



Housing Assistance Council

**COST BASED APPRAISALS
ON NATIVE AMERICAN
TRUST LANDS:
A LONGITUDINAL ANALYSIS**

\$4.00

December 1999

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ISBN 1-58964-099-0

This report was prepared by Lance George of the Housing Assistance Council (HAC). Assistance was provided by Susan Peck and Art Collings, both also from HAC. The work that provided the basis for this report was supported by funding from the Fannie Mae Corporation. HAC is solely responsible for the accuracy of the statements and interpretations contained in this publication and such interpretations do not necessarily reflect the views of the Fannie Mae Corporation.

HAC, founded in 1971, is a nonprofit corporation that supports the development of rural low-income housing nationwide. HAC provides technical housing services, loans from a revolving fund, housing program and policy assistance, research and demonstration projects, and training and information services. HAC is an equal opportunity lender.

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EXECUTIVE SUMMARY

Obtaining accurate and sufficient real estate appraisals has traditionally been a problem in remote rural areas. Factors such as a lack of comparable sales, proximity to infrastructure and supplies, and minimal or non-existent markets, often preclude the use of traditional appraisals in more remote areas. Difficulties with appraisals are most apparent on our nation's Native American trust lands, which are often characterized by the qualities listed above. This study investigates issues contributing to a lack of comparable properties on trust lands and the use of cost-based appraisals in their absence. In a longitudinal analysis of homes built on trust lands, the units' appraised values were obtained several years after construction to determine how values compared with initial sales price.

Primary findings are presented below.

- ▶ **Mortgage loan production on trust lands is relatively nonexistent.** Only a small number of mortgage loans are being made on Native American trust lands. A review of production levels from conventional and subsidized finance sources provides an estimate of less than 300 loans made on trust lands annually.
- ▶ **The cost-based appraisal is a necessity on trust land.** Due to a lack of sales and housing production on trust land, cost-based appraisals are a last resort method, yet absolutely necessary to facilitate affordable housing in often remote and depressed areas.
- ▶ **Cost-based appraisals are almost exclusively being used on trust land.** A survey of rural housing producers and appraisers from states with high numbers of remote rural counties revealed that cost-based appraisals are generally only being used on trust lands.
- ▶ **Cost-based appraisals are not an impediment to affordable housing or loan production.** A wide array of entities familiar with affordable housing and loan making on trust lands agreed that the use of cost-based appraisals does not impede the loan making process. Cost-based appraisals are currently accepted as a norm in residential financing on trust lands.
- ▶ **The sustained accuracy of cost-based appraisals on value is still undeterminable.** The current analysis contained too few loans and transactions to determine if cost-based appraisals were effective in estimating long-term values of homes on trust lands. However, initial results from the small sample presented are encouraging. The longitudinal analysis revealed that while the re-appraised value of transferred homes on trust land was generally lower than its initial sales price, the difference was not extreme nor inconsistent with the reason for transfer.

INTRODUCTION

Appraisals are a systematic estimate of the value of real property. They are most often conducted in preparation for a sale, loan, or other transfer of real property (Klamanski & Piskulich, 1998). Appraisals may be calculated in several different ways, but the most commonly used and accepted method is the *comparable sales* approach. Also known as the market data approach, this system establishes value by comparing similar properties that have been recently sold (Arnold, 1993). The comparable sales approach simply compares two or more similar properties with each other.

The act of obtaining traditional comparable appraisals has been problematic in many areas of rural America, particularly in more remote and distressed locations such as Indian reservations. Difficulties with comparable appraisals generally arise from a lack of real estate sales or housing production. Furthermore, in depressed areas, such as Native American Reservations even if comparable sales are available, a true and accurate appraisal will almost always yield a value less than cost because of the limited market (Collings, 1992). In 1993, the Housing Assistance Council (HAC) and other national housing partners conducted a survey of appraisals in rural areas. Of the respondents that utilized USDA Rural Housing Service¹ (RHS) programs, 70.4 percent reported problems in obtaining and utilizing comparable appraisals. Of these, 67.0 percent indicated problems of appraised values estimated at less than cost, and 52 percent stated they had problems obtaining comparable sales (Housing Assistance Council, 1993).

One particular appraisal method that may be used in lieu of comparable sales is the *cost-based* approach. In this method, the value of real estate is established by the value of land plus the “reproduction cost new” of improvements (Arnold, 1993). Reproduction cost new is generally based on construction cost figures. The cost-based approach is rare and most often used for special purpose buildings, such as schools, churches, or where comparable sales are lacking.

This study investigates the use of cost-based appraisals on Native American trust land as an alternative to the comparable sales approach. It specifically addresses the impact of this appraisal approach on housing issues such as loan making and long term value.

Native Americans and the lands on which many of them reside are ensconced in an array complex social, economic, and legal issues. As a pretext, the following background section briefly addresses several of these issues.

¹RHS was formerly the Farmers Home Administration (FmHA). Rural Development offices administer RHS housing programs locally.

BACKGROUND

Legal Land Issues for Native Americans

In the United States there are over 550 Native American Nations and state recognized tribes (Rice, 1999). Within designated Native American communities, treaties, federal laws and tribal laws have created a variety of homeownership patterns. Some parcels may be classified as unrestricted fee simple, other parcels are restricted tribal trust or allotted trust lands. In addition each tribe develops its own codes and structure for doing business, which may vary from neighboring tribes or local governments (Rice, 1999). Below are the general designations for land ownership status of Native American households.²

Fee Simple Unrestricted

Fee simple unrestricted ownership is ownership of real property that may be bought, sold and transferred between Native American or non-Native American purchasers without review by the tribe or Bureau of Indian Affairs, (BIA).

