Documenting Property Condition after Natural Disasters

Assessing and reporting changes of condition in residential real estate following natural disasters.

Bill King

President, Chief Valuation Officer

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Natural disasters are very democratic. When they strike they impact young and old, rich and poor, large and small, public and private alike. Assessing and documenting property damage following a storm, fire, flood or other disaster can be a monumental task. This paper looks at the process of assessing residential property damage from a mortgage lending perspective and provides an overview of the various tools for the job and when each should be used.

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The biggest and most lasting impact of natural disasters is the loss of life. Our thoughts and prayers are always foremost with those who have endured the lasting pain of losing a loved one because of a natural disaster. No amount of property recovery or restoration can return their lives to “normal”. Everyone at Real Info is committed to rendering services to those affected by these events in the most compassionate and thoughtful way possible.

A portion of our revenue from Disaster Inspection Services is donated to local charities in the affected areas.

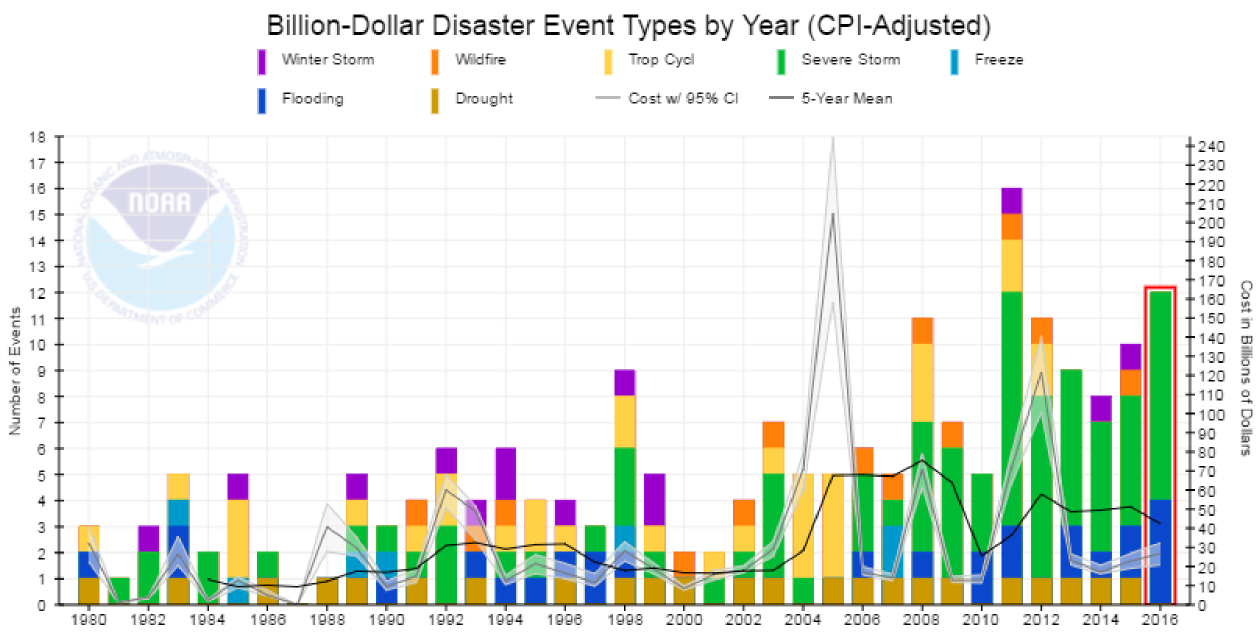
Note: This paper was originally published in October of 2016. We are re-distributing it in response to Hurricane Harvey which hit the Texas coast on August 25, 2017 and brought unprecedented rainfall, resulting in substantial loss of life. Our most fervent prayers are for the health and safety of all people impacted by this devastating storm.

How Big is the Problem?

