

FORSYTHE FLASH

Appraisal Insights for the Real Estate Professional



Cost Approach—Optional?

By Jason Miles, Branch Manager: Forsythe Appraisals – Chicago

With the November 1, 2005 Fannie Mae implementation of the new appraisal forms, there were many changes aimed at improving and increasing the overall communication and description within the appraisal report. One area where the appraiser's responsibility was diminished is in the requirement to develop a "Cost Approach to Value" for every assignment.

Developing a cost approach requires the following steps. The appraiser researches the market for vacant land sales in order to accurately identify a site value. The appraiser then considers physical characteristics of the subject, which includes size, below grade finishing, additional features and garage area. A replacement cost per square foot is then researched. The primary factor contributing to the estimated replacement cost is the quality of construction. This estimate is based upon actual costs available from local builders and cost guides, such as Marshall and Swift, which may be adjusted for differences in costs of materials regionally.

The appraiser then estimates the physical, functional and external depreciation/obsolescence that affect the subject property. Physical depreciation typically represents wear and tear on the dwelling. Some physical depreciation can be "cured" by repairs or updating, decreasing overall physical depreciation. Functional depreciation takes place within the subject dwelling or site, such as an atypical layout, a steeply graded site or lack of typical features. These too, could potentially be "cured" but it is not always financially feasible to do so. External depreciation occurs when something outside the subject's boundary negatively affects the subject's overall value. This can include being on a busy street or close to an airport.

Given the difficulty in accurately measuring these three influences on property values, Fannie Mae has made the cost approach optional. The cost approach is most accurate and relevant when land sales are readily available and the subject property has been recently built. The cost approach is not as meaningful for older properties.

In an upcoming edition of "The Forsythe Flash", we will discuss Fannie Mae's FAQ "How can appraisers assist lenders in determining an appropriate level of hazard insurance coverage for loans to be delivered to Fannie Mae" and how their suggestion of using the cost approach on a URAR for insurance purposes might put lenders (and others) at risk of having properties over- or under-insured.

Frequently Asked Questions:

Q: Can I order an interior inspection on the new 2055 form?

A: No, the scope of assignment will dictate the form type. The new 1004 URAR will be used for interior inspections, while the new 2055 will be used for exterior appraisals only.

Mortgage Rates As of March 2

30 Year Fixed: **6.24%**
15 Year Fixed: **5.89%**
1- Year ARM: **5.34%**

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