Restricted Trust

Restricted trust land is held by an individual Native American household or tribe and is subject to federal restriction against alienation or encumbrance. Before any lien can be placed against restricted land, the transaction must be approved by the Bureau of Indian Affairs (BIA).

Tribal Trust Land

Tribal trust lands are held in trust for the tribe by the United States government. Tribes may lease portions of the tribal trust land for the use of specific individuals, but ownership, through federal trust, remains with the tribe.

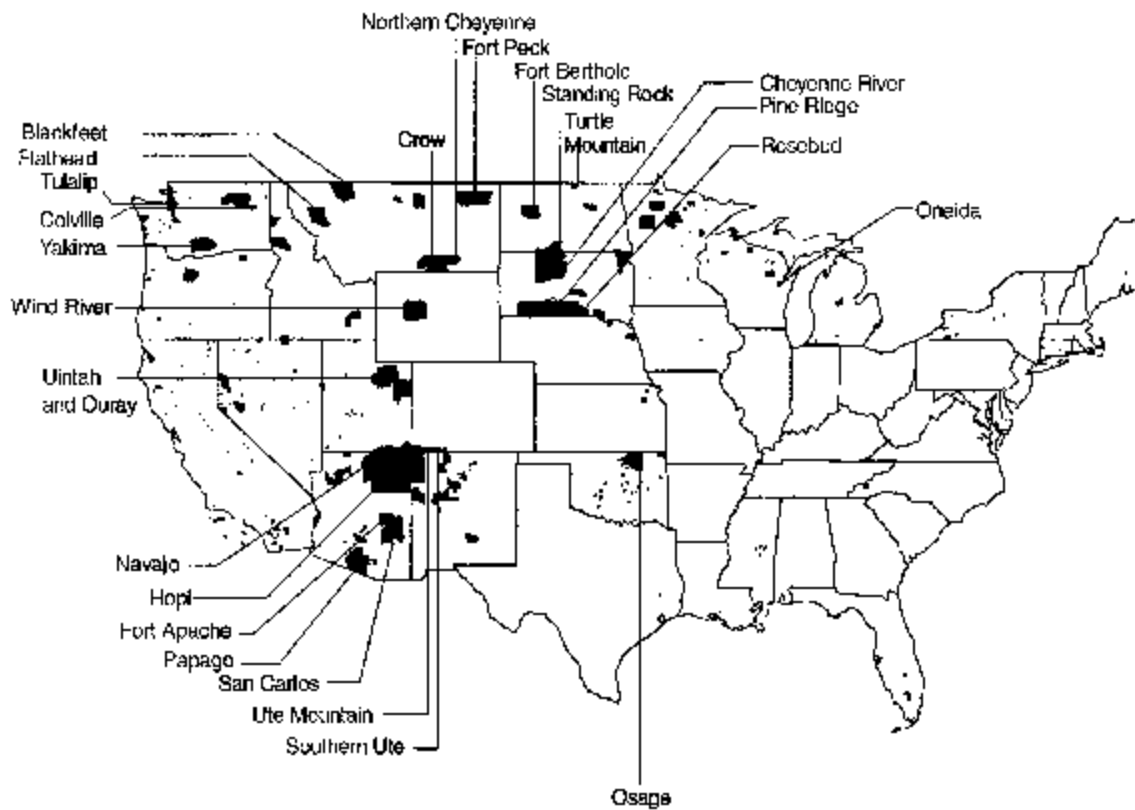
Allotted (or Individual) Trust Land

This designation applies to land owned by individual tribal members but held in trust by the United States government. It is common for allotted trust lands to be owned by several individuals. If a prospective borrower proposes to use all or a portion of a fractionated property, all other owners must indicate acceptance of this arrangement by becoming parties to the mortgage or subdividing the subject parcel out to the individual for undivided ownership.

This study will predominately use term *trust lands* when referring to any restricted Native American lands including both tribal trust and allotted trust designations. Trust lands in this sense are also analogous to other terms designating Native American locations such as reservations or tribal lands (See Map 1).

²Excerpted from HUD, *Valuation Analysis for Single Family One-To Four Unit Dwellings*. Handbook 4150.2, Appendix A.

Map 1. Selected Native American Trust Lands in the United States



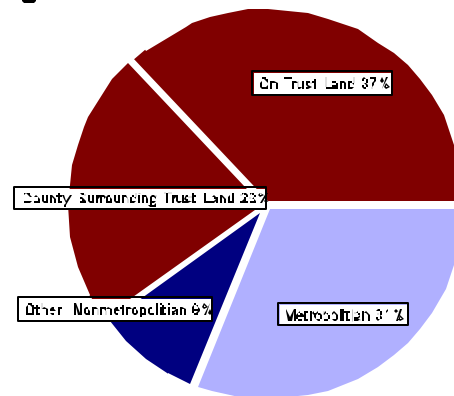
Source: General Accounting Office, 1998:
page 31

Note: This map shows general locations of
selected of Indian Reservations in the
United States