There were ten weather and climate disasters in the United States in 2015 that each exceeded $1 Billion in losses[1]. Through August of 2016 there have been a dozen billion-dollar natural disasters and as of this writing, we are just beginning the recovery process from Hurricane Matthew, which was estimated to reach as much as $4 Billion to $6 Billion in insured property losses alone – this does not include losses for uninsured properties. The Louisiana flooding in August of 2016 destroyed more than 50,000 homes and with estimated total costs of more than $10 Billion, it exceeds Superstorm Sandy that devastated the Northeast in 2012.

By the time we account for flooding, landslides and earthquakes, every state and nearly every community is impacted to some degree with property damage. Thus far in 2016, total estimated property damage stands at $26.9 Billion. For perspective, in 2012 the National Oceanic and Atmospheric Administration (NOAA) estimated total property damage from severe storm events in 2012 at nearly $32.8 Billion[2].

Historic data from NOAA makes clear that the magnitude of the problem is increasing with time:



[1] NOAA National Centers for Environmental Information (NCEI) U.S. Billion-Dollar Weather and Climate Disasters (2016). https://www.ncdc.noaa.gov/billions/

[2] Total economic cost of these events is far greater. In 2012 Hurricane Sandy alone had an estimated cost of $65.7 Billion; Sandy caused the New York Stock Exchange to close for two consecutive business days, which last happened in 1888 due to a major winter storm.

These estimates include all property types, residential, commercial, public and private. But since residential real estate is the largest asset class in the United States, it is safe to say that a significant portion of this damage accrues to our nation's housing stock.

Accounting for property damage from natural disasters presents a significant challenge for residential real estate lending. The means for documenting the impact of a disaster on property condition depends on a variety of factors. Loans in escrow are often delayed or cancelled, but lenders have a chance to assess damage and react before funding; closed loans present lenders with possible changes in security and loan risk.

Identifying Disaster Areas and Affected Homes

Just as there are many types of natural disasters, there are also many types and levels of disaster declaration. The most prominent are those declared by the Federal Emergency Management Agency (FEMA) headquartered in Washington, DC, but declarations can also be made at the state and local level.

Disaster area declarations are commonly made on a county-wide basis. Federal assistance is typically available to "affected individuals and households" within the declared county. Lender identification of collateral at risk begins with knowing where disasters have been declared.

Many lenders, servicers and investors as well as data and service providers such as Real Info maintain direct data feeds from FEMA. Upon notice of a disaster declaration, addresses of properties can be compared against the declared disaster areas. Deciding how to react to properties within the boundaries of a declared disaster area can be made based on investor requirements, internal policy and any additional local knowledge about the area, as well as by whether a loan is in process, closed and funded but not delivered, or held in portfolio.

Freddie Mac Loan Delivery & Servicing Requirements

The Freddie Mac Seller/Servicer Guide provides guidance for properties affected by disasters in Chapter 5601.2. Specifically, once FEMA announces a major disaster or emergency, the loan seller should "take appropriate steps to ascertain the condition of properties in affected areas to preserve any relief of Seller representations and warranties that were granted regarding the Mortgaged Premises, and to minimize risk of future liability arising from a warranty violation."

Recommended steps include:

- Within a reasonable period of time following a disaster, the Seller should perform inspections of properties that may be affected to assess the degree of any damage**;**

- The Seller should consider, in consultation with the appraiser, the impact of any revision to the contract of sale for subject properties or the impact of any termination of leases entered into prior to such disaster**.**

The Freddie Mac Seller/Servicer Guide Chapter 8404 addresses servicing mortgages impacted by a disaster:

In the event of a disaster impacting Mortgages serviced for Freddie Mac, a Servicer must:

- Ascertain the number of such Mortgages and the extent of the damage that may have been caused by the disaster for each Mortgaged Premises, which may be completed by:
    - Determining the status of the property through discussions with the Borrower; and/or;
    - Completing a property inspection. Servicers are reminded that property inspections will be reimbursed based on the limits set forth in Section 9701.9. Property inspections that are completed outside of the requirements set forth in Section 9701.9 may not receive reimbursement.

