Rural Property Appraisals:

Avoiding the Pitfalls Between Origination and Closing

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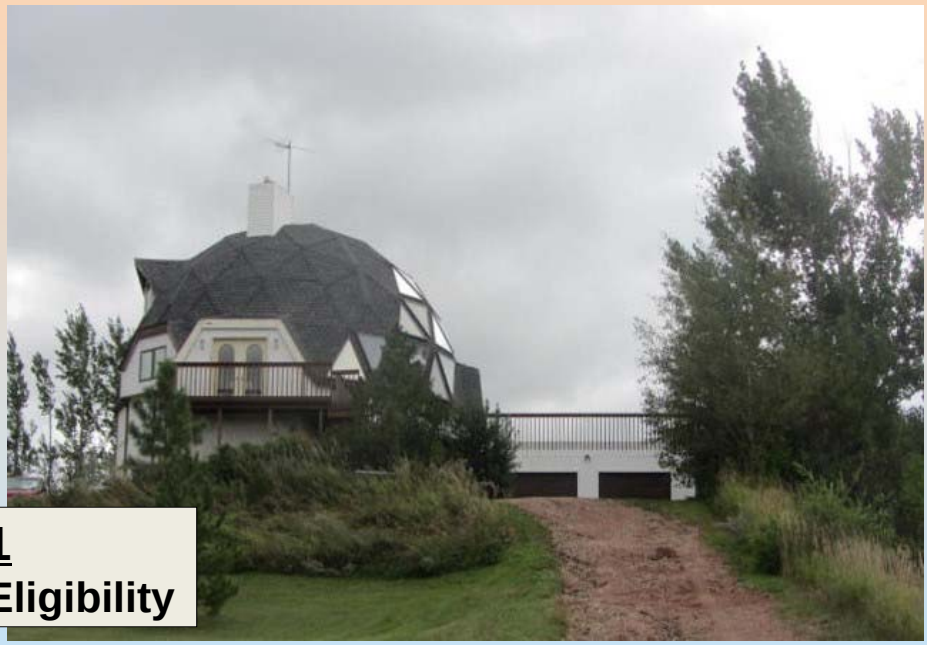
2019 Mortgage Conference
Des Moines, Iowa
April 16, 2019

Today's Agenda

1. **Property Eligibility**
2. **Supporting Adjustments in the Sales Comparison Approach**
3. **Final Thoughts**



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Property Eligibility

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Section 1
Property Eligibility

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Rural Property Appraisals

Ineligible Properties

- Vacant land, undeveloped land or land development properties
- Properties used primarily for agriculture or farming
- Properties used primarily for commercial enterprises (including, but not limited to, bed and breakfasts, boarding houses, Condominium Hotels and units located in a PUD operating as a hotel or similar type of transient housing that includes hotel type services and characteristics)

Freddie Mac Single-Family Seller/Servicer Guide, 04/03/2019, p. 5601-2



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Rural Property Appraisals

Property Requirements

The mortgage premises must be:

- Residential in nature as defined by the characteristics of the property and surrounding market area
- Safe, sound, and structurally secure
- The **highest and best use** of the property as improved and the use of the property must be a legal or legal non-conforming use
- <…>

Fannie Mae Selling Guide, 04/03/2019, p. 265

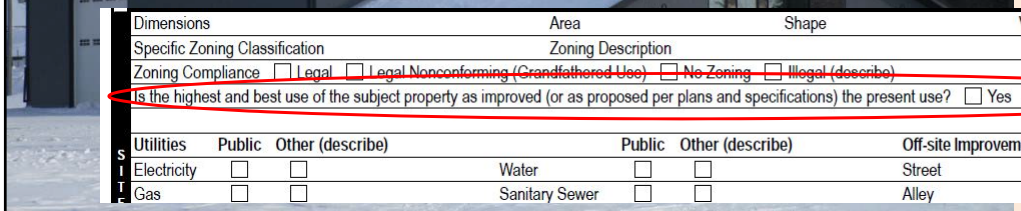


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Q. Why Analyze Highest and Best Use?