Location Patterns of Native Americans

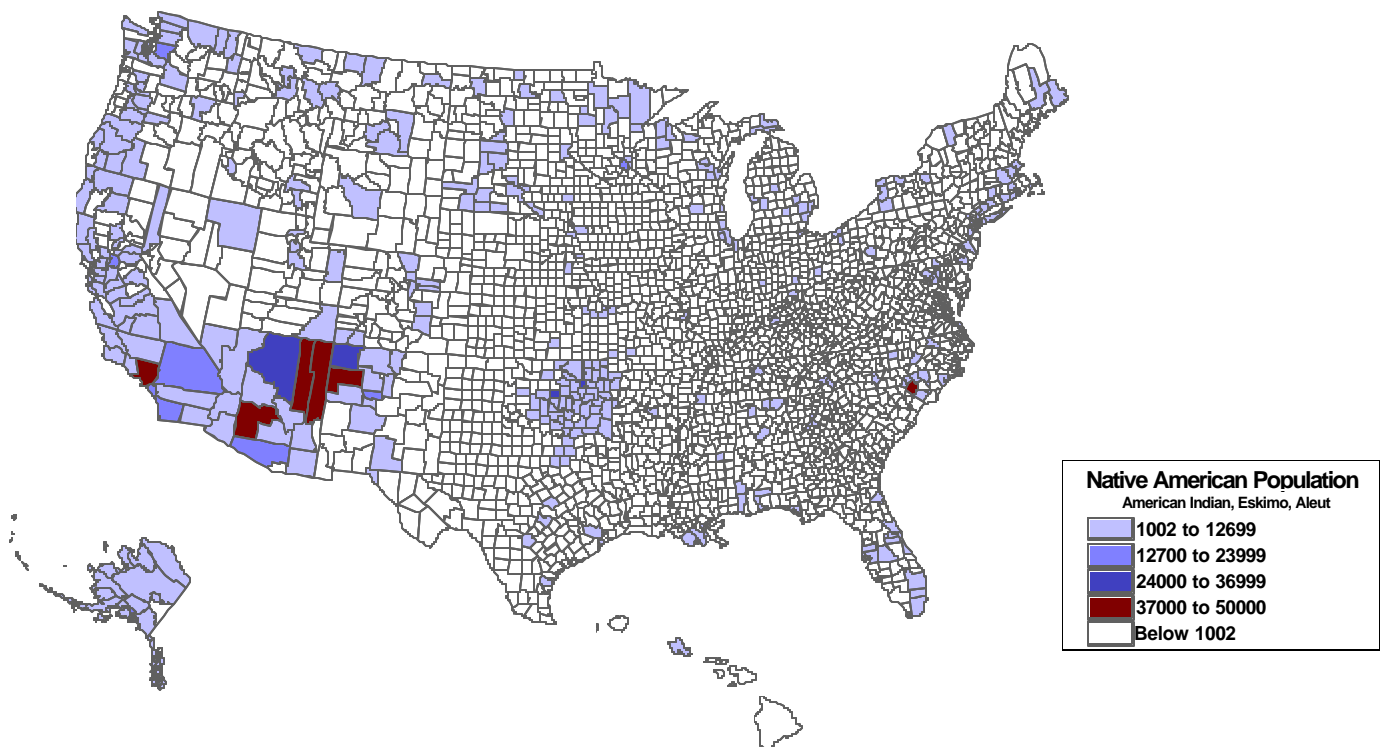
Of the approximately 2 million Native Americans³ in the U.S., 37 percent live on trust lands, and 23 percent live in counties surrounding trust lands. Overall, 60 percent of the Native American population lives on trust lands or in counties which surround them. Of those Native Americans living away from trust areas, 31 percent reside in metropolitan areas, and 9 percent live in nonmetropolitan areas (HUD, Urban Institute, 1996) (See Figure 1). Native Americans also tend to reside in more remote rural locations. In 1990, 61 percent of Native Americans lived greater than 50 miles from an urban population center of 50,000 or more (HUD/Urban Institute, 1996).

Figure 1. Location of Native Americans



Source: 1990 Census; HUD/Urban Institute

Map 2. Native American Concentrations, by County



³The term Native American in this report generally refers to persons in racial categories of American Indian and Alaskan Native. However, because this study utilizes an array of information sources, some inconsistencies between the definition of Native American may occur.

Housing Patterns Among Native Americans

In general, housing conditions for Native Americans are worse than the nation as a whole. For Native Americans who reside on land held in trust by the U.S. government, housing conditions are even more dire. According to the 1990 Census, 57 percent of Native Americans own their homes compared to 65 percent of all non-native citizens. Homownership rates are surprisingly higher for households on trust lands at 69 percent. This statistic may be misleading due to HUD's mutual self-help program. Most persons who occupy mutual help homes do not yet have titles to them, but the Census Bureau believes that many mutual help occupants possibly identified themselves as homeowners. If mutual help occupants are excluded, the homeownership rate on trust lands drops to 51 percent (HUD/Urban Institute, 1996) (See Table 1).