For loans in place at the time of a disaster, Freddie Mac provides details of its property inspection requirements in Chapter 9202 of the Seller/Servicer Guide and outlines the documentation requirements in 9202.11:

> A Servicer must document each inspection of the property with an inspection report that is prepared on Form 1013, 1-4 Unit Property Inspection Report, or a substitute report. The substitute report can be the Servicer's proprietary form or a form the inspection company performing the inspection prepares, including a computer-generated or automated form. The substitute form must contain all of the data elements on Form 1013.

The loan seller, whether aware or not of the disaster, represents and warrants to Freddie mac that the property is undamaged at the time of origination and delivery. Appropriate documentation is essential.

Fannie Mae Loan Delivery Requirements

The Fannie Mae Selling Guide addresses lender requirements for properties affected by a disaster in Section B2-3-05, Properties Affected by a Disaster (04/15/2014):

> The *Mortgage Selling and Servicing Contract* requires the lender to warrant for each mortgage loan it delivers to Fannie Mae that the property is not damaged by fire, wind, or other cause of loss.
>
> The lender must be able to make the warranties that are described above. Therefore, before delivery of a mortgage loan to Fannie Mae where the property may have been

damaged by a disaster, the lender is expected to take prudent and reasonable actions to determine whether the condition of the property may have materially changed since the effective date of the appraisal report. The lender is responsible for determining if an inspection of the property and/or new appraisal is necessary to support this warranty.

Lenders are responsible for ensuring that properties are not damaged at the time of loan delivery, and for ensuring that property condition has not changed between the time of the appraisal – the lenders "eyes and ears" on the property during the loan production process – and loan *delivery*, not necessarily loan *closing*.

Loans in process with appraisals, made "subject to" repairs or completion

Properties appraised "subject to" completion of construction, or "subject to" repairs or other inspections such as a roof inspection, termite inspection or other specialized inspection are easiest for lenders to deal with since the loan has not yet funded, and there are already reasons to have the appraiser return to the property before closing.

Typical protocol for properties appraised "subject to" completion, repairs or inspections involves having the appraiser return to the property to determine that whatever requirements were made at the effective date of appraisal have been completed/repaired/inspected and that the property value can now be considered an "as-is" value enabling the loan to proceed to closing.

The purpose of a completion report (Fannie Mae Form 1004D Appraisal Update and/or Completion Report; Freddie Mac Form 442) is to convert an appraisal report that had been made "subject to" something being completed, repaired or inspected and make that appraisal report, in effect, an "as-is" report as of the effective date of value in the original appraisal report. In other words, the appraiser is certifying that the property value as of the original effective date for the property *as described in the original appraisal report* remains valid and that any of the "subject to" conditions have been addressed.

Indicating that the value remains valid as of the effective date also means that there have been no material changes to the property. If the property is not substantially the same as it was at the time of appraisal (except, of course, for the completed items), the value as of the original effective date may no longer be valid and the appraiser has a duty to report the differences.

When a natural disaster is known to have occurred in the area after the effective date of the appraisal but before the loan closing, the re-inspection of the property for completion is an opportunity for the appraiser to report any changes to the property that may have resulted from the natural disaster (or from any other cause).

The lender may be able to call for an additional completion inspection once any disaster related damages have been addressed, or they may opt for a new appraisal with a more current effective date of value. Either way, the appraiser plays a critical role in enabling the lender to meet their loan delivery obligations.

Loans in process with appraisals made "as-is"

When a natural disaster is known to have occurred in the area after the effective date of the appraisal but before the loan closing, and the appraisal report was made with the property in "as-is" condition as of the effective date of value creates a different challenge for lenders. There are no additional planned inspections so a new service request must be generated.

