

Reviewing a Residential Estate Appraisal Report

by Thomas Murry, CRA

Estate properties provide the most complex residential review performed. An estate has a high value due to the combination of location in an estate community, size of the site and improvement features. Though standard practices are employed, the review should include additional research and not simply rely on the appraiser's presentation. In this writing, the estate property, appraisal contents and estate review topics are discussed.

ESTATE PROPERTY ISSUES

The site and improvements of the subject are constantly being evaluated in comparisons. The neighborhood, site, improvements and depreciation need consideration as conditions dictate.

Neighborhood

The estate neighborhood is usually a unique portion of the city or community. In most, the value range is typically wide due to a range of site sizes, improvement sizes, and features. Large estates are often the most valuable real estate in the neighborhood. Due to this, the value may be limited by the neighborhood's price range more than the amenities or sheer size. Even the value range of adjacent estate areas may influence the values in the subject's neighborhood.

Site

Estate valuations are affected by legal constraints, site features and conformity. Legal constraints, such as zoning, limit actual and potential development. Site features such as size and topography establish utility. Conformity of the site considers adjacent uses and neighborhood standards.

Zoning establishes use standards and minimum site requirement. The subject will usually be zoned a single residence, but a guest house with a kitchen may cause the estate to be considered a duplex by the building department. However, when the guest house is on a separate lot within the same site, it may require treatment as a second and separate property.

For sites with excess acreage the potential for development should be considered with caution. In some locales, estate property has a minimum size, even if part is not landscaped or utilized. A subdivided site may cause an imbalance of improvement size to site size. A small lot with a large house may no longer be an estate but simply an over-improvement. The resulting over-improvement will lack the lot of an estate and be too big a house to be part of the typical housing stock; nearly unmarketable.

Improvements

The estate property is usually part of a regional luxury housing market. This market may require construction well above the normal standards. Consistency of style identifies high quality, not a single feature.

Each architectural style has trademark features and the higher quality house includes those style features inside and out. The style may even affect the floor plan, but to say one style is superior to another is beyond the scope of the appraisal process. Equal quality standards tend to have equal market appeal, regardless of style.

Quality in the materials used and features provided include the use of brand name plumbing fixtures (Kohler or American Standard) and kitchen appliances (Gaggenau, Kitchenaid, Thermadore). Superior features also include multiple heating and cooling systems, alarms, central vacuum, and a second flight of stairs.

Depreciation

Causes of depreciation include three categories: physical, functional, and external. The physical depreciation should be based on the relationship of effective age to total economic life (effective age plus remaining economic life).

In considering functional obsolescence in estates, conventional standards may not always be applicable. Good architectural design balances the custom homeowner's needs with general design standards. The size, number and location of rooms will often be determined by the owner's family size and entertainment needs.

The determination of what warrants an over-improvement is complex for estates. Clearly the largest house in the neighborhood should be subject to consideration as an over-improvement, but determine the relevant market area before reaching a conclusion. An over-improvement has diminishing marginal utility verses the general housing stock and not simply compared to recent sales.

The external depreciation should be consistent with the site description. External obsolescence can have a large impact on estates. The buyer of estate property usually expects a dream property, free of any adversity. As a result, property having external obsolescence may not attract buyers at a price as similar estates without the adversity.

ESTATE APPRAISAL ISSUES

Report Type

Though most lenders prefer estate property appraisals to be on FNMA/FHLMC forms, some prefer narrative reports. In either type it is the content not the format that determines the soundness of the report. Narrative reports do have some advantages, but many readers prefer the condensed information of a form report.

Use of form reports does not imply that the USPAP or other standards may be ignored due to the form's lack of topic inclusion or space. For example, the Condominium Appraisal Form (FNMA

1073/FHLMC 465) provides no specific line for a legal description. The legal description must still be provided in the report.

Report Contents

The appraisal should represent a single and complete thought. The report should be a repeating series of description, evaluation and conclusion. This cycle is repeated for the area, subject, each value approach, and finally a conclusion, with supporting addenda. Industrious appraisers are also articulate. A presentation that uses good grammar and spelling has more communication. Appraisals that avoid excess abbreviations are also easier to read.

The appraisal should describe the property sufficiently to denote the range in features and materials. Interior photos are excellent support for descriptions. The description should encompass all finished areas, such as a basement, guest house, or recreation room. Each area warrants a separate description of construction material and depreciation.