Table 1. Native American Housing Characteristics, by Location

	Native American Population					Non-Native
	Total	Trust	Surr. Co.	Other Metro	Other Nonmet	U.S. Total
Number of Housing Units (Thousands of Units)						
Owner Occupied	461	161	96	150	54	59,349
Renter Occupied	351	74	92	148	38	31,405
Total	812	235	188	298	92	90,754
Percentage of Units						
Owner Occupied	56.8	68.6	51.2	50.3	58.9	65.4
Renter Occupied	43.2	31.4	48.8	49.7	41.1	34.6
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: 1990 Census; HUD/Urban Institute

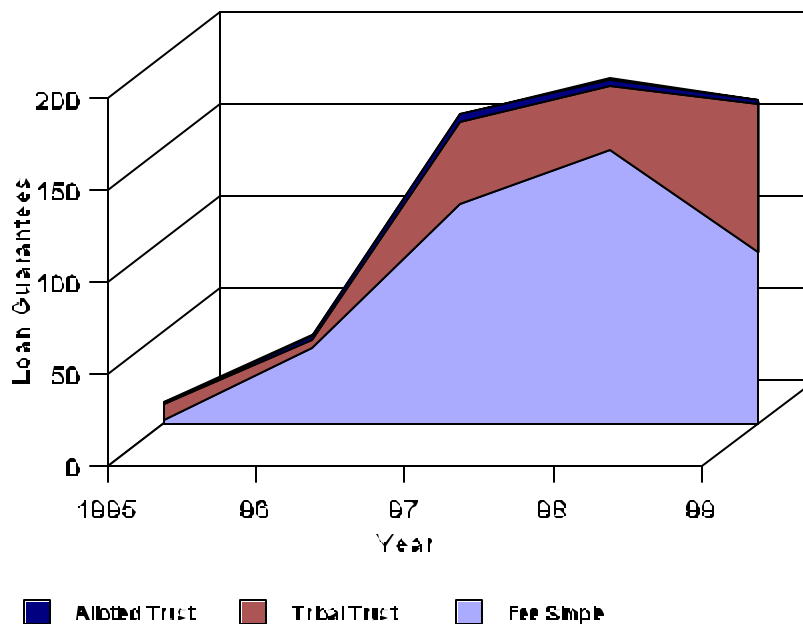
The physical quality of homes on trust lands also tends to be problematic for many Native American households. Overall, 28 percent of housing units on trust lands are overcrowded or lack adequate plumbing facilities. This is relatively high compared to a national level of just 5.4 percent. Of housing problems on trust lands, overcrowding seems to be worst; 12 percent of all households are overcrowded, which is four times greater than the national rate of 2.7 percent (HUD/Urban Institute, 1996). Although not as extreme, housing affordability is also a concern for Native Americans in which 29 percent of them pay more than 30 percent of their incomes toward housing. Nationally, 23 percent of households experience this housing cost burden. Affordability problems are not as prevalent for Native Americans living on trust lands (HUD/Urban Institute, 1996).

Loan Production on Trust Lands

One primary factor exacerbating the low quality of housing on trust lands is a lack of financing for affordable homeownership opportunities. For decades a plethora of legal, socioeconomic and cultural constraints have severely curtailed the level of residential financing on trust lands. This problem is exemplified in a 1999 General Accounting Office (GAO) report investigating mortgage lending on trust lands. The report cites that between 1992 and 1996 a total of only 91 conventional mortgage loans were originated on trust lands. Furthermore, 81 of these were between just two tribes; the Oneida of northeastern Wisconsin and the Tulalip of northeastern Washington state (Government Accounting Office, 1998).

While federally subsidized loans are somewhat more available than private market conventional loans, their contribution to trust homeownership has also been limited. One of the newest and most prominent homeownership programs dedicated solely for Native Americans is the U.S. Department of Housing and Urban Development (HUD) Section 184 loan guarantee program. Instituted under the Housing and Community Development Act of 1992, Section 184 authorizes HUD to operate an Indian home loan guarantee program that will stimulate access to private financing for Native Americans. Under the program, HUD guarantees loans made by private lenders to Native American families, tribes, or Indian housing authorities for construction, acquisition or rehabilitation of single family-homes (Government Accounting Office, 1998).

Figure 2. HUD Section 184 Program
Loan Guarantees by Location and Year



Source: HUD/Office of Native American Programs, 1999

Since Section 184's inception in 1994, HUD has issued 590 loan guarantees to private lenders totaling \$58,273,647. Of these, 404 have been on fee simple parcels, whereas 174 are on tribal trust land, and 12 are from allotted trust parcels (HUD/Office of Native American Programs, 1999) (See Figure 2).

While the number of Section 184 loans made with cost-based appraisals cannot be easily estimated, officials from HUD's Office of Native American Programs (ONAP) maintain that as the number of guarantees made on trust land rises, so have those that utilize cost-based appraisals.

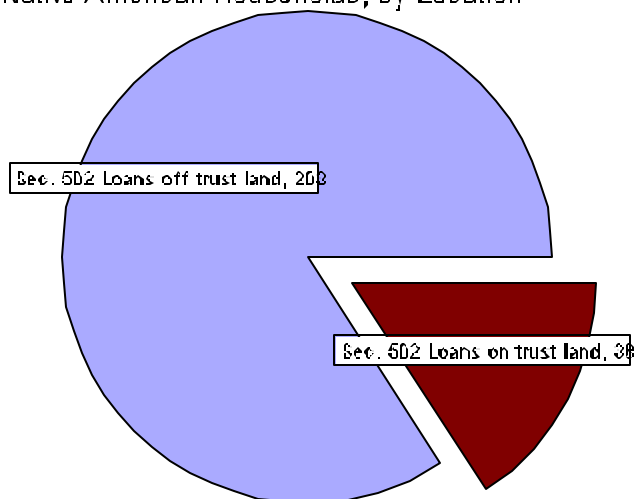
Another lending program intended to stimulate Native American loan making is the Section 248 guarantee. Under this program, The Federal Housing Authority (FHA) insures mortgage loans for groups of Native Americans on trust land whose higher incomes disqualify them from other federally subsidized housing programs. In 1998, FHA insured 18 loans totaling 1.4 million dollars through the Section 248 program (Government Accounting Office, 1999). HUD officials familiar with the Section 248 program maintain that about half of the guarantees used cost-based appraisals.