Referring back to the Selling Guide, "The lender is responsible for determining if an inspection of the property and/or new appraisal is necessary to support this warranty." In most cases, before deciding that a new appraisal is necessary, a visual inspection of the property is made. After all, while many properties may be impacted, the lender may find that any given property in the area is unaffected and the loan can proceed to closing without further action or delay.

It is also worth noting that the lender may determine that an inspection is *not* necessary. When other available information indicates that a given property is unaffected, the lender may opt to proceed directly to closing – but they remain responsible for the representations and warranties.

When the lender opts for a property inspection, options include the original appraiser, a different appraiser, or another inspection professional altogether. The Completion Inspection report does not apply here because the original appraisal, as of the effective date, did not require anything. The typical tools of choice when the inspection is done by an appraiser are the Fannie Mae Form 2075 Inspection Report or the Freddie Mac Form 2070 Condition and Marketability Report. There are also many types of Property Condition Report forms that are prepared by real estate agents or other inspectors.

Depending on the extent of damage found, a new appraisal may be required, especially if the repair or restoration of the property results in significant changes. Even seemingly minor things can have an impact on value. For example, if a house with a 20-year-old, but serviceable roof sustains roof damage and a new roof is installed, the property value may be affected. Often, if damage is significant, entire portions of the house may be made new through restoration, reducing the effective age of the whole house and increasing the property value. In such cases, a new appraisal would be the best solution.

But the first step is assessing the property condition to facilitate sound decision making.

Post-funding assessment

Assessing property damage from natural disasters on closed, funded loans is an exercise of determining whether or not damage has occurred that changes the risk of loan repayment. Inadequate insurance coverage might result in further deterioration of the property, further jeopardizing the loan.

Loan servicers documenting property condition for properties owned or securitized by Fannie Mae will need to complete Fannie Mae Form 30, Property Inspection Report, so they should be sure that their field inspection provider is gathering all the information they will need to complete this form.

There are no defined processes for loans held in portfolio. Some lenders and servicers may opt to only obtain field inspections for properties with loans that become delinquent following an event, or when a borrower contacts the lender to report damage. If the loan remains current and appropriate insurance is in place, a property condition inspection may not be needed since, from a loan performance viewpoint, there is nothing to act on.

Obtaining a new appraisal is always an option as well, but it may be wise to only go that expense after determining that a given property is likely to have suffered damage and a comprehensive condition assessment has been done. A competently prepared and comprehensive property condition inspection is generally the best staring point in the decision making process after a natural disaster.

Property Condition Inspection Options

Property condition inspections requested from appraisers are most commonly done using either the Fannie Mae from 2075 or the Freddie Mac from 2070. Neither form is very comprehensive and relies heavily on specific narrative detail from the inspecting appraiser.

As a consequence of recent regulatory changes regarding lender's use of automated valuation models (AVMs), there are more companies offering stand-alone property condition reports than ever before. The inspection reports take a wide variety of formats and include varying types of data. There are no specific requirements for becoming a property inspector at this level[3]. These inspections might be conducted by real estate agents or brokers, insurance inspectors, or in some

[3] These property condition inspections are not the same as a comprehensive Home Inspection conducted by a credentialed home inspector.

cases even by students or part-time workers with minimal real estate training or experience. Choosing your property inspection provider too casually can have significant consequences and result in unreliable reports.

A picture says a thousand words, and every property condition report should have plenty of photographs to support the findings reported by the inspector. But photos alone do not make the inspection report a good one.

Whether your inspections are provided by real estate appraisers, real estate agents, insurance inspectors or other inspection providers, in addition to a bevy of photographs, a good quality inspection report might include:

- Detailed, itemized descriptions of storm/disaster damage
- Assessment of possible vandalism (as opposed to storm damage)
- Itemized estimates of repair or replacement costs of damaged areas
- Estimated remaining economic life or undamaged improvements
- Occupancy status
- If unoccupied, whether or not the property is secured
- Utility status
- Description of overall neighborhood condition, including damage to adjacent and nearby properties

This list is not intended to be comprehensive, but it provides a starting framework. Assessing your organizations needs and the needs of your lending partners as well as regulatory and investor requirements against the format and content of available inspection report options will result in selecting the right vendor and the right product for meeting your needs. Over-purchasing services can be as costly as under-purchasing so understanding the goals and needs before procuring services is a prudent starting point.

