The High Performance Appraisal Process Unveiled

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Presenter:

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Objectives

• Unveil the Appraisal Process
• Identify your “Bill of Rights”
• Identify documents clients must submit
• Reveal the appraisal appeal process

Appraisal Process Challenges

• Lack of knowledge – all parties
• Limited and/or inaccurately populated green fields in MLS
• Few sales to develop green premiums
• Appraisers, REALTORS®, Builders, and Raters have limited communication
• Lack of data standardization
• Appraisal Forms do not address green
Appraisal Process Challenges, continued

• Appraisal fees are not commensurate with time and complexity in many markets

• Appraisal quality education on high performance is expensive and may not payoff for years

• Appraisers are not provided appropriate documents to understand features

Appraisal Process Challenges, continued

• Underwriters have limited knowledge of high performance and challenge anything outside the norm, like an energy efficient adjustment
Appraisal Ordering Process Unveiled

• Borrower makes application and lender or Appraisal Management Company (AMC) orders appraisal.

• Appraiser choice should be based on property type (per guidelines)

• Property type and complexity **should** determine the competency of appraiser (not rotation list)

Appraisal Ordering Process Unveiled

• If borrower does not clearly identify the property as a "high performance" property, chances are the appraiser choice will not be appropriate.

• Appraiser makes inspection and MAY realize it is a complex assignment and decline if not competent. (Best case scenario)
Challenges to Appraisal Ordering Process

• Lender or AMC is not aware of high performance features because
  • Borrower did not alert lender of features
  • Borrower did not provide a completed AI Residential Green and Energy Efficient Addendum

Competency Qualifier is often based on a

Rotation List

Dice Game

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Achieving Appraiser Competency May Include

- Take a minimum of 14-hours of tested appraisal green valuation courses
- Achieving a LEED designation
- Working with an experienced appraiser
- Reading "Residential Green Valuation Tools"
- Reading other green valuation articles and materials relating to green valuation
- Reading articles on high performance and interviewing builders

Appraiser Competency Excuses

- Clients will not pay for expertise
- No one ever questions competency/education
- There are no green appraisal courses in our area and it cost too much to travel to get a course.
- Green appraisals are no different from non green properties
- No one is building green in my market - no green fields
- The 1004 form does not have green fields so we do not need to address it
Appraiser Competency Reality

- Where there is demand and perceived value - there will be competency!

- Appraisers have access to computers and online education - AI has 14 hours of tested education online now! No excuses!!!

- Guidelines for secondary mortgage market loans require competency prior to accepting assignments

High Performance Game Changers

- The borrower
- The builder
- The real estate agent
- The energy rater
- The appraiser

- You can make the difference!!!
High Performance Game Changers Tips!

• Choose the lender carefully

• Builders - prepare the borrower to communicate with lender that they expect a competent appraiser that has green valuation education and experience

High Performance Game Changers Tips!

• Review the appraisal with the borrower using the tips that follow

• If you find concerns, follow the appeal process to have the appraisal concerns answered satisfactorily

• Just because you do not like the value conclusion is no reason for an appeal
Choose Your Lender Carefully!

- Research the experience your lender has with high performance properties
- Encourage your lender to tour your homes and point out the high performance features and financial benefits to the owner
- Give your lender a copy of "Residential Green Valuation Tools". It addresses lenders also!

Choose Your Lender Carefully!

- Ask your lender to explain the appraiser selection
  - How do they identify competency for a particular property type?
  - Can they tell you how many appraisers on their list have education in high performance houses?
  - All appraisers on our list are competent is not the right response!
Lender’s Responsibility Confirmed by Fannie Mae

Selection of the Appraiser

The lender

- is responsible for the selection of appraisers and for the qualifications and quality of work provided by the appraisers that are selected;

- may not use appraisals ordered or received by borrowers or other parties with an interest in the transaction, such as the property seller or real estate broker. Fannie Mae does allow lenders to use third-party vendors (for example, appraisal management companies) to manage the appraiser selection process. However, it should be noted that if a lender enters into a contract with any vendor, contractor, or third-party service provider, the lender is accountable for the quality of the work performed as if it was performed by an employee of the lender.

The lender (or its authorized agent)

- must establish policies and procedures to ensure that qualified individuals are being selected in accordance with Fannie Mae requirements, including the Appraiser Independence Requirements.

“Bill of Rights” Unveiled

Uniform Standards of Professional Appraisal Practice

Competency Rule

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.