Another federally subsidized homeownership finance source for Native Americans is the USDA/Rural Housing Service (RHS). The majority of RHS's housing finance efforts for Native Americans fall under their Section 502 program, which makes direct homeownership loans for low-income families in rural areas.

Because Native Americans tend to live in rural areas, RHS programs may be more suited to their finance needs. RHS loan origination rates among Native Americans are similar to other agencies offering federally subsidized housing assistance. In fiscal year 1999, 241 Section 502 direct loans were made to Native American households. Of these, 38 were located on trust lands (USDA Rural Housing Service, 1999) (See Figure 4).

RHS also has a homeownership initiative specifically for Native American households, which they operate in conjunction with Fannie Mae. The Native American Pilot Program guarantees loans for low- and moderate-income families who are first time buyers and who are located in rural areas. The program is relatively new and has seen limited activity. Currently one loans has been guaranteed through the pilot program.

Figure 3. 1999 RHS Sec. 502 Obligations
For Native American Households, by Location

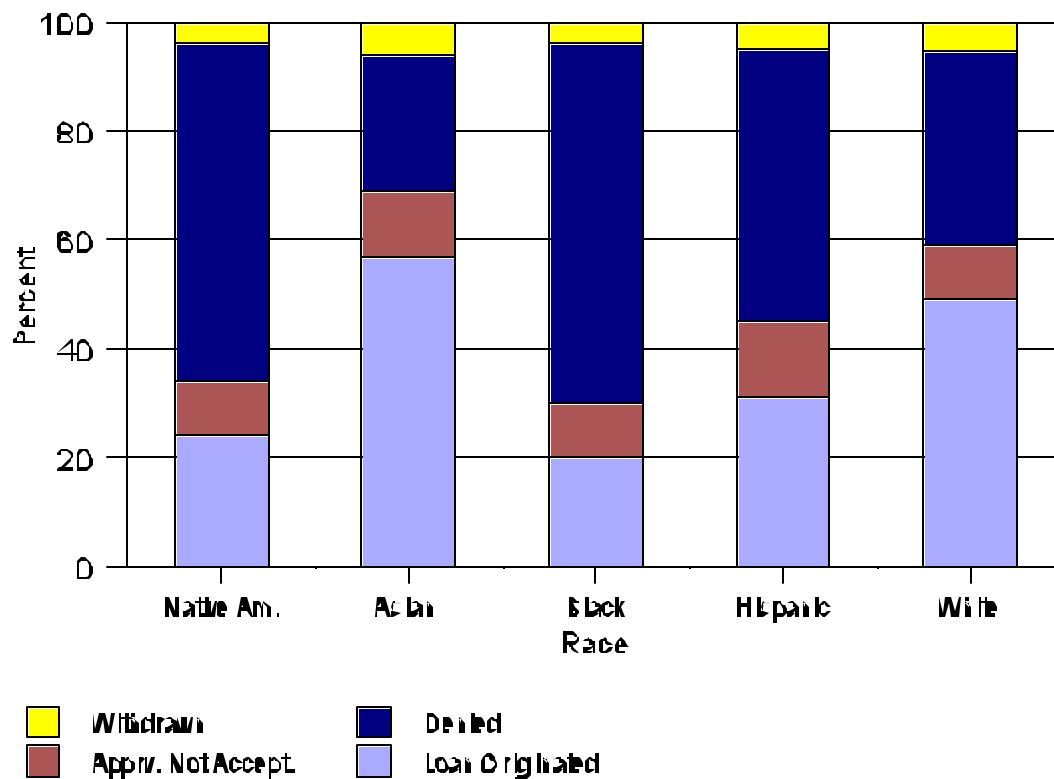


Source: USDA Rural Housing Service, 1999

A further examination of lending patterns among Native Americans reveals they experience high levels of loan denials. A review of 1998 Home Mortgage Disclosure Act (HMDA) data indicates that Native Americans experience the highest rates of home purchase loan denials (47 percent) and lowest levels of loan originations (36 percent) of any racial group nationwide. These rates are even more profound in nonmetropolitan areas where the denial rate for Native Americans rose to 62 percent and originations declined to 24 percent (In nonmetropolitan areas origination and denial rates were slightly worse for African American applicants) (HAC, 1999) (See Figure 4). However since HMDA data does not distinguish between locations for Native American applicants, it is difficult to ascertain denial rates on trust land.

Figure 4. 1998 Nonmetro HMDA Findings

All Home Purchase Loan Actions, by Race



Source: Housing Assistance Council, 1999

As evidenced by the preceding production numbers only a small number of conventional real estate loans are being originated on Native American Trust lands. From these findings it is estimated that less than 300 loans, including conventional and subsidized, are made on trust lands annually.

Cost-Based Appraisals on Trust Land

The preceding information concerning low housing production on Native American trust lands alludes to several of the complexities associated with providing affordable housing in these areas. Remote location, reduced market, legal issues, and various other socioeconomic constraints are readily apparent on many trust lands. These factors directly contribute to the minimal number of new and quality housing units being produced. In turn, limited sales data in these areas often inhibit the use of the standard comparable sales approach and necessitate the cost-based approach in obtaining appraisals on trust lands.