A. "Market Value" Presumes H&BU



Dimensions	Area	Shape	View
Specific Zoning Classification	Zoning Description		
Zoning Compliance ☐ Legal ☐ Legal Nonconforming (Grandfathered Use) ☐ No Zoning ☐ Illegal (describe)			
Is the highest and best use of the subject property as improved (or as proposed per plans and specifications) the present use? ☐ Yes ☐ No If No, describe			

SITE	Utilities	Public	Other (describe)		Public	Other (describe)	Off-site Improvements—Type	Public	Private
	Electricity	☐	☐	Water	☐	☐	Street	☐	☐
	Gas	☐	☐	Sanitary Sewer	☐	☐	Alley	☐	☐

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Highest and Best Use?

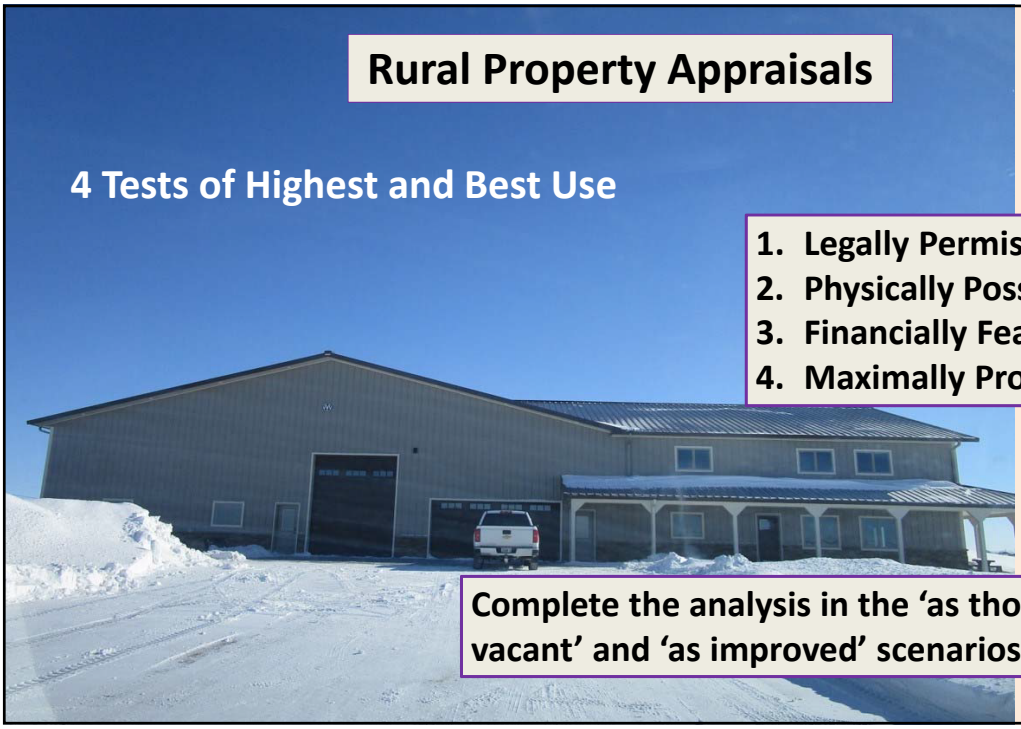
Is the highest and best use of the subject property as improved (or as proposed per plans and specifications) the present use? ☒ Yes ☐ No If No, describe



USPAP: The H&BU Conclusion *Must* Be Supported in the Appraisal Report

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Rural Property Appraisals



4 Tests of Highest and Best Use

1. Legally Permissible?
2. Physically Possible?
3. Financially Feasible?
4. Maximally Productive?

Complete the analysis in the 'as though vacant' and 'as improved' scenarios.

