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**What Appraisers Keep Doing Wrong (According to Fannie Mae)**

By Richard Hagar, SRA

Another phase of Fannie Mae’s Collateral Underwriter (CU) is scheduled to be implemented shortly. This will place additional pressures on appraisers to “get it right.” There still appears to be confusion on the part of many appraisers regarding several aspects of the appraisal analysis and reporting process. Let’s clear up the confusion with some information.

Confusion often exists when facts are hidden, explanations are fragmented, reasons are unknown, and examples are nonexistent. However “confusion” also exists when people’s habits are forced to change; especially when people disagree with the reason or goal of the change.

In the appraisal world, “confusion” occurs when appraisers, failing to accept change, cling to past beliefs and methods. Lenders and AMC are telling me about their frustration with appraisers who “still don’t get it” and are not adapting to the new appraisal protocols. We are seeing similar problems in our appraisal reviews, so this isn’t just an AMC problem.   
  
Some examples of problem areas:

• Relative comparison vs. Fixed Definitions

• Quality vs Condition Ratings

• Condition vs. Updates

• Quality vs. Updates

• Actual Age vs. Effective Age

• Location Adjustments vs. Site Adjustments

• Support for Adjustments

• Use of MLS Photographs

• Comparables vs Sales

**USPAP vs. Fannie Mae Guidelines**

For the most part, Fannie Mae guidelines are not in conflict with the Uniform Standards of Professional Appraisal Practice (USPAP). While USPAP allows appraisers wide latitude on how we appraise and report findings, Fannie Mae and Freddie Mac (GSEs) are more demanding in how information is reported on *their* forms. If appraisers are creating reports that might be used by the GSEs, then supplying what the GSEs need is vital to the appraiser expecting to stay in business and obtain a [*Tier 1 Rating*](http://www.workingre.com/tier-1-tier-2-appraiser/), along with the associated higher fees. Remember it’s their forms, their requirements and their world. If you choose not to fulfill this expectation, then expect to fail in this business segment. Remember the “Golden Rule”- he who has the gold, makes the rules. The GSEs are in charge of the gold so appraisers need to live by their rules (and USPAP).

Many of the issues we are seeing are related to appraisers not adapting to new requirements. I hear appraisers say “This new Q and C rating system is stupid and I disagree with it.” OK, disagree. However, we should all remember that the prior appraisal system failed. Fannie Mae and Freddie Mac’s new Appraisal Quality Monitoring initiative (AQM), the Collateral Underwriter (CU), and the new Quality and Condition ratings are all a response to a failed system. And it’s not just the GSEs that are demanding higher quality work. Most properly run lenders are seeking out superior appraisers and creating new appraisal review systems; the GSE system is one among many. These new systems are designed to eliminate bad appraisers and improve the quality of future appraisals. This will benefit everyone by increased fees for the appraisers who survive the change.

So let’s look at a few of the stubborn relics that appraisers need to work on.

**Relative vs. Fixed Definitions**

In the past, appraisers used the same term to describe an “average” quality home built on stilts in the swamps of Louisiana and an “average,” but much different quality home, constructed of concrete and steel in Santa Barbara. This outdated protocol would classify the mega-expensive home of Bill Gates, which is located in an area of other mega-homes, as being an “average” home because it was similar to other homes in the neighborhood. Well, if the house was common, typical, average and like many others, isn’t that how appraisers should classify the home? *That’s nuts!*No one who’s interested in buying the Gates’ mansion would classify that home as “average.” A classification of “average” would be misleading to readers of the appraisal and insulting to buyers and sellers of similar homes. It’s inappropriate for appraisers to use this description.

**Relative**  
In the past, appraisers would compare an “average” home, and describe a superior home as “good,” then make adjustments relative to the other property (how they compared to each other). The problem is that the term “average” was misleading and confusing. Was the other home really superior or were appraisers merely indicating it was, so they could make an adjustment? People on the street, reading our reports, wouldn’t understand the relative use of the terms fair, average or good and be confused.