While cost-based and comparable sales appraisal methods are conceptually different, several appraisers when interviewed noted they use aspects of each when conducting appraisals on trust lands. Often a cost estimate is developed with no land value, then compared to a local fee simple land market sale for similar new construction costs. This hybrid model provides an estimate for market costs where none are available and helps give a proxy for the validity of the cost-based method.

Realizing the need for special appraisal techniques in remote rural areas, a number of entities who produce housing on trust lands have accepted the use of cost-based appraisals for their underwriting criteria. For example, Directive 4150.2 in HUD's handbook of valuation techniques on Native American lands states, "The cost approach is often the primary indication of value based on the unique nature of the reservation setting" (HUD, 1999). Likewise, RHS formally issued Administrative Notice 3267 (1922-C) in 1996, which authorized local Rural Development offices with the authority to use cost-based appraisals in remote rural areas (HAC, 1996). Even officials of private mortgage companies such as Norwest Mortgage, one of the more active private financiers on Native American lands state, "cost-based appraisals are a tool that must be used to make any loans on trust lands."

Currently it appears as if cost-based appraisals are almost exclusively used on trust lands. A survey of RHS Rural Housing Program Directors from states with high numbers of remote rural counties⁴ revealed that cost-based appraisals are generally only being used on trust lands. For example, over half of the RHS eligible areas in North Dakota are considered "remote-rural" and thus, are eligible for the use cost-based appraisals if needed. However, only two RHS Section 502 loans outside of trust areas have utilized cost-based appraisals. Furthermore, in other remote areas of the nation such as Appalachia, RHS officials and housing producers maintain comparable sales are for the most part being obtained and the use of cost-based appraisals are rare. These findings are substantiated by interviews with other Native American housing officials and representatives from private lending entities.

⁴Remote rural counties are those with an urban population fewer than 2,500, and not adjacent to a metropolitan area.

LONGITUDINAL ANALYSIS

To determine if cost-based appraisals are effective in estimating long term values of homes in remote rural areas, a longitudinal analysis of appraisals for RHS Section 502 loans made on trust land was conducted. The analysis specifically sought out loans which had been involved in a transfer to help determine the effect on value.

Methodology

The data for the analysis consists of appraisal information from various RHS Section 502 direct loans that were made on trust lands between 1979 and 1995. The data were initially collected by HAC in 1996 and were solicited from local Rural Development offices in areas with significant amounts of trust land. For the analysis, these same Rural Development offices were re-solicited to update information of the initial data.

The analysis examined and compared the initial appraisal data with updated values to determine the current status of each loan. Those loans which had been involved in some form of real estate transfer (ie. sale, foreclosure, reconveyance, etc.) were selected for longitudinal analysis. The transfer details of the selected loans (reappraised value, resale value, etc.) were then compared with the initial appraised value and sales price to determine the effect on value.

The original HAC data set, although small (n= 21), provides the best possible chance for finding transfers that are needed to determine a change in value. Other data sources were considered, but deemed insufficient due to a lack of available information.

The quantitative analysis presented in this report was augmented by qualitative interviews from appraisers, lenders, government officials, community development groups, and other entities familiar with housing production on Native American trust lands.

Data Limitations

Conducting social science research on Native American populations has traditionally had many challenges associated with it. Data for Native Americans is sparse, and they are largely invisible from national record keeping (Snipp, 1992). In addition, most survey or public opinion polls do not permit reliable numbers from such a small number of Native Americans in the population. Therefore, studies on Native Americans are often restricted to qualitative field work or case studies with small scale surveys (Snipp, 1992).

The small number of mortgage loans made on trust lands greatly inhibited available data for this study. Furthermore, finding loans from this small pool that have been involved in a transfer is even more difficult. Therefore, with the exceedingly small number of available data a reliable statistical sample is impossible to obtain. Thus, caution is advised when generalizing from the results of this small nonrandom sample of loan transfers on trust lands.

Review of Data

Location

The initial appraisal data set from 1996 contained 21 observations (appraisals). Of these, 19 resulted in successful loan originations from RHS. Therefore, the actual number of usable cases from which to derive possible transfer data is 19. The appraisals came from eight different Rural Development offices throughout seven different states that have significant amounts of trust land. These states included Arizona, Idaho, Nevada, New Mexico, North Dakota, South Dakota, and Wisconsin (See Map 3).

