

1004MC – The Real “April Fools” – Part One



How appropriate is it that the [1004MC addendum](#) to the URAR will be required for all valuation assignments for Fannie Mae, Freddie Mac, VA and FHA, beginning April 1 2009 – "April Fools Day"?

The looming question on the 1004MC, who will be "the fools", those filling it out (without consideration to or analysis of the "four forces that influence value trends in the neighborhoods"), or those using the conclusions on the 1004MC that are absent (by design of the form itself) of the impact of those same forces during the time-periods specified and therefore have rendered the 1004MC Market Conditions form useless and misleading?

Introduced by Fannie Mae and Freddie Mac in November 2008 and now adopted by [FHA](#) and [VA](#), the 1004MC has generated far more [questions than answers](#).

Instructors have [prepared courses](#), various individuals have offered free or low cost solutions using Excel, online programs and the MLSs are scrambling to provide 1004MC statistics via their systems, yet despite the efforts there still are disconnects and conflicting opinions vs. cut in stone answers and there is a reason for that. The instructions on the 1004MC are vague and pose a problem with respect to USPAP and Generally Accepted Appraisal Practice.

With that in mind, I'll try to cover some of the many of the issues raised in my 1004MC Workshop and provide you with my observations. At the very least, you get the idea of the tasks ahead and some suggestions on what you may have to do to meet the challenges posed by the 1004MC.

FAQ #1 – "Should we transfer the conclusions and trends on the 1004MC into the neighborhood section of the URAR"?

The instructions on the 1004MC state: "The appraiser must use the information required on this form as the basis for his/her conclusions and must provide support for those conclusions, regarding housing trends and overall market conditions as reported in the Neighborhood section of the appraisal report form".

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This is conflicting for several reasons. First, the 1004MC requires the appraiser to provide statistical analysis of sales, listings, etc., in the 1004MC for properties that are "competitive to the subject from the buyer's perspective". In my mind, trends for the subject property may or may not be representative of trends for all properties in the neighborhood .

The apparent underlying assumption is, "all ships rise and fall with the tide", essentially the trend for one market segment is the same for the others in the neighborhood, regardless if the area is homogeneous (conforming) or heterogeneous (mixed).

If you use all of the sales and listings from the neighborhood, the trend can be dominated by one market segment and misleading for the subject property. If you only use "competitive to the subject", the trend may be meaningful (to some degree, we'll discuss that later), but often will not be the same trend for all of the homes and shouldn't be used in the neighborhood section of the URAR.

This raises another question. Are the instructions for the 1004MC in conflict with Fannie Mae's Appraisal Guidelines for 1-4 units? It would seem that Fannie Mae isn't consistent on the neighborhood issue. Within their Appraisal Guidelines, they seem to consistently use the terms neighborhood and market area as if they are interchangeable, when they are separate and distinct. Trying to second-guess Fannie is a full time chore.

Wouldn't it seem logical that the 1004MC Market Conditions addenda for the URAR (that calls for competitive to the subject), reflect trends for properties that are similar to "the collateral" (subject property), so that a lender could evaluate and measure the risk in the general neighborhood (identified by URAR trends and their potential impact on other properties) as opposed to properties in that neighborhood that are similar to the subject which is also the collateral?

Is it possible to have trends for the overall neighborhood going in one direction (declining), while at the same time, there is higher demand for a property like the subject and vice-versa? Could a lender be duped into granting a loan on a higher-risk property (over-improvement for example) when the neighborhood trends support stable to increasing and there is limited or lesser demand for properties similar to the subject?

As formatted, the 1004MC is set-up (by focusing on competitive to the subject from the buyer's perspective) to compliment the URAR neighborhood trends section, not replace them and that is logical, considering that Fannie Mae and Freddie Mac are making a loan on the subject and not the neighborhood. The trends in the neighborhood are important, but trends for properties competitive with the subject "are critical".

Logically, I think you have to provide separate analysis for the neighborhood as a whole and for "competitive to the subject", so that they can be compared and contrasted. Neighborhood trends are important, however it is possible (and often occurs) that trends for the subject can be different than those of the neighborhood in both homogeneous and heterogeneous areas. Since USPAP requires us to provide a "meaningful analysis" (and not mislead), using one to compliment and clarify the other makes sense.

There are [free](#) and low cost [Excel workbook solutions](#) that are quick and accurate with most MLS data providers. Simply search and retrieve all of the sales data (sales, listings, expired, etc.) for 1 year prior to the "effective date of your appraisal". Download and save the neighborhood data set. While you are still in the MLS, change the criteria to "competitive to the subject" and download the subject data set.

