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Scope of work and value opinions on solar PV systems - by Guy Andrews

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I recently received a notice from a local bank that is becoming a lender with Fannie Mae.

The lender indicated that their interpretation of Fannie Mae guidelines regarding solar photo voltaic systems was that the “Fannie Mae guide indicates that adjustments must be made based on market reaction. This appears to exclude other methods such as cost, income, NPV, cost benefit analysis, etc. So, in order to become compliant with Fannie Mae guidelines, “we, the lender” will now require adjustments for solar panels, and other energy efficient items, to be made based on market reaction (paired sales or sales comparison approach) only”

I discussed this recent notification with Sandy Adomatis, the national expert and instructor on appraising green and energy efficient homes/home features and author of Residential Green Valuation Tools. I wanted a dialogue with another appraiser at the forefront of residential valuation issues, such as valuation of solar photovoltaic systems before offering this lender an alternative interpretation of “market reaction” and the importance of keeping the appraisers scope of work unlimited. As Adomatis and I are like minded on this topic we agree with my interpretation of the guidelines.

Adomatis was the instructor who taught all the Appraisal Institute classes in the Professional Development Program- Valuation of Sustainable Buildings, Residential. I took those classes and passed the exams, and am now listed on the Appraisal Institute’s national registry as an appraiser with specific training and education making me competent to appraise homes with green features, such as Solar Photo Voltaic (PV) systems.

A core focus of the Professional Development Program was how to develop an opinion of value of the solar PV system or the value of the energy the solar PV system produces, when there are no comparable sales with similar solar PV, or when paired sales are not available. This is frequently an issue for appraisers now, as the turn toward solar and other alternative energy sources has been a market transformation occurring most recently within the last few years. Many homes that have had solar PV installed have not re-sold. Our training reminds appraisers that we have other tools in our

tool box besides the sales comparison approach/paired sales: we have cost, we have income (gross rental multiplier approach, straight line multiplication approach, GRM, discounted cash flow analysis approach). These approaches are all accepted as valid approaches to use when developing opinions of value.

Fannie and Freddie both say the appraisal report must meet "Appraisal Standards," which to me as an appraiser means Uniform Standards of Professional Appraisal Practice (USPAP).

USPAP Standard Rule 1-4 States: "In developing a real property appraisal, an appraiser must collect, verify, and analyze all information necessary for credible assignment results"

- When a Sales Comparison Approach is necessary for credible assignment results, an appraiser must analyze comparable sales data;
- When a Cost Approach is necessary for credible assignment results, an appraiser must analyze: cost data; and
- When an Income approach is necessary for credible assignment results. An appraiser must analyze: income data.

I'm paraphrasing the standards, but the requirement is clear.

Also USPAP Scope of Work (Acceptability) Rule states that: "An appraiser must not allow assignment conditions to limit the scope of work to such a degree that the assignment results are not credible in the context of the intended use."

Let's look at market reaction: why are people installing solar PV systems? Sure, to go green and off set or reduce their carbon footprint, but also to reduce operating costs.

There are many home owners paying to have new solar PV systems installed and many different solar installation companies, all with different pricing/costs. Does the market react to cost? Yes, if a product is overpriced, the market will not buy it, under the appraisal principle of substitution the least expensive system will attract the most demand. So, is price or cost a function of market reaction? I interpret the answer as: "Yes". If so, a cost approach could be used to create credible results. Cost approach, under the appraisal principle of "substitution" reflects market reaction.

Are home owners installing solar PV to save money? Yes, they want to save on their energy costs over time, using a solar PV system to generate this income. So, is income (potential) a function of market reaction? I interpret the answer as: "Yes". If so, an income approach could be used to create credible results. Income, under the appraisal principle of "anticipation" reflects market reaction.

Another thought: Fannie/Freddie say there must be support for adjustments made in the sales comparison approach. This means that a "\$0"/zero adjustment, is an adjustment that the appraiser must have support for. By simply saying "I could not find any sales with similar solar PV, so I gave

the subject solar PV \$0 value” would be a flawed methodology, and one in conflict with USPAP. The appraiser likely has the “cost” of the system and the “income” (energy the system produces) available, and they simply cannot ignore these value indications. While cost and income are not as market tested as sales comparison/paired sales, they do have some meaning and could be used to support adjustments made in the sales comparison approach. Lenders accept the cost approach all the time, even in the sales comparison approach: three comparable sales sold for \$100,000 each, they each cost the buyers \$100,000; so the subject is presumed to be worth...\$100,000.

As an appraiser, my interpretation is that if a client limits my scope of work, in this case to use paired sales as the only approach in which to value solar PV; I may be in violation of the USPAP standards that Fannie and Freddie are requiring my appraisal to conform to. For these reasons, I would suggest that the lending community allow appraisers to create their own, un-encumbered scope of work around developing value opinions about solar photovoltaic systems.

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