Map 3. Location of Appraisal Data, by State

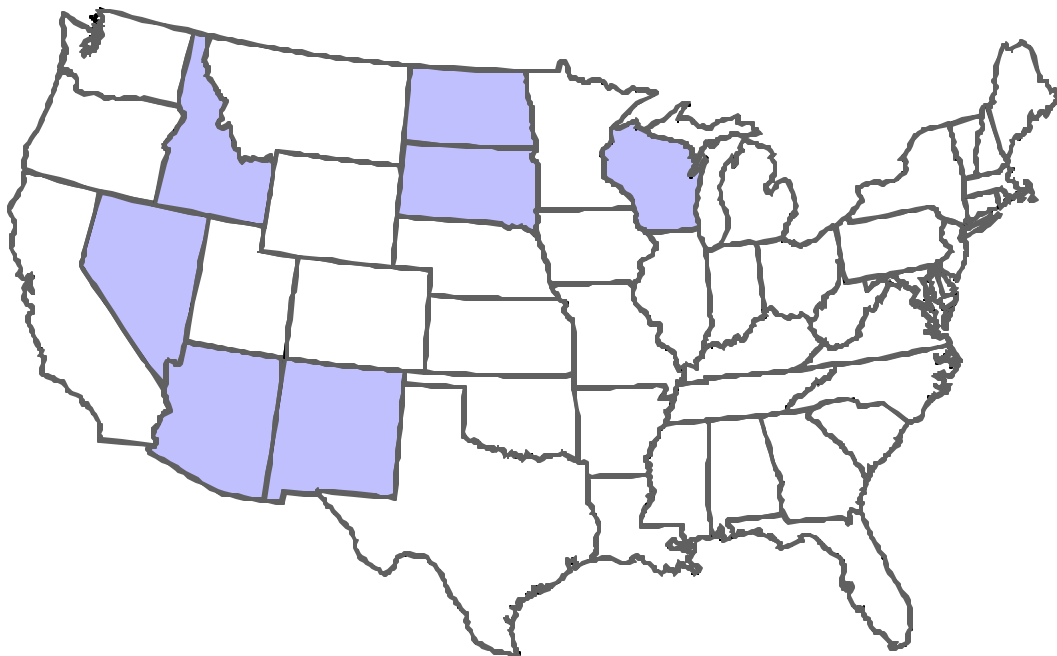


Table 2. Location of Appraisals

State	Number of Appraisals	Reservation(s):
Arizona	3	Hopi, Navajo
Idaho	1	Fort Hall
New Mexico	2	San Juan Pueblo, Mescalero Apache
Nevada	1	Te-Moak
North Dakota	3	Standing Rock
South Dakota	7	Pine Ridge, Cheyenne River
Wisconsin	4	Red Cliff, Bad River

Appraisal Type

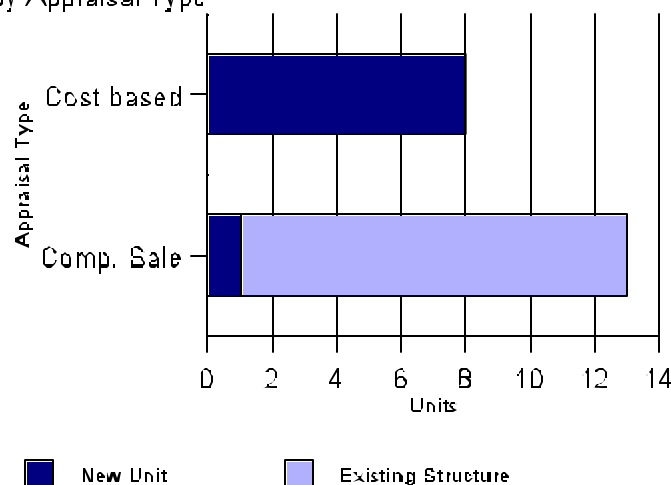
A majority of the appraisals in the original data set were based on the comparable sales approach. Overall, 13 of the 21 appraisals (62 percent) used comparable sales and the remaining eight (38 percent) were cost-based appraisals. This may be in part explained by the fact that at the time many of these appraisals were conducted RHS did not have established procedures that readily accepted cost-based appraisals. A closer review of dates on which appraisals were conducted indicate that cost-based appraisals in general were conducted later than those that used the comparable sales approach. The median year in which a comparable sales appraisal was conducted was 1992, where as the median date for the cost-based appraisals was 1995. Furthermore, one of the comparable appraisals indicated that the appraiser gave more weight to a cost approach due to a lack of comparables.

Construction Status

The difference in construction status was relatively similar between new and existing structures. Overall, 57 percent of the structures (12 units) were existing units and the remaining 43 percent (9 units) were newly constructed at the time of the initial appraisal. However, when viewed in context of appraisal type the differences in construction status are somewhat more distinct. Nearly all (92 percent) of the units which had a comparable appraisal were existing structures. To the contrary all of the cost-based appraisals were for newly constructed units. However, this is to be expected as cost-based appraisals are rarely conducted on existing structures (See Figure 4). Most of the homes were conventionally constructed, however, two the units were manufactured homes. Indicative of homes financed with Section 502 loans, the appraised units were relatively small, ranging in size from 864 to 1277 square feet, with a median size of 1074 square feet. These housing sizes were basically consistent among both appraisal types.

Figure 5. Construction Status

by Appraisal Type



Land Value

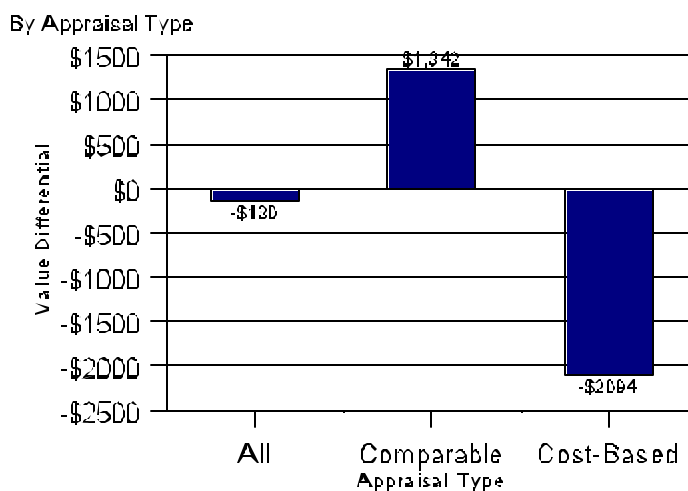
Placing a value on trust land has become a somewhat convoluted issue. HUD's valuation handbook states, "in the completion of this [cost-based] approach on tribal trust sites, the value of land does not apply. . .the value of the site is zero or a small leasehold value" (HUD, 1999). No such directive exists for RHS, and interviews with their appraisers yielded an array of differing approaches. Some appraisers maintained that because the land is held in trust and has no market value, it should have absolutely no value attributed to it. Conversely, other appraisers stated that even though restrictions are in place, the tribal member actually gleans some inherent value from the property and thus justify placing a value on land.