Source: 2014 Fannie Mae Selling Guide

Printed copies may not be the most current version. For the most current version, go to the online version at https://www.fanniemae.com/singlefamily/originating-underwriting.
USPAP Addresses Methods-Techniques-Change

Standards Rule 1-1

In developing a real property appraisal, an appraiser must:

(a) be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal;

Comment: This Standards Rule recognizes that the principle of change continues to affect the manner in which appraisers perform appraisal services. Changes and developments in the real estate field have a substantial impact on the appraisal profession. Important changes in the cost and manner of constructing and marketing commercial, industrial, and residential real estate as well as changes in the legal framework in which real property rights and interests are created, conveyed, and mortgaged have resulted in corresponding changes in appraisal theory and practice. Social change has also had an effect on appraisal theory and practice. To keep abreast of these changes and developments, the appraisal profession is constantly reviewing and revising appraisal methods and techniques and designing new methods and techniques to meet new circumstances. For this reason, it is not sufficient for appraisers to simply maintain the skills and the knowledge they possess when they become appraisers. Each appraiser must continuously improve his or her skills to remain proficient in real property appraisal.


USPAP Addresses All Agreements...

Standards Rule 1-5

When the value opinion to be developed is market value, an appraiser must, if such information is available to the appraiser in the normal course of business:

(a) analyze all agreements of sale, options, and listings of the subject property current as of the effective date of the appraisal; and

(b) analyze all sales of the subject property that occurred within the three (3) years prior to the effective date of the appraisal.

Comment: See the Comments to Standards Rules 2-2(a)(viii) and 2-2(b)(viii) for corresponding reporting requirements relating to the availability and relevance of information.

“Bill of Rights” Confirmed by Fannie Mae

Fannie Mae Selling Guide April 15, 2014
B4-1.1-03, Appraiser Selection Criteria – Page 541

Knowledge and Experience

Lenders must use appraisers that

- have the requisite knowledge required to perform a professional quality appraisal for the specific geographic location and particular property type; and
- have the requisite knowledge about, and access to, the necessary and appropriate data sources for the area in which the appraisal assignment is located.

Appraisers that are not familiar with specific real estate markets may not have adequate information available to perform a reliable appraisal. Although the Uniform Standards of Professional Appraisal Practice (USPAP) allows an appraiser that does not have the appropriate knowledge and experience to accept an appraisal assignment by providing procedures with which the appraiser can complete the assignment, Fannie Mae does not allow the USPAP flexibility.

https://www.fanniemae.com/content/guide/

2014 Fannie Mae Selling Guide – Page 538

Prohibited practices include:

- use of unsupported, descriptive comments or drawing unsupported conclusions from subjective observations. These actions may have a discriminatory effect;

- use of unsupported assumptions, interjections of personal opinion, or perceptions about factors in the valuation process. These actions may have a discriminatory effect, and may or may not affect the use and value of a property;
National Association of Homebuilders Lender Agreement Wording

"This Home is being built/renovated/updated to nationally recognized standards above prevailing code. It is designed and constructed with unique features and materials and with high-efficient equipment and in accordance with high-efficiency standards. The Lender shall choose an Appraiser educated and knowledgeable in this type of valuation of these specialized Homes, preferably an appraiser who holds a professional appraisal designation that requires advanced education on such issues as the valuation of sustainable buildings (e.g., MAI or SRA designations from the Appraisal Institute). The appraiser shall provide verification of green valuation education of 14 hours or more from a qualified educational provider and knowledge to be permitted to conduct the appraisal for this project."

http://www.nahb.org/generic.aspx?genericContentID=219188&fromGSA=1

Documents you must provide to the appraiser

• Complete HERS Report that provides input for income approach method. (Present Value)
• Green Rating and worksheets
• Complete cost breakdown
• Highlight the cost of additional energy or green features.
• Provide sales of similar properties that are arm’s-length transfers
• AI Residential Green and Energy Efficient Addendum
Market trends are important

• If you have sold a number of high performance houses that did not go through MLS, provide the following:

  • Address – size – price – features – closing statement
  • Date contract was signed is the sale date – not the date it closed! Important
  • If custom homes were sold, they can provide cost data but may not meet the definition of a “comparable”.

Appraisers must have data

• MLS is key database for valuation- educate real estate agents
• Adjustments must be supported
• Underwriters often say, no sale of high performance house - no value
• There are tools in the appraiser's toolbox that go beyond paired sales analysis.
  • The following tools are your best friend and have already made a huge impact on the appraisal process and marketability of the high performance house.
AI Residential Green and Energy Efficient Addendum and Residential Green Valuation Tools

These two tools complement each other. Chapter 6 of the book, *Residential Green and Energy Efficient Addendum Form*, has 67 pages that takes the reader through completing the Addendum and provides valuable resources.

