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Revisits the 1004MC: A look at this form and asking the question, does it need fixing?

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A note of caution: the following might be a little technical. It could even hurt. It might not mean much to folks on the commercial side, but is rich with meaning for those on the residential...

The following revisits the 1004MC, a look at this form after a couple years of use and asks the question, does the 1004MC need fixing?

FNMA Form 1004MC, Market Conditions Addendum to the Appraisal Report, was designed for use in 1-4 family secondary market residential appraisals to support the conclusions and opinions in the neighborhood section of the URAR form. The directions state that the "appraiser must use the information required on this form as the basis for his/her conclusions regarding housing trends and market conditions as reported in the neighborhood section of the report." Note emphasis on must, meanings use of the results is not optional, but required. Importantly, it means one can't simply ignore the results derived from the analysis in this form, even if you think it is wrong.

The form consists of rows of quarterly analysis which when taken together provide a "housing inventory analysis" that tracks numbers of sales, numbers of listings, listing and sales prices, days on market changes, months of housing inventory, etc. Out of the box solutions make it easy to populate these fields based on the appraiser's input choices. Appraisers can also choose to additional data and analysis.

I've talked to a few dozen classrooms full of appraisers who have "gripes" with the 1004MC appraisal form. Their arguments against the form include: a/ it does not reflect market conditions, i.e., it understates or overstates them; b/ clients do not find it useful, nor do appraisers; d/ FNMA requires that it "must" be used meaning that appraisals can be based on misleading results which would then run afoul of USPAP requirements.

This last issue gives an interesting perspective for practitioners, who, by trying to meet FNMA requirements then violate USPAP. It's a classic Catch-22, a loop of violating one set of requirements and then violating another set.

Further, real estate markets do not tend to behave neatly over quarters, like corporations do. Real estate markets often decide to accelerate or decelerate at their own speed and in their good old time: quarterly markers don't signify, therefore. It is then entirely possible to miss significant market changes based on the artificial time divisions on which the form is based. In markets crying for some good news, this amounts to a major miss on the appraiser's part.

Since the appraiser must rely on this information for housing trends and market conditions, the appraisal might end relying on flawed market analysis but be consistent with the results of the analysis in Form 1004MC. The instructions state that "sales and listings must be properties that compete with the subject property, determined by applying the criteria that would be used by a prospective buyer of the subject property."

Where data is very similar, good results can be had from small data samples. Where data is not highly similar (e.g., rural, complex markets), small data samples may not produce useful results. Some analysts therefore expand the search to obtain more data, which may or may not conform to FNMA requirements.

Much work has been done in real estate using regression methodologies and predictive statistical analytic techniques. It seems like a mostly wasted opportunity not to advance residential real estate market analysis by forcing use of the 1004MC by appraisers.

This form is a prime example of "good idea, badly executed." Introduced into the appraisal process during a period of extreme crisis, the form suffers from being rushed into service without appropriate vetting.

Nonetheless, it falls to the residential appraiser to have the responsibility to be right, even if the 1004MC output is wrong. Big problem, though, because by being forced to rely on the output of the 1004MC, the appraiser can be so wrong while being quite right by complying with the intended user's requirements.

What, the MC needs fixing? Most of the appraisers out there didn't even know it was broken.

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