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Rural Property Appraisals



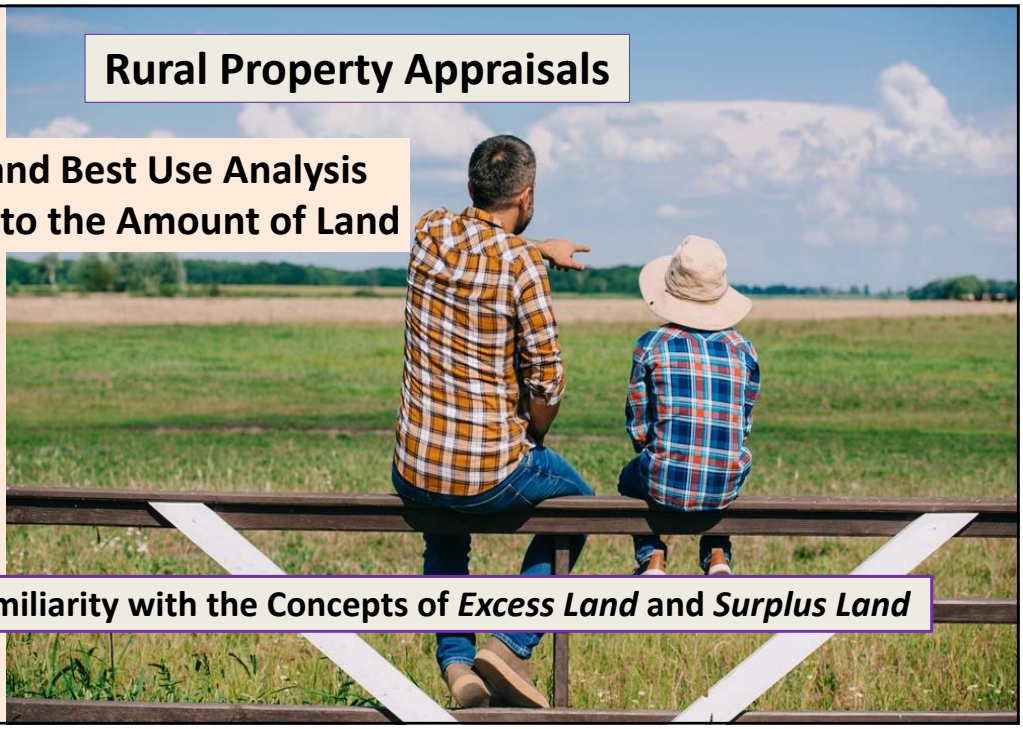


Is the Highest and Best Use as a Commercial Shop with Living Area, or as a Residence with a Shop?

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The Highest and Best Use Analysis Also Extends to the Amount of Land



Familiarity with the Concepts of *Excess Land* and *Surplus Land*

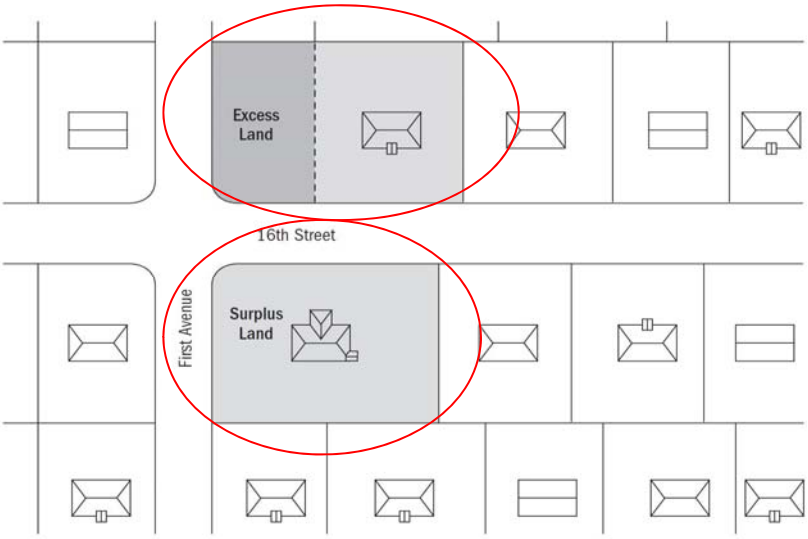
Rural Property Appraisals



Land that is not necessary for the existing improvements or those required for the vacant site's H&BU, and typically exceeding the amount included with competing properties, may be classified as either ***Excess Land*** or ***Surplus Land***.

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Rural Property Appraisals



***Appraising Residential Properties*, 4th Edition**, Appraisal Institute, page 127

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Rural Property Appraisals

Additional Insights into Eligibility:

■ Freddie Mac does not have site size or acreage limitations. However, when a property consists of a large acreage parcel(s) and is in a location where commercial farms or ranches are typical, the Seller needs to perform additional analysis of the property characteristics to make sure the property is residential (Highest and Best Use).

