

Working RE

Real Estate Appraisers & Inspectors

Winter/Spring 2012, Volume 29

Customary and Reasonable Assignments

CUSTOMARY AND REASONABLE ASSIGNMENTS

AMC Bad Debt—Lenders Responsible?

Success Collecting AMC Debt from Lender

Making Good Adjustments

FNC Data Mining Lawsuit Settles Quietly

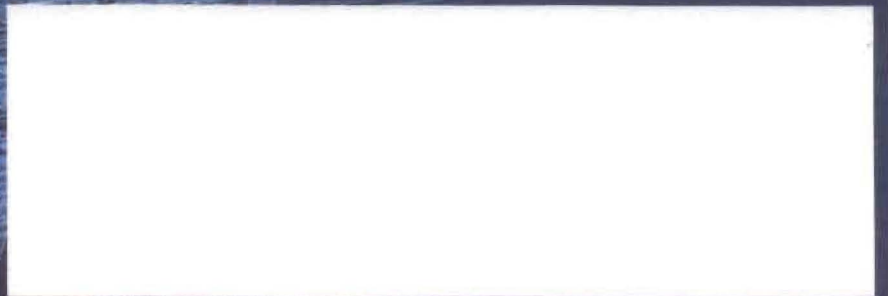
CLOSER LOOK for Home Inspectors

In Search of Perfect Home Inspection

Don't Inspect for Pests, Sued Anyway

Working RE

6760 University Avenue, #250
San Diego, CA 92115



Making Good Adjustments

By Philip G. Spool, ASA

Editor's Note: *Whether you are appraising a single family residence or a condominium unit, if your adjustments are either not supported or not reasonable, your value conclusion could be totally wrong.*

My last article discussed choosing comparable sales in a tough market. As was discussed in that article, in today's market, it is very difficult to obtain comparable sales and listings that best reflect comparison to the subject. Some sales and/or listings might be older but more similar to the subject, others may be further away in a similar substitute neighborhood. Once you select your comparable sales, the next step is to make adjustments to them.

Whether you are appraising a single family residence or a condominium unit, if your adjustments are either not supported or not reasonable, your value conclusion could be totally wrong. This article explains how to make appropriate and reasonable adjustments for residential properties, both single family and individual condominium units.

Adjustments: Fact or Opinion?

Most adjustments are considered "opinion." Therefore, anyone can have a difference of opinion as to the amount of an adjustment. However, all adjustments or lack of adjustments must be reasonable. If you choose not to make an adjustment for a lot size difference between one comparable

and the subject and if one lot size is twice the size of the other, what support do you have for not making the adjustment? Reasonableness is also a measure with respect to the amount of an adjustment. Say your subject house has a lot size of 15,000 square feet and a comparable sale has 30,000 square foot lot or one that is twice the size. If you choose to make a \$1 per square foot adjustment, that is saying that a house with a lot twice the size as the subject is worth only \$15,000 more than a house with half the lot size. This is reasonable, perhaps, if the land values in that area are selling for around \$2 to \$3 per square foot. But would it be reasonable if lot sizes are worth \$15 per square foot or more? Any adjustments you make must be considered reasonable.

What adjustments are considered fact instead of opinion? The answer is any adjustment that requires a known calculation based on facts. Most percentage adjustments are factual adjustments, assuming that the percentage adjustment is based on supportable facts. A good example is a sales concession, also referred to as a seller's contribution to the sale. Most Multiple Listing Service write-ups disclose sales concessions. If not, this is another reason why it is important to verify the sale. Another example is an adjustment for market conditions (time) where you are relying on a data source that specifically indicates the percentage decline or increase in market price.



Philip G. Spool, ASA, is a State-Certified General Real Estate Appraiser in Florida, appraising since 1973. Formerly the Chief Appraiser of Flagler Federal Savings and Loan Association, he has been self-employed for the past 18 years. In addition to appraising, he is an instructor with Miami Dade College, teaching appraisal courses and continuing education. He is also the Vice President and Chairman of real estate programs with the Greater Miami Chapter of the American Society of Appraisers. He can be reached at pgspool@bellsouth.net.

Not All Adjustments Equal

Some appraisers and reviewers are of the opinion that line item adjustments have to be consistent for each sale. This is not necessarily correct. If you are making an adjustment for either site size or gross living area differences and one sale has a small difference in size between the subject and comparable, that adjustment may be different than if the difference is large. For example, let's say that the subject has a gross living area of 1,500 square feet, comparable sale number one has a gross living area of 1,600 square feet and comparable sale number two has a gross living area of 1,900 square feet. You might have the opinion that no adjustment should be made to sale number one as there is only a 100 square foot difference, but an adjustment might be warranted for sale number two because the size difference is 400 square feet, or 27 percent larger in gross living area than the subject. On the other hand, if your adjustments across the board are \$100 per square foot, a 100 square foot difference would indicate a \$10,000 adjustment and, therefore, sale number one would more than likely need to have the adjustment made. However, there is nothing requiring the appraiser to make a \$100 per square foot adjustment across the board. One adjustment could be more or less than \$100 per square foot while the other can be \$100 per square foot. Whatever adjustment decision you make, you need to be consistent in your analysis, and it should be explained in your text addendum, otherwise the client, review appraiser or (hopefully not) an expert witness on the opposing side might consider your analysis a mistake rather than a reasoned decision.