**Fixed Definition**With the GSEs’ creation of six quality definitions, appraisers can now determine which definition fits the subject and comparables best. Does the house fit Q2 definition or not? Yes or no? This isn’t hard. Now which definition fits the comparable best – Q1, Q2 or Q3? I know many appraisers are shaking their heads and saying Nooooo! This system doesn’t work! And I say: stop being stubborn. Take a deep breath. This is a new appraisal world - adapt and properly classify the houses. This is no longer a simple description of how they compare or relate to each other. Today the appraiser determines which fixed definition best describes the home. Now for part two. The market can still decide that two homes with the same Q Rating have different values. *Gasp*! This is madness! Heresy you say! No, not really, it’s called change, evolving into a new way of thinking and describing. Let go of the past.

Classifying a home is one thing, adjusting is another. Two homes that fit a certain Q rating can be perceived by buyers as having the same or different value. One home can be at the upper end of Q2 while the home next door can be at the bottom end of a Q2 rating definition. The appraiser’s job is to analyze the market and answer these questions: A) Does the market adjust for differences between the two homes? B) If buyers are adjusting, what is the adjustment? If there is a *measurable* difference in the marketplace, then make the adjustment on the grid and explain what the difference is between the two homes. It’s not rocket science but it is change and appraisers must learn to adapt.

Two different homes can have the same Q rating and still have market adjustments. Two different homes can have different Q ratings and there are no measurable market adjustments. Classifying is one thing, adjustments are another. Even though they are on the same line, they’re separate boxes. For lender/GSE work, Good, Average, Fair are dead; long live the Q and C.   
  
**Q1 or C1?**  
Not every market will have homes that fit every definition. Some markets may not have a Q1 while others might not have a Q6. The best house in an area does not automatically become a Q1. The worst house does not automatically become a Q6. Q and C definitions are fixed. The appraiser must classify the house under the definition that best describes the property (fixed definition vs. relative comparison).

**Adjustments: List vs Opinion vs Facts**

In the old days, during training, many appraisers were given “adjustment sheets.” These sheets listed the theoretical adjustments that new appraisers were to use. These were “training wheels” designed to get appraisers started, never intended to replace analysis and facts. The problem is, many appraisers never “graduated” to using proper methodologies. The figures on these worthless scraps of paper cannot be applicable to both a farm home on twenty acres in Minnesota and a waterfront home on a 5,000 square foot lot in Florida. If appraisers are using these sheets, stop it! The usage of these sheets are archaic and out of touch. Reliance on a document like this is misleading and indicates a lack of understanding and competency (Tier 1 vs Tier 2 appraiser).

Other appraisers were inappropriately told to use their “opinion of what an adjustment should be.” This is equally inappropriate, outdated, and downright wrong. By law, adjustments *must* be based upon market data… facts, not opinion. In the past it was difficult for adjustments to be challenged by lenders and review appraisers. More than likely they had less information than the original appraiser or didn’t have the time to determine the appropriately supported adjustment. As a result adjustments were rarely challenged by lenders. In legal settings and state disciplinary actions, appraisal adjustments were challenged but rarely for lending work. Many appraisers became lazy form fillers, tossing their opinions around as if they were fact. Those opinions and adjustments are not facts. They are unchallenged, sloppy opinions, backed by emotion. Those days are gone. Welcome to the computer age!

**The change**Today lenders and the GSEs have access to massive amounts of data. For the most part, it’s the same data that appraisers access. The GSEs, via information providers like CoreLogic, have access to *every recorded sale* in most of the 3,143 counties across the United States. Within minutes they can cross check appraisal adjustments against the sales prices and metrics of approximately five million home sales that occur each year. New wiz-bang computer algorithms can spot sloppy opinion-based adjustments in a nanosecond. Computers “hard stop” appraisals and reviewers challenge or blacklist appraisers. Hold habits die hard. Appraisers must support every adjustment, especially if you want to stay in business. Data crunching computers will become more powerful and analyze every corner of every appraisal.