■ Freddie Mac will purchase mortgages secured by properties considered to be hobby farms, which are typically small farms where the homeowner engages in farming activity for personal use and are otherwise eligible properties. In this case, the primary use must be residential (Highest and Best Use).

Paraphrased from Freddie Mac Requirements for Rural Properties Q&A
www.freddiemac.com

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Additional Insights into Eligibility:

■ Properties with agricultural-type outbuildings may be eligible. These include silos, facilities for farm animals, and large barns, however they may be an indication that the property is a farm. The Seller needs to determine whether the property is primarily residential based on the property characteristics, zoning and land use of the property (Highest and Best Use). If the primary use is residential, despite the presence of agricultural-type outbuildings, the property is eligible for Freddie Mac financing.

■ Freddie Mac will purchase mortgages secured by properties that are unique or may not conform to the neighborhood in terms of type, design, age, or the materials/techniques used in construction. Appraisers must be able to evaluate how the nonconformity affects the value and marketability of the property (Highest and Best Use).

Paraphrased from Freddie Mac Requirements for Rural Properties Q&A
www.freddiemac.com

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Section 2
Supporting Adjustments in the Sales Comparison Approach

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Section 2
Supporting Adjustments in the Sales Comparison Approach

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Rural Property Appraisals

Accepted Methods and Techniques to Support Adjustments in the Sales Comparison Approach



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Example: Contributory Value of a Typical Outbuilding?

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Artificial Template of the Past:
Max Gross Adjustments of 25%, Net Adjustments of 15%, and Line Item Adjustments of 10%

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It is common for comparable sales to be distant from the subject, dated, or to require high adjustment percentages (%'s). So, the solution is to add sales that are even ***more*** dated or ***more*** distant… does this make sense?

Example: Contributory Value of a Typical Outbuilding?

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***Today*: Provide Support for the Adjustment for an Outbuilding in the Appraisal Report**

Example: Contributory Value of a Typical Outbuilding?

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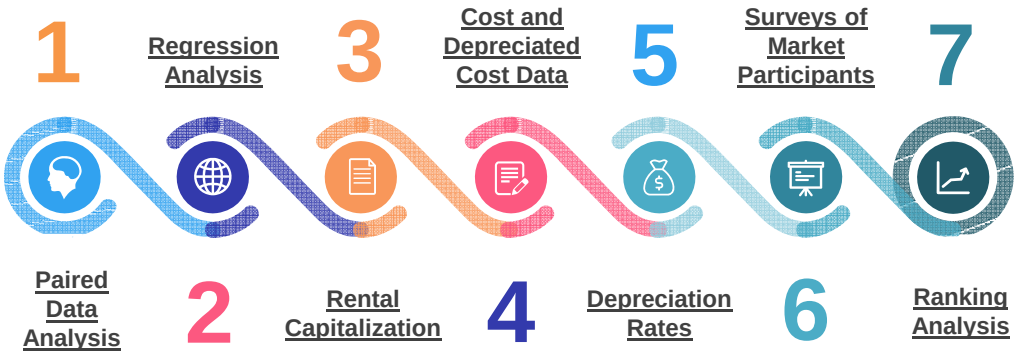
Adjustments

Comparable adjustments support becomes even more important to developing credible assignment results when there are limited sales. Several methods and analyses can be employed to support adjustments, including paired sales, regression, prior sale of the subject, depreciated cost, and conversations with market participants.

Fannie Mae Appraiser Update, December 2018, page 3

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Supporting Adjustments in the Sales Comparison Approach



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Supporting Adjustments in the Sales Comparison Approach



Paired Data Analysis

Perfect sets of comparables that vary in a single, identifiable respect are rarely found. Because properties that are sufficiently similar to the subject are usually limited in number, the decision to apply paired data analysis in a given situation is a matter of judgment. Often the sampling size may not be large enough to provide a solid statistical foundation for the appraiser's conclusions.