Qualitative Versus Quantitative Adjustments

Some residential appraisers follow the way commercial appraisers make adjustments. That is making *qualitative* instead of *quantitative* adjustments. Qualitative

adjustments in a grid might be just the word "positive" versus "negative" or it might be "superior" versus "inferior." These types of adjustments do not commit the appraiser into stating a specific dollar adjustment amount. This would be good to utilize if the adjustment is not as supportable as one with an actual dollar or percentage amount. For example, if a comparable sale is located in a different neighborhood that might be slightly superior or inferior, to quantify that adjustment would be difficult. The same is true for quality of construction and many other differences.

However, an appraiser should not make both quantitative and qualitative adjustments on the same grid. This results in an adjusted sales price that would need further change. An example is a \$300,000 sale that after quantitative adjustments results in an adjusted sales price of \$350,000. If qualitative adjustments would also be stated, either as "superior" or "inferior," then the adjusted sales price of \$350,000 would be misleading to the reader of the report, even though additional qualitative adjustments are mentioned. I don't recommend using qualitative adjustments in a Fannie Mae grid where dollar amount adjustments are expected. But this would be perfectly acceptable in a narrative format.

Adjustments Using Paired Sales Analysis

In your experience as an appraiser, how often have you actually supported an adjustment utilizing a paired sales analysis? Probably not often. While in beginning and advanced appraisal classes, and even in courses specifically about the sales comparison approach, it is always mentioned that paired sales analysis is the best method for determining how much the adjustment should be. Realistically, very few appraisers do this, especially after appraising for several years. It is wrong for a supervisory appraiser to tell a

trainee what the adjustments should be without showing or explaining to him or her how the adjustments are derived. When a trainee appraiser, who eventually becomes a *Certified Appraiser*, makes adjustments and states in the appraisal report that the adjustments are based on a paired sales analysis, unless there is support based on a paired sales analysis, that appraiser is misleading the reader of the report.

Supporting Adjustments

Other than a paired sales analysis, what are other ways to support an adjustment? This is probably one of the most difficult questions to answer and probably the most controversial. For this answer, I would like you, the readers of this article, to reply to me via email with your suggestions (email below). I have one suggestion that is somewhat novel and which, at the same time, can possibly bring you business. In my story, *How to Increase Your Residential Income* (to read this story, visit WorkingRE.com, Library, Volume 21), I suggest that you give lectures to local Realtors, either at their office or at the Realtors' Association office where they are members. I have recently talked to Realtors about the changes in the way an appraisal report is written via the Uniform Appraisal Dataset. I have also given talks on what an appraiser looks for in a house that might warrant an adjustment in comparison to a comparable sale. I have created a survey with separate line item adjustments that I would make for a single family residence, such as one-car versus two-car garage, swimming pool versus no swimming pool, etc. I indicate the specific neighborhood for the survey but leave the answers blank. I might have two or three different locations on the same survey.

Since I know what I make as an adjustment, I want to know what the Realtors' buyers say they are willing to

page 22 ►►

pay for that extra garage space or swimming pool, etc. I have the manager of the office distribute the survey to all attendees the day prior to when I speak to the group (most real estate offices have a guest speaker either once a week or once a month) and they know we will be discussing their answers and my answers.

I have found this to be very successful and enjoyable for both the Realtors and myself. Interesting discussions follow from this talk and, in the end, several Realtors usually ask for my business card for future business. But the primary purpose of my talk is not to get additional business, but to accumulate these surveys and to tabulate the results so that I can use them as support for the adjustments I make. This is just one way of supporting the adjustments you make. After all, the adjustments you make are supposed to be what the market is willing to pay for that extra garage space or swimming pool, etc., and not just what we were told by our supervisory appraiser.

Single Family Residences

Most appraisers, when appraising a single family residence, utilize Fannie Mae or general purpose forms (if not for a mortgage transaction). In either case, all forms have a Sales Comparison Approach grid which itemizes what is considered information that is important enough to consider whether an adjustment is necessary. It is important to understand that it is up to the appraiser to consider if an adjustment is warranted. There is no requirement that an adjustment be made for any line item. However, if there is a difference between the comparable and the subject, either an adjustment should be made or, if not, it should be explained why an adjustment was not necessary somewhere in the report. Many appraisers utilize boilerplate statements to justify either the adjustments or lack of adjustments. I suggest that you get away from the boilerplate statements and write something that pertains to the appraisal report you are preparing.

