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**Neighborhood Description**

By Rachel Massey, SRA

Certainly not all appraisals are written to Fannie Mae's *Selling Guide*, but much of our writing is for what is common in the industry, which, at this point, is mortgage appraisal work. Within the Fannie Mae *Selling Guid*e is an abundance of information about what it seeks as part of the neighborhood analysis. These include identified boundaries, characteristics, and factors that affect value and marketability within the neighborhood. Fannie Mae also requires information related to property value trends, supply & demand trends, and marketing times, as well as items such as age range, present land use and what percentage the neighborhood is built-up. Although there are a number of check boxes that can be used for this section of the report, the expectation is that we as appraisers need to present enough detailed information in this part of the report for the neighborhood section of the 1004 form to be meaningful, to contribute to the subject's highest and best use analysis, as well as lead the reader to our value conclusion.

Fannie Mae's Selling Guide reminds residential appraisers how important the neighborhood section really is within the report's overview of the subject's marketability. It simply states, *“Neighborhood characteristics and trends influence the value of one- to four-unit residences. Therefore, an analysis of the subject property’s neighborhood is a key element in the appraisal process.”*

The form breaks the neighborhood analysis into a few sections, one with check boxes and small areas to fill in. The other allows for written narrative, which often needs to be kicked into the explanatory comments pages. Please do not let the small area on the form deter you from writing a detailed neighborhood analysis!

The first section of the neighborhood analysis is related simply to whether there is growth in the neighborhood, or if it is stable; whether the property values are increasing, declining or are stable; whether demand & supply are in balance; what the standard marketing time is in the neighborhood; and what the price range and predominant price is for the neighborhood. Over-improvements, the age range and predominant age, and current land use is requested. The neighborhood section in the Fannie Mae *Selling Guide* is B4-1.3-0.3, most recently updated on 9/30/14 calls for the following:

* Degree of Development and Growth Rate
* Trend of Neighborhood Property Values, Demand/Supply, and Marketing Time
* Price Range and Predominant Price
* Over-Improvements
* Age Range and Predominant Age
* Present Land Use

Consider, for example, the appraisal's statement that the subject's neighborhood is *stable*. This means that the subject's neighborhood generally sees a *dynamic* balance in supply and demand factors over the passage of time. These time periods are generally the last 12-months, the last 6-months, and the last 3-months.

Given this, the appraiser needs to have completed these analyses credibly, as well as to maintain that information and analyses in the workfile. Merely to *guess* and then mark "stable" will likely work most of the time. However, if the state files a complaint against an appraiser, or if there is a buy-back scenario on that property, and the appraiser cannot support the conclusion, both out of the market, as well as out of the workfile, that the market is indeed stable, that appraiser may experience some unpleasant days and sleepless nights. In other words, have market-support for that *stability* conclusion, and then maintain that support in the workfile.

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The next section of the form relates to the boundaries, characteristics, and factors that affect the value and marketability of the properties within the neighborhood (i.e., the subject). This is where the 1004 form has devoted six woefully *inadequate* lines for a proper analysis. Remember, we do *not* need to fit the communication of our analysis of the neighborhood into these six lines, but can expand them into the explanatory comments pages.

Take the following paragraph as an example of a neighborhood description found in the typical residential mortgage appraisal (Call this one description A):

*There are no apparent adverse factors which should affect the subject's marketability. Employment centers are nearby with easy access by local major freeways. The subject has access to local public and private schools, shopping malls and strip centers as well as recreational facilities.*

Does this description really tell you *anything* at all about the neighborhood or the value influences in it? Chances are it does not. How about something like the following (from a real of a real house in a real neighborhood in Michigan)? [Call this one description B]:

*The subject is located in a distinct neighborhood known as XYZ Farms. The subdivision is east of DA2 Road, west of the railroad tracks and the Big River, and east of the downtown corridor of the village of Dreams. It is located in Suburban Township but also serviced by the Village of Dreams in terms of municipal services. Taxes are carried through Suburban Township and the Village of Dreams.*

*Most of the houses in the subdivision were built from 2000 to 2002 although there were a few later sales, mainly along the southeastern edge of the subdivision near the corner of U and W. The subdivision has a total of 265 housing units. ABC Farms is adjacent to XYZ Farms and shares some of the amenities such as a play park on R Dr. XYZ Farms common land is mainly along the juncture between U, W and R Dr. Although adjacent and competitive, the houses in XYZ Farms are generally of better overall quality and have sold higher than those in ABC Farms.*

*Houses in XYZ Farms vary in style and size but all have similar quality of construction. They range from smaller ranch style houses around 1,600 square feet up to larger two-story colonials topping 2,500 square feet. Many houses back to areas that allow for walkout basements, while some open to features such as the woods, ponds or hills. The properties that have walkout basements and more private settings typically hold the greatest appeal in the neighborhood followed by the styling. Ranch houses remain popular in the market.*

*Linkages that contribute to the appeal of the subdivision include shopping, with Big B’s grocery at the far west side of the subdivision (and part of the 10% commercial along DA2 Road), some restaurants at D and DA2, as well as into the Village Center, including fine dining as well as bakeries and pubs. Recreation is proximate, both within the village center as well as within the subdivision. Education is within one mile, to CS Elementary and WY Elementary, as well as to the Junior High school on DA2 Rd. The high school is further west at the corner of P and S, approximately 2 miles west. Access to employment is typical. Dream is a bedroom community for the larger big university market, but also has a solid employment base in close proximity. The railroad tracks at the eastern edge of the subdivision do not appear to negatively affect value or marketability.*

*XYZ Farms had numerous houses devastated by a tornado in 2012, and due to the damage to many houses, there have been many roof, siding and window replacements throughout the development. This has had a positive impact due to recent updating to a large number of properties in the subdivision.*

*When inadequate sales are found in XYZ Farms, competing projects include W of Dreams on the west side of the village, QRS Farms across DA2 Road and to a limited degree, TUV Farms at the corner of J and P Roads in Rural Township.*

Guess what? Paragraphs A and B describe the same subdivisions! Which one is more meaningful? Which one results from *analyses* of the neighborhood? Which one is worthy of a professional-level fee? The first one clearly says too little; the second one probably says too much. Nevertheless, the second paragraph, the more analytical paragraph, sets the stage for what is competitive *outside* of the immediate defined neighborhood.