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### An Appraisal Should Be Consistent

An appraisal should be consistent with the market and the subject property. The appraisal report should provide a clear and comprehensive analysis of the property's value, taking into account its location, condition, and characteristics. The example below illustrates a typical appraisal report format:

<table>
<thead>
<tr>
<th>Neighborhood Description</th>
<th>Gross Living Area</th>
<th>occasional</th>
<th>Gross</th>
<th>Following</th>
<th>Good Appraisal</th>
<th>Location:</th>
<th>Market Data:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northside</td>
<td>2,800 sq. ft.</td>
<td>68.00</td>
<td>$238,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Southside</td>
<td>1,200 sq. ft.</td>
<td>68.00</td>
<td>$78,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Porch and deck</td>
<td>1,200 sq. ft.</td>
<td>24.00</td>
<td>$16,500</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Total Estimate of Cost of Sale**: $347,520

**Less 50% Physical**: $16,391

**Adjusted Value of Improvement**: $324,491

**Indicated Value by Cost Approach**: $391,800

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Appraisers do have tools

Supported Value

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Present Value Calculations from HERS Report

- Installed Cost of Improvements ($): 8200
- Cost Weighted Life of Measure (Years): 29
- Mortgage Term (Years): 30
- Discount/Mortgage Rate (%): 5.00
- Present Value Factor: 15.1
- Expected Annual Energy Savings ($): 513
- Expected Annual Maintenance Costs ($): 0
- Expected Annual Savings ($): 513
- Increased Annual Mortgage Costs ($): 533
- Present Value of Savings ($): 7755
- Expected Annual Cash Flow ($): -20
Present Value Calculations Using HP-12C

HP12 C
29 N – Number of years
5 I – Discount Rate
513 PMT – Annual savings amount
Press PV - Should give present value or
$7767 (It will show as a minus-press CHS for change sign)
Or $513 x Present Worth Factor of 15.141074 = $7,767 (Uses Annual
Compound Interest rate of 5%)
Appraiser must be able to follow the numbers.

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Data Underwriters Dream about....

Paired Sales Analysis

<table>
<thead>
<tr>
<th>Description</th>
<th>Sale A</th>
<th>Sale B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale Date</td>
<td>07/XX</td>
<td>06/XX</td>
</tr>
<tr>
<td>Sale Price</td>
<td>$274,000</td>
<td>$270,000</td>
</tr>
<tr>
<td>Living Area</td>
<td>2,200</td>
<td>2,180</td>
</tr>
<tr>
<td>Garage</td>
<td>2-Car Attached</td>
<td>2-Car Attached</td>
</tr>
<tr>
<td>Energy or Green Features</td>
<td>Hers Index 64</td>
<td>Hers Index for Code-Built 95</td>
</tr>
<tr>
<td>Difference attributed to Energy Features ($274,000-$270,000)</td>
<td>$4,000</td>
<td></td>
</tr>
</tbody>
</table>

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Cost of High Performance Features

<table>
<thead>
<tr>
<th>% of Cost to Build Green Compared to “Code-Built” Construction</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>McGraw – Hill Construction Report – 2012 New Construction</strong></td>
</tr>
<tr>
<td><strong>McGraw-Hill Construction Report -2012 Remodelers</strong></td>
</tr>
<tr>
<td><strong>Marshall &amp; Swift Res. Cost Handbook</strong></td>
</tr>
<tr>
<td><strong>Costs vary by experience of builder – McGraw-Hill Construction Report - 20112</strong></td>
</tr>
</tbody>
</table>

Costs vary by experience of builder – McGraw-Hill Construction Report - 20112
12% of dedicated green builders (90% of their projects) report 0% additional costs

Test of Reasonableness

<table>
<thead>
<tr>
<th>Method</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present Value</td>
<td>$7,767</td>
</tr>
<tr>
<td>Paired Sales</td>
<td>$4,000</td>
</tr>
<tr>
<td>Cost of EE Features</td>
<td>$8,500</td>
</tr>
</tbody>
</table>

Cost sets the upper limit of value with present value calculation supporting a value slightly less than cost. However, the present value calculation has more room for error in the estimate of interest rate and discount period. The sales data provides a more direct measure of the market’s view of value. Most weight must be given to the paired sales supporting $4,000.

Appraisal Report should provide the reasoning for the adjustment process.

A -0- adjustment requires support!
No Adjustment is a Zero – Zero is a number!

635 Standards Rule 1-6
636 In developing a real property appraisal, an appraiser must:
637 (a) reconcile the quality and quantity of data available and analyzed within the approaches used; and
639 (b) reconcile the applicability and relevance of the approaches, methods and techniques used to arrive at the value conclusion(s).