Run both datasets in one of the various 1004MC Excel Workbook Templates/Programs and compare and contrast the trends and report them on the URAR and 1004MC. You'll need an addendum to the 1004MC addendum to discuss the two, but you will be providing the client with perspective they can use vs. something that is meaningless or misleading at best.

Due to poor or conflicting directions from Fannie Mae, many underwriters will be looking for consistency between trends on the 1004MC and the URAR. You can take that position as well, but you should include a disclaimer within your clarification of scope of work or addendum to the 1004MC. With any appraisal assignment the key is to communicate to the client, what you did and why, so as to not mislead.

FAQ # 2 – "Define competitive to the subject property determined by using criteria that would be used by a prospective buyer of the subject property"?

While this is another gem of a question, it does have a sound basis in logic. Referring back to FAQ #1, if I am Fannie Mae, Freddie Mac, VA or HUD, while the neighborhood trends are important, my collateral is the subject property and therefore the trends of properties similar to the subject are critical. What is competitive to the subject from the buyers perspective?

This raises many questions. From the buyer's perspective, if the subject is 2,400 square feet, 3 bedrooms and two baths, is a 1,200 square foot home in the same area "competitive to the

subject" and should it be included in the statistical analysis? The same situation arises with homes in good condition vs. REOs needing \$50000 worth of repairs.

If the subject is a new tract home, are re-sales competitive? Perhaps to some, but many "buy new" because "they want new" and the argument can be made that only new homes apply here. Likewise, if the subject has a unique feature (golf course view, waterfront lot, etc.), are only highly similar properties "competitive"?

We could argue the merits of either position all day long. It would be my opinion (and a statement made in many discussions with my friend Anthony Young, talking about statistics), "if it wouldn't be on the sales comparison grid of the URAR, it shouldn't be in your statistics for the 1004MC". This may sound straight-forward, but often we have difficulty gathering enough data for direct sales comparison and many of those require significant adjustment, hence if you take this approach, you may not have enough data for a good trend analysis. On the other hand, if you use dissimilar data, the trend could be misleading.

This brings us back to another of the many issues with the 1004MC, insufficient data in a fluctuating market. You are appraising a home in good condition in a neighborhood that has similar homes that are REOs and need extensive repairs. While the REOs may be "fixer upper bargains", the subject represents a turn-key solution to the buyers' problem. Are REOs that need substantial work competitive, "from the buyer's perspective"?

In the case above, reverse it. You are valuing an REO that needs extensive repairs. Are homes in good condition "competitive"? Some may argue the point, but if the buyer is purchasing the REO (and presumably had the opportunity to purchase a turn-key house), they selected the REO for a reason. Once again, if it wouldn't be on the grid, should it be in the statistics for the 1004MC?

FAQ #3 – "Why are the reporting areas in the matrix dissimilar in months covered"?

In the matrix, the numbers are the numbers, but there is a catch. The first period (prior 7-12 months) is a 6-month period as opposed to the prior 4-6 months and current to 3 months, which are both 3-month intervals. The other key area of the matrix is the Overall Trend check box grid. Overall means beginning to end, so even if the trend has improved in the past 6-months, if the 7-12 period numbers are higher than the 0-3 period numbers, it would seem that you must check decline or explain (at some length) why you didn't. This will be confusing for appraisers and underwriters as the way the 1004MC is setup, you'll need 9-months or more of improving conditions to check the stable box.

At the same time, it would seem that 6-months of improving housing statistics (along with supporting economic indicators that are not on the 1004MC), would be sufficient to support a shift in the trend. How will you make your case for "stable or increasing" over a 6-month period in a market that is correcting, but the numbers are below the 7-12 month indicators?

From my perspective, you'll need to look at and relate improving conditions in more than the sales/listings numbers. I would expect to see improving jobs, migration, credit and housing supply conditions at the market level to support a "shift in the trend".

This can be accomplished with a simple economic grid that tracks these indicators over time. As these are common statistics reported for all metro areas, the information is available monthly for your market. Declining jobs, migration and rent levels, equal declining housing demand and vice-versa.

Once again you'll need an "addendum to the 1004MC addendum" to discuss current economic conditions (employment, migration, seasonality, credit issues, interest rates, etc.) and their impact on the various statistical periods shown on the 1004MC, as contrasted to current conditions

In part two well take a look at more FAQs from my 1004MC Workshop

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