It can be argued that the neighborhood itself is further reaching than described, and includes the additional subdivisions named above. In our opinion, the “neighborhood” is the most competitive area and is often a lone subdivision. Nevertheless, it can be a group of subdivisions, or even a larger area. What is noted above is an alternative “market area” which provides for some alternative areas in which buyers also look for housing if nothing is available within the subject's immediate neighborhood.

The operative driver for both the neighborhood and the market area is that buyers have to consider these areas as comparable, even with slight variations in price ranges. For example, if *XYZ Farms* has houses that sell on average for $140 per square foot, we would want to show that houses in *W of Dreams* sell in the same range if we were to use a sale in that area as a comparable. This is true despite the fact that subdivision is not adjacent and is on the opposite side of the village, over a mile away. The simplest way to show the differences is using grouped data analysis, which was explained in an earlier article (e.g., compare median or mean values in one subdivision to another - see Figure 1, below).   
  
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The example below compares *XYZ Farms* to *W of Dreams*, both including new construction that is ongoing in W of Dreams, as well as the resale properties. As noted, the prices are generally on par once the new construction is eliminated from the analysis, as new construction is not the direct competition for the subject property in this instance (although it does remain an alternative to some buyers).



Figure 1

Through the process of describing the neighborhood and actually analyzing what the makeup of the neighborhood is, as well as the alternatives, we are hitting on each of the points that are requested to be described in the Selling Guide as part of the neighborhood analysis. We are addressing neighborhood boundaries, neighborhood characteristics, and factors in the neighborhood affecting marketability. In addition, we are going a step further with this discussion by giving the reader a complete picture of what the neighborhood consists of and what a competitive area is. Of course, all of these data come from comparable sales in both neighborhoods. They are comparable because potential buyers would consider properties in either XYZ Farms or W Dreams as analogues one for the other.

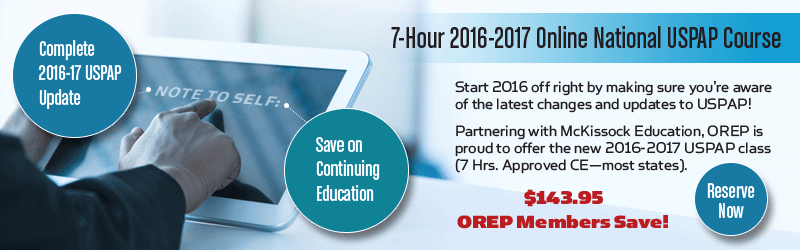
When you work an area repeatedly, it is easy to develop this type of analysis, which is updated whenever you receive a new assignment in the neighborhood.

Therefore, to review, relative to neighborhoods, the 1004 form asks appraisers to *analyze* and then *describe* the following neighborhood aspects. Remember that an analysis answers the questions "Who? “What?", "Where?", "When?", "Why?" and "How?” Of these, the answers to "Why?" are the most important, since that answer explains what we did and why we did it.

Here, from the 1004 form itself, are the questions the appraiser must answer in analyzing the subject's neighborhood. These answers to these questions *must* have market-support and that support *must* be maintained in the appraiser's workfile:

* Why is the neighborhood's location urban, suburban, or rural?
* Why, and for how long, is the neighborhood as built-up as it is?
* What is the growth rate in the subject's neighborhood, why is it at this level, and how long has it been at this level?
* Over the last 12-, 6-, and 3-months what are the value trends in the subject's neighborhood and why are they trending that way?
* What is the demand/supply relationship in the subject's neighborhood and why are they are these levels?
* Why is the typical marketing time in the subject's neighborhood at its current level?
* For one-unit housing, what is the typical age and price range?
* What are the land uses in the subject's neighborhood? Are they changing? Why?
* Why did the appraiser choose the specific boundaries of the subject's neighborhood?
* What is a short but complete description of the subject's neighborhood?
* What are the market conditions in the subject's neighborhood that currently affect the value and marketability of the properties in it and why do they affect that marketability?

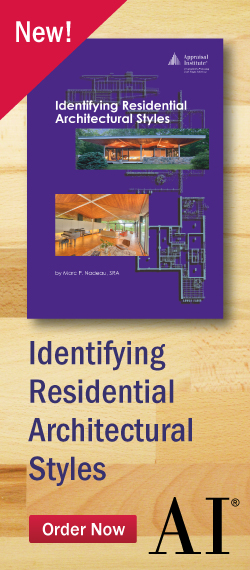
We all want to avoid questions from reviewers, state boards, and clients relative to how we arrived at a value conclusion. A comprehensive, well-supported neighborhood analysis goes a long way toward that end.

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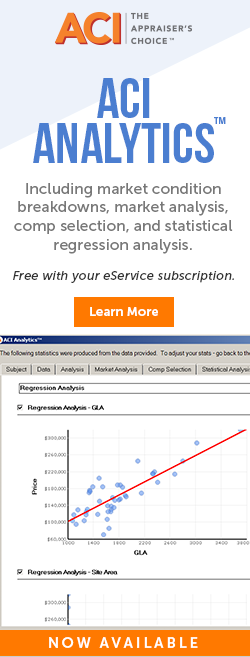
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