Choosing the Right Inspector

When it is determined that an inspection following a disaster declaration is necessary, selecting the inspector may be driven by internal policy or by the mortgage investor. Exterior-only inspections conducted by qualified individuals may be the least expensive option, and when accompanied by good quality photographs, may provide enough information for certain decisions. Home inspection professionals may provide a higher level of detail and typically charge higher rates for their services. Licensed and certified appraisers will often be at the top of the fee scale, but they are also the best qualified to determine how property *value* has been impacted by any damage and quantify the amount of damage.

Some lenders choose to go right to the appraiser for the first look following the notice of disaster. However, there are substantial benefits to obtaining a Property Condition Report as the first step.

While licensed home inspectors and appraisers typically demand higher fees and are often required to follow specific state-mandated report forms guidelines, there are inspection providers who manage networks of field agents outside the realm of the state regulations. Although the background of those agents may be varied, going through an inspection provider who provides clear guidelines and Quality Assurance reviews has benefits. The most important attribute to look for when using these providers is experience. The more Property and Disaster Inspections these companies have completed, the more confidence you can have that they know how to complete them quickly, consistently, and economically, which will help the lenders quickly assess which properties may need a more in-depth review by an appraiser or other licensed or certified individual.

By isolating those properties that are positively damaged first, precious time and resources can be focused on the properties that will require the most attention. In this way, the people whose lives have been irrevocably altered can receive the attention they deserve. As noted at the beginning of this paper, no amount of property recovery or restoration can return their lives to “normal”. Making them wait while inefficient processes unfold just adds to their frustration and can have long lasting reputational consequences for lenders.

Conclusion

Property damage from natural disasters is significant every year. Awareness and preparation can go a long way to reducing the financial impact of disasters. In the end, the real benefit of awareness and preparation is reduction of injury and loss of life – losses that make property damage seem suddenly unimportant.

The form or format for documenting changes in property condition might be influenced by internal policy, investor requirements or other factors including system integrations and data mapping. The choice of inspector – appraiser, real estate agent, home inspector, or other professional – is typically investor driven. Regardless of format or provider, complete, accurate and useable information is essential.

By responding quickly and effectively, by choosing the most appropriate professional partners and employing the proper inspection tools, lenders can give families and communities the best chance to minimize the duration of the impact and allow them to place their focus where it is most needed – on supporting each other as they come to grips with adapting to magnitudes of personal change many of us will never experience.

About Real Info

Real Info, Inc. has been providing Automated Valuation Models (AVMs), automated real estate analytics and property inspection/damage assessment services to national clients since 1995. Real Info provides access to one of the most comprehensive parcel databases containing assessment, ownership and sales data on over 110 million properties. The database serves as the foundation for the company's real estate reporting, home price indices, neighborhood & sales analytics, and proprietary Automated Valuation Models.

<u>Contact Information:</u>

Real Info, Inc.
701 Seneca St, Suite 641
Buffalo, NY 14210
(716) 608-4370
www.real-info.com

About the Author

Bill King is President and Chief Valuation Officer at Real Info, Inc. He is responsible for overseeing product development and expansion for the company's line of valuation technologies and services. Mr. King has over 35 years of experience in real estate and valuation; he has served as a forensic expert on valuation and housing issues, and contributed to the country's most widely used appraisal textbook, The Appraisal Institute's *The Appraisal of Real Estate*. Mr. King is a licensed real estate broker and certified residential real estate appraiser in Washington State, and nationally recognized instructor of real estate and appraisal courses and seminars.

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