What are some of the line items that require an adjustment? That depends on what is considered most important. In some neighborhoods, location is important while other neighborhoods the land size, street frontage, versus depth of a lot, is most important and in other neighborhoods it is the gross living area. Whichever line item(s) is (are) most important, special attention should be made to those adjustments and be adequately supported.

Gross Living Area

One line item I want to mention is the adjustment for gross living area. The gross living area is the air conditioned area of the house, with just a few exceptions. This square footage is typically what you measure when at the property. What about the comparable sales? Unless you have measured the comparable sale property, you don't really know the gross living area of that house. If you are fortunate enough

to have your property assessor's office post property diagrams or living areas online, that would be considered a supportable determination of the gross living area of the comparable. In some areas, an "adjusted square foot" size is published by the property assessor's office. This square foot size usually takes into consideration other components of the building, such as a percentage of the garage and covered areas. If you don't have the gross living area of your comparables, you cannot use the "adjusted square foot" size of the comparables in your grid when you use the gross living area of the subject, otherwise your adjustment would be based on two different square foot sizes. This is mostly true in condominium unit appraisals, which will be discussed next.

Condominiums

One adjustment for a condominium unit would be the floor level. Floor level adjustments may be the same, no matter the number of floor level differences there are between the subject and comparable sale. Or you might consider a different amount for the adjustment, depending if the floor level difference is minimal versus a large difference. With the slow market today, there are going to be fewer sales on a floor level that is close to your subject's, whether it is in the same building or a different building as your subject. If the subject is on the 15th floor and the comparable is on the 20th floor, the adjustment per floor level might not be the same as if the comparable is on the 5th floor or the 30th floor; a unit on the 5th floor may be less desirable or the 30th floor might be more desirable. This brings up an interesting point: Do you make the adjustment for the floor level based on the floor level difference, or do you also take into consideration that the lower levels have an inferior view compared to the higher floor levels? You might have

HOME INSPECTOR'S E&O INSURANCE

- ✓ \$1,250 minimum premium
- ✓ Covers Most Services with no additional surcharges
- ✓ Covers Multiple Inspectors/Contractors
- ✓ Free Prior Acts, Financing Available
- ✓ Broadest Coverage, Modest Premiums
- ✓ OREP in Year Ten!

OREP.org (888) 347-5273

info@orep.org

David Brauner • Calif. Lic. #0C89873
www.orep.org

two adjustments to make: one for floor level and the other for view.

An important adjustment made for a condominium unit is gross living area. As I stated above, within the single family residence, the appraiser must be careful when obtaining the square foot area of the comparable sales. Is the square foot area the gross living area or the "adjusted" square foot area? Are you using the measured gross living area for the subject and something else for the comparable sales? The best way to obtain the gross living area of the comparable sales is from the condominium documents.

Another important issue with adjustments for condominium units is that the amount of adjustment for the gross living area for a condominium unit should be much higher than for a single family residence. The reasoning for this is that a single

But the primary purpose of my talk is not to get additional business, but to accumulate these surveys and to tabulate the results so that I can use them as support for the adjustments I make.

family residence is divided between the living area and the lot size while a condominium unit does not have an adjustment for site size. The adjustment for gross living area would take into consideration the building's amenities, which is also reflected in the sales price per square foot.

In conclusion, most adjustments are considered an opinion but still should be supported. Your support should be

documented somewhere in your office, but most importantly, you need to explain your adjustments, especially if you believe that the reader of your report would question your adjustment if you did not include an explanation. In today's market, there are fewer sales that are similar to your subject, and adjustments are more abundant than when there were plenty of sales to choose from. **WRE**

Professional Education | Business Resources | Industry Representation

NAIFA: Your connection to your profession.[®]

With all of the volatility in the current real estate market, high quality, ethical, educated and designated appraisers are needed now more than ever. For 50 years, the National Association of Independent Fee Appraisers (NAIFA) has been the home for professional real estate appraisers. NAIFA member appraisers provide a proven standard of trust, unwavering integrity, and level of service that cannot be matched in the field today.

We want YOU! If you are a practicing appraisal professional who is looking to stand above the rest, NAIFA is your professional home. Join the ranks of the industry's finest and most experienced practitioners. Visit www.naifa.com or call 1-312-321-6830 to see what we offer to help grow your business.



401 N. Michigan Avenue
Chicago, IL 60611-4267
Phone: 312/321-6830
Fax: 312/673-6652
Website: www.naifa.com



Looking for education? Log onto www.naifa.com to attend a course in your area!