649 Standards Rule 2-1
650 Each written or oral real property appraisal report must:
651 (a) clearly and accurately set forth the appraisal in a manner that will not be misleading;
652 (b) contain sufficient information to enable the intended users of the appraisal to understand the report properly; and


No Adjustment is a Zero – Zero is a number!

Standard Rule 2

(xviii) summarize the information analyzed, the appraisal methods and techniques employed, and the reasoning that supports the analyses, opinions, and conclusions; exclusion of the sales comparison approach, cost approach, or income approach must be explained;

Comment: An Appraisal Report must include sufficient information to indicate that the appraiser complied with the requirements of STANDARD 1. The amount of detail required will vary with the significance of the information to the appraisal.

The appraiser must provide sufficient information to enable the client and intended users to understand the rationale for the opinions and conclusions, including reconciliation of the data and approaches, in accordance with Standards Rule 1-6.


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Obtain copy of appraisal report

• Only borrower has right to copy of report; therefore, the builder must work with the borrower to obtain a copy.
• Lender is required to give borrower a copy of the report 3 days prior to closing unless they sign a waiver
• Read report in its entirety and document concerns in writing
• Do not contact appraiser!!!!
• Contact lender with written concerns of error of fact- must be factual and not a complaint of value only- follow the tips
Appraisal Key Spots to Identify High Performance

- **Neighborhood** comments on high performance trends in the market area
- **Site and Improvement** Sections should address the high performance features or refer reader to the AI Residential Green and Energy Efficient Addendum that should be completed and attached.
- **Sales Comparison Approach** Section adjustments and descriptions should address energy efficient features and other special items the high performance may have. **Verify energy features on sales used.**
- **Summary to the Sales Comparison Approach** should explain basis for adjustment—not just repeat amount of adjustment.

Appraisal Key Spots to Identify High Performance, continued

- **Cost Approach** should address "Green" section of cost manual
- If subject is proposed construction, builder should provide cost breakdown. Appraiser should review cost breakdown for reasonableness and address reasonableness of the data provided.
- Is cost reasonable and well supported?
Appraisal Key Spots to Identify High Performance, continued

• If the Cost Approach and Sales Comparison Approach indications vary widely, an explanation should be made and if not a red flag raised.

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Neighborhood and Market Conditions Section

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Improvement Section

• Are the descriptions accurate and complete?
• Does the section refer to the Addendum you provided?
• Does the last question on the form address the conformity of the property to the market/neighborhood-more energy efficient, lower cost to maintain, etc.
• Are the energy savings addressed?
Sales Comparison Section

• Review the sales - do they have the same energy features?

• Can you verify the description of the sales? MLS-Zillow-Trulia-Agent

• Are the sales the best ones available?

Sales Comparison Section

• The sales must be arm's-length and cannot be the result of a custom home built on a lot owned by the borrower prior to construction.

• Are the sales newer structures

• Has energy efficiency of the subject compared to the comparables been explained or analyzed?

• Document any errors of fact in writing!
Sales Comparison Section

• Must stay within guidelines or explain....
  • 1 mile or explain
  • Sold in last year or explain
  • Gross and net adjustments are within 25% and 15% respectively or explain

Explain
Sales Comparison Summary Example

The most recent sales in the same neighborhood form the basis for the subject’s value opinion. All sales compete for the same buyer. Minor adjustments are necessary resulting in a tight value range and minimal gross and net adjustments.

Adjustments are based on market extraction and represent the thinking of buyers and sellers in the market. An adjustment for the green features is not warranted since there are no sales of similar properties with these newer features. All sales have similar energy efficient features. The data strongly supports value at $300,000 based on Comparable Sales No. 1 and 2, the most recent and least gross adjusted. The data suggests the subject sold over market value and no existing home sales exceeding $325,000 were found in the last year.

Challenge must....

• Be in writing
• Based on error of facts or omission
• Based on inconsistencies
• Addressed with the lender directly
• Addressed in a timely manner

Do not approach the appraiser directly – you are not his client.
Steps to a Smoother Closing

Solving the Data Challenge

• Get involved with MLS and assure the green fields are implemented and populated accurately

• Complete the AI Residential Green and Energy Efficient Addendum and make sure the borrower, appraiser, lender, and real estate agent has a copy.

• Attach full energy and green reports to Addendum

• Encourage agents to put Addendum, energy and green reports in MLS

• Communicate with industry parties
Solving the Data Challenge

• Appraisers do not determine or calculate value!
• Appraiser develop value based on market data.

Post the high performance features inside electrical box or near

• HERS Index and/or Green Rating
• Envelope Rating
• Duct Rating
• Insulation Installation Rating
• Date Rated
• Name of Rater
Thank you for Attending!

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