This is a sampling of adjustment codes utilized just by the GSEs:

606 – GLA Adjustment is larger than the model;

607 – GLA Adjustment is smaller than the model;

610 – The appraiser’s wide range of adjusted values indicates potentially inadequate adjustment;

611 – The lot size adjustment is materially different from the model;

And these *new codes* will be implemented shortly, by the GSEs:

621 (GLA), 623 (Condition), 624 (Quality), 625 (View), and 626 (Location). Each of the new codes will address adjustments in the wrong direction for a specific property attribute. Message Code 632 will address the absence of time adjustments for increasing or declining market conditions that appear to be warranted.

There are more than 22 codes that apply to adjustments and the number of adjustments that they analyze is growing.

**Solution**  
In this new world, appraisers must have support, proof, evidence for every adjustment. There are more than 25 different methods that can be implemented to determine adjustments. Not every method works every time or in every market but the appraiser must understand and use these different methods. Since the GSE computers use various algorithms and forms of liner regression, understanding these basic methods is vital. If appraisers don’t understand the various methods, get educated and do it fast! Archaic, stubborn appraisers will exit the business by choice or by force. This will leave room for higher paid appraisers who use facts instead of opinion.

**The Purpose of an Appraiser**

These are just two failures out of approximately a dozen other issues that appraisers stubbornly cling to. Clinging to these outdated conventions is preventing appraisers from producing superior appraisals and making more money.

The appraiser’s job is to provide a service to their clients while complying with USPAP *(I know it’s tough)*. Clients need information about the market along with understanding of the subject and its value, all conveyed in a manner that the client can use. Clients hire appraisers to provide the necessary information. *Appraisals are not for the appraiser, they are for the purposes of the client.* Remember what I said about the Golden Rule! Or as the Bhagwan says: “Let go of your preconceived notions. Open your mind to new things. For he who produces what the market needs, will reap the rewards.”

In future articles I’ll go over other issues including:

* + Upgrades vs. Condition
  + Actual Age vs. Effective Age
  + Location adjustments vs. Site adjustments
  + Site Adjustments for View and Waterfront
  + Support for adjustments - past vs today
  + Use of MLS photographs
  + Comparables vs Sales
  + Value statement and Transaction Analysis

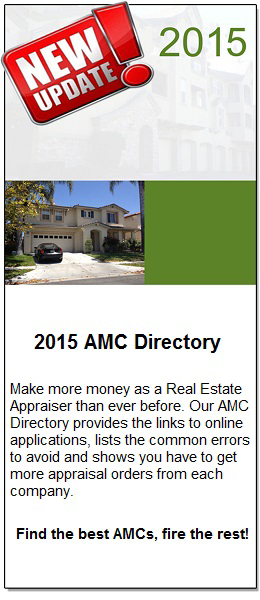
Stay tuned! I’m trying to keep you safe out there.

**This October**[**Identifying & Correcting Persistent Appraisal Failures: Quality, Condition, & CU**](http://www.workingre.com/professional-appraiser-series/) **Presented by:** Richard Hagar, SRA **Dates:** October 15th and 22ndCU Version 3.0 is coming this September, promising "improvements" and enhancements that will undoubtedly affect how appraisers interact with their lender and AMC clients going forward. CU continues to flag appraisers for unsupported adjustments and erroneous Q&C ratings. In this upcoming two-part webinar, Richard Hagar, SRA shows appraisers, step by step, how to avoid the most common appraisal failures and "get it right" with Q&C ratings.[**Sign Up Now!**](http://www.workingre.com/professional-appraiser-series/) **FREE Webinar Tomorrow**[**Claims, Complaints, and E&O Insurance**](http://www.workingre.com/insurance-liability-town-hall-complaints-claims-and-your-teflon-suit-free/) **Presented By:** David Brauner, Senior Broker at OREP  
**Date:** September 17th, 10:00 – 11:30 a.m. PST   
  
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