The quality range in estates ranges from average to excellent. On form reports, quality above "good" should be noted by comments. Besides neighborhood standards and special features, cost services also provide quality definitions. These services include detailed descriptions used in their estimating methods. The quality level is important as it affects all approaches to value,

Cost Approach

For existing estates, the cost approach is not usually given most weight in the final reconciliation. Due to this, appraisers often spend little time in this approach. The reproduction cost should indicate a data source for the cost estimate. In most cost services, the base cost per square foot for the highest quality class does not exceed \$100.00. Unique features, such as hand painted walls or complex foundation should be itemized.

The land value is often difficult to determine by direct sales analysis in fully developed areas. As a result, most land value estimates are via abstraction (also known as the residual approach) with no sale data. Despite a lack of direct analysis, information about "tear down" residences that sell for land value is helpful. Also, sales of similar vacant site from adjacent market areas may add credibility to the land value estimate.

Market Approach

This is generally the most relevant approach to value for estates. In simple terms, what makes a residence worth a million dollars is that a similar property sells for a million dollars, not a particular special feature. Errors or inaccurate data in this part of the report can destroy the credibility of the entire report. The data should include relevant comparables, accurate descriptions, and market sensitive adjustments. Atypical site features require at least some comparables to have the same features or the market analysis may be comparing apples to oranges.

For most estates relevant sales will be only within the same neighborhood and community, however large estates may have an extended market area. This does not mean that a big house, far from similar properties, allows the appraiser to ignore nearby housing prices. Remote comparables may need additional analysis to understand the comparative demographics and government. Additional comparables and other market data can be as helpful as the data provided in the grid. Listing data and dated sales of nearby homes can help to verify the value conclusion.

A special area of concern for estates is the age/condition and site/view adjustments. Compound adjustments often causes confusion. In many established estate communities, the actual age of most mansions is over fifty years, with updating used to keep the improvements useful. The effective age of these estates is often significantly differs from the actual age. Preferably, the condition line will denote effective age and condition, such as "Good/Eff 10yr,"or"Avg./Eff25yr". This method ties the related terms of effective age and condition together.

The site/view adjustments can be separated on the form grid in two ways. In the most common method, the view adjustment is made on a separate line and the site/view line used only for differences in the gross lot sizes. Another method provides the gross lot size and view rating on the site/view line, then a separate line indicates the. useful pad area. This method uses the site/view line for the view adjustment and the pad area line for lot adjustments, based on the usable pad size. Either way, when explained, reduces confusion.

Income Approach

Estate valuations seldom use the income approach. Owners usually occupy estate properties. Use of this approach in estate valuations should only be used when the appraiser can prove that estates, in that area, typically transact for income potential.

Final Reconciliation and Addenda

The final portions of the appraisal include a reconciliation, conditions of the report, sale history, a reconciliation and a variety of addenda. All conditions should be reasonable and a certificate of completion included in the report.

The sale history of the subject is often invaluable information. In addition to historical price, any recent marketing should be analyzed. Local real estate boards should confirm that the subject has not been listed for sale recently when appraised for a refinance. For pending sales, the listing information can provide an additional source to verify the features of the subject and comparables.

The purpose of the appraisal should be identified. The date of value, date prepared, and effective date should be similar. The appraiser must be competent to do the appraisal. A statement describing the scope of the appraisal process aid in determining diligence.

As FIRREA takes hold, the reviewer must increase their awareness of requirements of these regulations. It is important that the appraisal report was prepared to conform to the Uniform Standards Of Professional Appraisal Practice (USPAP). Some lenders now require a statement indicating that the departure provision of the USPAP was not used.

ESTATE REVIEW ISSUES

An estate appraisal review will usually have several complex aspects. Whatever the presentation, estate appraisal should be convincing to the reader. The reviewer should be able to identify accurately whether the estate is within an estate community or simply one of the largest residence in the area.

General Review Standards

The Financial Institution Reform, Recovery and Enforcement Act of 1989 (FIRREA) became a law on August 9, 1989. Title XI of FIRREA included provisions calling for appraisals prepared for most depository institutions to be completed by certified or licensed appraisers. Residential estate transactions with a dollar amount over one million dollars require a certified appraiser. A reviewer of high value residences will need to recognize complex property and expand the review as the appraisal warrants.

