200=234.37
   3 unit property sold for $320,000 and was rented for $2,000 $320,000/$2,000=160
   2 unit property sold for $210,000 and was rented for $1,500 $210,000/$1500=140
   4 unit property sold for $420,000 and was rented for $2,200 $2,200=190.91
   3 unit property sold for $400,000 and was rented for $1,900 $1,900=210.53
   3 unit property sold for $370,000 and was rented for $2,100 $370,000/$2,100= 176.19

Which sales are most comparable to the subject property and what is the most appropriate GRM for the subject?

The 2 unit properties have significantly lower GRMs than the 3 and 4 unit properties, indicating that they could be reflective of a different market than the 3 and 4 unit properties. The one 4 unit property falls in the range of the 3 unit properties and may indicate a market that separates from the 2 unit buildings on the basis of the motivation of a typical purchaser. If the motivations of the typical purchaser of 3 unit buildings is similar to the motivation of 4 unit properties but different from the motivations of 2 unit properties the comparables would align:

234
160
191
211
176

The 2 unit sales would not be considered comparable and the GRM would be between 160 and 234. The number of data points is fewer than ideal for statistical analysis. The appraiser would need to reconcile the selection of the GRM. The appraiser may decide to ignore the high and the low and pay more attention to the numbers in the center—176,191 and 211; say 190.

If the subject currently rents for $2,100 a month, what is the value indicated by the sales comparison approach?

$2,100 x 190= $399,000

You may have a different opinion of the appropriate factor than the appraiser who provided these answers. That's part of the point of the exercise. Do the work, analyze the results, explain what you did, what you found AND WHAT IT MEANS!

The following photos demonstrate why FHA requires an inspection of the attic and crawl space areas

Looks like Yeti took a bite

"Mechanical contractors and power saws are a dangerous combination. This evisceration of the rafters was not needed to install the unit or ducts. They were cut out just in case."

Steve Anderson
Anderson AmeriSpec
Germantown, Tenn.

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Drained

"Well, first of all, we know why the tub won't drain. And secondly, we know how it got full to begin with."

David Grudzinski
Advantage Home Inspectors
Cranston, R.I.

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Vent-O-Rama, aka the Tin Man

"The attic space was the full service venting location. The right-side venting came up from the water heater in the basement. The larger vent on the left arrived from the microwave exhaust fan in the kitchen and they all were heading out the roof through a non-functioning powered attic fan."

Bob Farnham
Metropolitan Home Inspections, Inc.
Minneapolis, Minn.

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Jacked Up

"I found a tire jack being used for structural support in a crawlspace"

Brandon Dyles
Picture Perfect Inspections
Bartlett, Tenn.

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