***Appraising Residential Properties*, 4th Edition**, Appraisal Institute, page 343

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Supporting Adjustments in the Sales Comparison Approach



Regression Analysis

Regression analysis can be used to isolate and test the significance of specific value determinants. [It] reveals apparent relationships between the values of different variables and their tendency to vary regularly with one another. [Once] considered an esoteric statistical method, more real estate professionals are [today] using regression analysis as an analytical tool in appraisal practice.

***Appraising Residential Properties*, 4th Edition**, Appraisal Institute, page 346

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Supporting Adjustments – Regression Analysis







Input

Input sales data information (MLS)

Output

1. Adjustments (coefficients)

2. Coefficient of multiple determination (*R-squared*), a measure of "reliability".

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Supporting Adjustments in the Sales Comparison Approach

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Rental Capitalization

The difference in rent attributable to a difference between otherwise similar income-producing properties can be capitalized to derive an indication of the difference in the values of the properties.

***Appraising Residential Properties*, 4th Edition**, Appraisal Institute, page 344

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Supporting Adjustments in the Sales Comparison Approach

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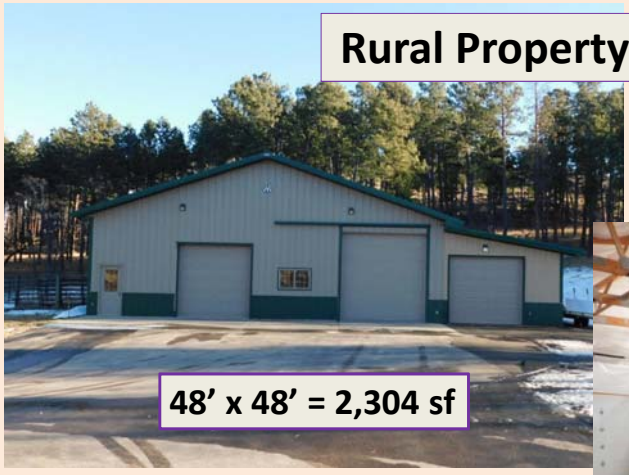
Cost and Depreciated Cost Data

Cost and depreciated cost data may be used in making adjustments, especially data on the costs of upgrading existing homes and installing amenities in subdivision houses under construction.

***Appraising Residential Properties*, 4th Edition**, Appraisal Institute, page 344

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Rural Property Appraisals





Q. How Does an Appraiser Support the Contributory Value of the Outbuilding?

A. Extract the Contribution from the Market!

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Market Extraction from Closed Sales

Analysis of a Residential Sale w/ Acreage in a Rural Area (Givens):

* Suppose, Sale Price of $321,000 on 02/01/2019
* Home has a Judged Effective Age of 10 years, and a Total Economic Life of 50 years. Outbuilding has 2,304 sf.
* Home’s Cost New Today is $307,500 & Land Value is $45,000

Extraction:

$321,000 Less Land ($45,000) = $276,000

Depreciation Affecting Home: 10/50 = 20%

Home’s Contributory Value: $307,500 * 80% = $246,000

$276,000 Less $246,000 = $30,000

$30,000 is the Contributory Value of the Outbuilding

$30,000 Divided by 2,304 sf = $13.00 (r) per sf

Repeat with Other Sales to Develop a Range of Value for OBs

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Supporting Adjustments in the Sales Comparison Approach



Depreciation Rates

Data on the rate of depreciation may also be used to derive an adjustment for the age of the property and condition of the improvement (physical characteristics).

***Appraising Residential Properties*, 4th Edition**, Appraisal Institute, page 345

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Supporting Adjustments in the Sales Comparison Approach



Surveys of Market Participants

Interviews with contractors, construction experts, buyers, sellers, and brokers can provide an appraiser with information on the costs of such features, [and the market's reaction to them].

Cost vs. Value Studies – NAR – NAHB – Remodeling
www.remodeling.hw.net

***Appraising Residential Properties*, 4th Edition**, Appraisal Institute, page 344

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Supporting Adjustments in the Sales Comparison Approach

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Ranking Analysis

Ranking analysis is generally used in conjunction with relative comparison analysis. Comparable properties are arrayed either in descending or ascending order according to their degree of similarity or dissimilarity to the subject property.

***Appraising Residential Properties*, 4th Edition**, Appraisal Institute, page 343

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Section 3
Final Thoughts

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Questions?
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