

## Looking beyond the appraisal form

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Fannie Mae's new appraisal report form is designed to make lenders' and buyers' lives easier.

It doesn't.

The new Uniform Residential Appraisal Report (URAR) merely exacerbates an age-old problem. It ignores the complexity of real estate valuation. It doesn't capture such nuances as market conditions, districting, zoning, demographics and housing trends — the subjective factors that ultimately determine value.

What's more, by minimizing the impact of the appraiser's experience and judgment, the form actually undermines its own usefulness.

It could also undermine the confidence of the underwriters and purchasers who depend on the appraisal to make an informed decision.

The most skilled appraisers solve this dilemma by explaining their analysis and methodology in narrative addenda to the URAR. This is where you find the experience and integrity of the appraiser — not to mention the integrity of the appraisal itself.

But you have to look beyond the form.

Addenda should cover at least five things. First, what's the appraiser's method for adjusting comps' sale prices? It's not enough simply to use formulaic percentages for number of rooms or obvious amenities. Do the amenities actually have value, given the market conditions, demographic preferences and style of the house? How did the appraiser arrive at the values? Does he or she truly know the market or just know how to apply formulas?

Two, how thoroughly has the appraiser analyzed and documented market conditions? A comprehensive analysis should include sales-to-listings ratios, inventory trends and other metrics. How is the spread between listing and sale prices trending over the past 12 months? How long are properties on the market? How is seasonality affecting sale prices? Has the appraiser considered that seasonality could mean a difference of 10% or more? That could make a big difference if the owner buys in May 2005 and defaults in December 2006.

Three, has the appraiser defined the scope of work? USPAP requires this, but the new form barely men-

tions it (the old one didn't at all). Where is the market data from? Can it be verified? Has the appraiser done a supply-and-demand analysis and documented the data sources? Business and employment trends change quickly. If the lender has to remarket the property after a default, it certainly helps to know what they are.

Four, how did the appraiser find sales comps? It's a no-brainer to look for same-size properties within a square mile. But the two properties might have vastly different customers. If two-story homes haven't sold as well as ranches because the community's demographic is older, a split-level or Colonial on the same block is a less valid comp than a ranch that's further from the subject.

What's more, a house across the street might be in a different school district. Or it might not be eligible for the same services. No matter how closely the specs match up, it might be less valid than a larger property within the same district. No form accommodates these factors, but this is how you determine value. It's where

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the appraiser's market knowledge is essential.

Five, though residential appraisers seldom use them, the income and cost approaches are quite relevant under some circumstances. Their absence is conspicuous in the new form, although the old form allowed for a perfunctory cost analysis. If the subject property is in a community populated by young couples or recent immigrants who are saving for their first homes, a valuation based on rental income and a rational holding period assumption might be more appropriate than the sales-comp approach.

In a market with a lot of new construction, an older home should be valued lower than if surrounded with homes of the same vintage. The appraiser might even have to take into account the cost of demolition and new construction. This is a critical piece of information, since in this case the only real collateral is the land itself. An appraiser with market knowledge can explain this rationale; the form can't.

The form's addenda could, of course, cover other material. But these five points provide a framework for judging the appraisal's integrity — not to mention the valuation itself.

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