The third standard of the USPAP (see exhibit 1) specifically addresses review appraisals. Information provided by the client should include the appraisal report, title report, escrow instructions, and any other information appropriate to the review,

Review Sequence

The review process for estates is an amplified version of basic residential review techniques. However, a desk review is seldom adequate and most lenders require a field review. The sequence of the process is important for the reviewer to avoid multiple or redundant trips to the subject's neighborhood.

Conduct initial research in the office, followed by field inspection, and concluded in writing the review. The report

should be cohesive and logical during the first reading. Check common source of math errors, like the living area sketch. Additional checks for all other math areas, such as room count, lot size, and comparable's adjustments are also part of the first review.

Next, verify the comparable's sale price, date, and terms. Also, access data sources to verify the improvement and site information on the subject and the report's comparables. During this search look for additional sale data.

The field portion of the review starts after the reviewer has analyzed an adequate amount of data. Unfortunately, many estates are behind tall walls and gates, allowing the reviewer to inspect only the street side appearance. Take care to be thorough but not intrusive. Have your business card ready and be direct with neighbors or security patrols who may question your motives. The reviewer has a legitimate business purpose, but conducting your review unprofessionally invites query.

Available Information

A review of public records, to verify that the appraiser correctly identifies the improvements is a good practice. It is not uncommon to accidentally identify a finished basement or attic as part of the living area, grossly over-stating the actual size of the living area.

The reviewer usually lacks the knowledge of a personal interior inspection, but should be an expert regarding relevant public information. Local demographic data, geological maps, flood maps, zoning codes, and building codes are essential tools in estate reviews. Replacement cost figures are available from several sources: appraiser, local contractors, Marshall & Swift, R. S. Means, and construction loan data. Sale data sources usually include public records, Realtors, private data services and appraiser files.

Appraising is a research process that incorporates some knowledge in many separate professions. Drafting, writing, architecture, photography, building construction, mortgage banking, and real estate

brokerage all have information used for appraisal. A sound appraisal library includes traditional appraisal books, time-dated facts, and information from seminars and conventions.

Market Analysis

In estate appraisals and reviews, errors in value tend to be large. The appraiser may not only be incomplete in the report presentation, but may select sale data that is not relevant to the subject. Sale information that is recent and in the same general area, may not be appropriate, resulting in a grossly inaccurate value conclusion.

Comparable selection

Critical analysis of the comparable's relative location, size and features distinguish relevancy. If all the comparables are a mile east, then the appraisal tells you what the subject is worth if it was a mile away, not where it is. When the comparables are next to a beach, or other recreational features and the subject is not, the appraisal is not comparing like properties.

The next concern is the similarity of lot size and improvement size. A comparable that is half or double the size of the subject is rarely germane to the subject's valuation. A wide range of size usually causes a large range for the indicated value. This makes it difficult to feel that any particular value is the best.

Estate communities usually have homes designed with extra livability. Comparables which all have an extra garage space or extra fireplace may warrant a minor dollar adjustment, but also could indicate that the subject does not have the features which that area's estate properties have.

An over-improvement is implied when the comparables are all significantly smaller or the only comparables of similar size are selected from outside the neighborhood. Comparables which are nearby and similar in size, but have not recently sold suggests a slow market for that size of estate instead of functional obsolescence.

After considering location, size and features, the reviewer needs to verify the report's data. During the verification a search for additional comparables can be started. I recommend a three stage approach. First, locate recent sales in the immediate area and identify several properties that are clearly superior and others that are inferior. These will bracket the value range of next search and confirm the appraisals neighborhood price range.

Next, conduct a search for most similar properties with an expanded search area and time frame. This provides additional direction toward a specific value and suggests value trends for estates in this area. Next, compare the data with the comparables the field reviewer selected. Any comparables used in the appraisal but not found in your search will require additional verification and may be suspect.

Adjustments

The comparable's features are fact, but adjustments based on those features are often subjective. The size and number of adjustments often influence credibility. A half dozen adjustments for a custom estate comparable is not uncommon, but comparables with over a dozen adjustments are not

really alike. Adjustments for features that the data sources identified in the appraisal do not describe and not observable at street side, should be questioned.

Atypical adjustments, such as a separate adjustment for features typical to estates of the same quality, should be scrutinized. Unique features are common in custom homes, though they might be considered upgrades in tract style homes. Items such as luxury landscaping or deluxe kitchen appliances can seldom be verified for the comparables, causing them to be unsupported adjustments.

Another typical estate adjustment problem is very small amounts used for adjustments. Adjustment, but adjustments

under one percent of the value will have no noticeable affect on the indicated value for the subject. Small adjustments may understate the market reaction.

Estate appraisals frequently require some subjective adjustments that may lead to disagreement. A review of the comparable's price range and dollar per square foot of gross building area can provide a cross check on the subject's value. The comparables may not be appropriate when the subject's indicated value is above or below the price of the comparables.

REVIEW CONCLUSION

The NARA/MU review form or FNMA 2000/FHLMC 2032 is used for appraisal report critiques. The appraisal's information and reasoning is a combination of quantity and quality. The thicker appraisal does not always have better reasoning, but more information is available for review. A quality report will be accurate and relevant. The review critique needs careful treatment of subjective factors. Each report and review is just one person's opinion, and everyone's entitled to theirs.

When information on the review and appraisal differ, the underwriter will need to decide who is more credible. Appraisal and reviewing involve independent thinking and conflicting views are expected occasionally. It is the reviewer's duty to service the client and promote the review's merits. Dialogue with the underwriter or appraiser may be more constructive than a series of review response letters may confuse instead of resolving the issues. If the reviewer's opinion is better, the reviewer should be willing to face contrasting opinion.

Recently, many institutions have standardized FIRREA statements, with the form a required item, increasing the amount of addenda. The qualifications of the reviewer should include experience in the valuation of this property type. A statement describing the scope of the review process increases the client's understanding of your review. It also can avoid implied research.

Value Change

When the report has accurate descriptions, but fails to arrive at a reasonable value, a difficult task faces the reviewer. The value should be lowered without bringing the entire report into question. The appraisal should be logical to remote underwriters and not just to local readers, who know the housing dynamics of that community. If the report is adequate, but the value conclusion is not the best effort given the data available, the reviewer's conclude value should be different.

A different concluded value should be supported by adequate comments and data. New listing data or corrections of data contained in the appraisal should have the source of the revised information provided. The reviewer should feel that the appraiser has correctly identified the subject's relationship to the neighborhood's housing stock, based on the data and value selected.

SUMMARY

Estate properties require review skills beyond the conventional residential appraisal report. Additional research and a field inspection are typical. The review appraiser will analyze the report, then compare it to the Uniform Standards of Professional Practice and the standards typical for the subject's market. As most estate areas have wide value ranges, care to analyze the subject's relationship to the general housing stock. An investment grade appraisal review is an accurate and complete statement.

Exhibit 1

UNIFORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE

Standard 3

In reviewing an appraisal and reporting the results of that review, an appraiser must form an opinion as to the adequacy and appropriateness of the report being reviewed and must clearly disclose the nature of the review process undertaken.

Explanatory Comments Relating to Standard 3

General Comment

The function of reviewing an appraisal requires the preparation of a separate report or a file memorandum setting forth the results of the review process. These appraisers are normally checking for a level of completeness and consistency in the report and cannot be expected to have first-hand knowledge of the subject property and other data in the report. This is a distinctly different function from that addressed in S.R.2-5. To avoid confusion in the marketplace between these two functions, appraisers reviewing appraisal reports should not sign the report being reviewed.

Appraisers who engage in the function of reviewing an appraisal report must take appropriate steps to indicate to third parties the precise extent of the review process. A separate report or letter is one method. Another appropriate method is a form or check-list prepared and signed by the appraiser conducting the review and attached to the report being reviewed. It is also possible that a stamped impression on the appraisal report signed by the reviewing appraiser may be an appropriate method for separating the review function from the actual signing of the report. To be effective, however, the rubber stamp must briefly indicate the extent of the review process and refer to a file memorandum that clearly outlines the review process conducted.

Thomas Murry, CRA, is the chief appraiser for Camden Financial Services, a national mortgage banking firm. He has been appraising multi-million dollar residences for many years. He has personally valued over a billion dollars in one-to-four family residential property and reviewed estate appraisals nationwide.

He received his bachelor of science degree in business economics and finance from the University

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Mr. Murry is a senior member of the National Association of Review Appraisers & Mortgage Underwriters and currently holds the "CRA" (Certified Review Appraiser) designation. He also is a Senior Residential Appraiser in the Appraisal Institute and participates in The Mortgage Banker's Association.

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