Consistent with the controversy of placing value on trust lands, the appraised land values from the RHS data set also varied greatly. Overall, 66 percent (14 appraisals) attributed no value to the land on which the structure was built. Of those appraisals that did place a value on land, figures ranged from a low of \$500 to a high of \$13,000. Most of those appraisals with no value were comparable sales in type.

Initial Appraisal Value vs. Initial Sales Price

The data set indicates both initial appraisal value and sales price. For comparable sales appraisals the mean appraised value of homes was \$35,675 and the mean sales price was \$37,017. These same values for cost-based appraisals were \$54,945 and \$52,851 respectively. The overall values for comparable sales may be lower because most of them were existing units. Because these figures take into account both new and existing homes and different structure types a value differential ratio was calculated. Among all cases the average value differential between appraised value and sales price was -\$130. For comparable appraisals, sales prices outpaced appraised values on average with a differential amount of \$1,342. However, among cost-based appraisals the sales price generally did not meet appraised value with an average value differential of -\$2,094 (See Figure 6).

Figure 6. Initial Value Difference



Value Comparisons by Appraisal Type (Longitudinal Analysis)

Of the 19 available RHS Section 502 loans in the original data set, 14 were still outstanding loans with RHS at the time of this analysis. Five (5) of these loans have been involved in a transfer. All five are currently in foreclosure proceedings. Two of the loans utilized comparable appraisals and three utilized the cost-based approach in their initial appraisals. Details of these cases, including differences between initial sales prices and re-appraised values are chronicled below to determine if cost-based appraisals are effective in estimating long term values.

Case # 1

The first transfer involved the foreclosure of a loan on the Red Cliff Reservation in Wisconsin. In 1991, the existing unit appraised for \$16,100 from a comparable sale appraisal. The unit sold for \$15,778. In 1998, the loan went into foreclosure proceedings and was reappraised at \$14,270. This accounted for a value differential of \$1,508 below the loans original sales price.

Table 3. Transfer # 1, Details

Location:	Bayfield, Wisconsin	Land Value:	\$ 0
Date:	4/9/91	Initial Appraised Value	\$16,100
Appraisal Type:	Comparable Sale	Initial Sales Price	\$15,778
Building Type:	Existing	Re-Appraised Value	*\$14,270
Square Feet:	1,152	Value Differential	\$ (1,508)

Comments: Initial sale was from an inventory property.* Foreclosure appraisal. Transfer and subsequent loan in process, \$52,780

Case #2

The second transfer involved the foreclosure of a loan on the Bad River Reservation in Wisconsin. The initial comparable sales appraisal valued the existing home at \$42,500 in 1992. It sold at slightly under the appraised value for \$42,000. The loan fell into foreclosure in 1998 and was re-appraised at \$40,000.

Table 4. Transfer # 2, Details

Location:	Ashland, Wisconsin	Land Value:	\$ 0
Date:	4/10/92	Initial Appraised Value:	\$42,500
Appraisal Type:	Comparable Sale	Initial Sales Price:	\$42,000
Building Type:	Existing	Re-Appraised Value:	*\$40,000
Square Feet:	1,008	Value Differential:	\$(2,000)

Comments: * Foreclosure appraisal. House was extensively rehabilitated before initial sale.

Case #3

The third transfer involved the foreclosure of a home on the Cheyenne River Reservation in South Dakota. The initial cost-based appraisal determined a value of \$62,500 for the new unit in 1994. It sold for \$61,900. The loan went into foreclosure and was re-appraised at \$55,000.

Table 5. Transfer # 3, Details

Location:	Cheyenne River, SD	Land Value:	\$ 0
Date:	8/23/94	Initial Appraised Value	\$62,500
Appraisal Type:	Cost-based	Initial Sales Price	\$61,900
Building Type:	New	Re-Appraised Value	*\$55,000
Square Feet:	1,198	Value Differential	\$(6,900)
Comments: * Foreclosure appraisal			

Case #4

The fourth transfer also involved the foreclosure of a loan made on the Cheyenne River Reservation. The initial cost-based appraisal yielded a value of \$52,400 for the new unit in 1994. It's actual sales price was \$49,500. A subsequent foreclosure re-appraisal yielded a value of \$43,300 which accounted for a value differential of -\$6,200.

Table 6. Transfer # 4, Details

Location:	Cheyenne River, SD	Land Value:	\$ 500
Date:	10/25/94	Initial Appraised Value:	\$52,400
Appraisal Type:	Cost-based	Initial Sales Price:	\$49,500
Building Type:	New	Re-Appraised Value:	*\$43,300
Square Feet:	988	Value Differential:	(\$6,200)
Comments: *Foreclosure Appraisal			

Case # 5

The fifth transfer involved a foreclosure appraisal of a home on Mescalero Apache Reservation in New Mexico. The property's initial sale price was \$23,000 as an existing unit in 1979. After going into foreclosure in 1997, the property was re-appraised at \$22,000 using comparable sales.

Table 7. Transfer # 5, Details

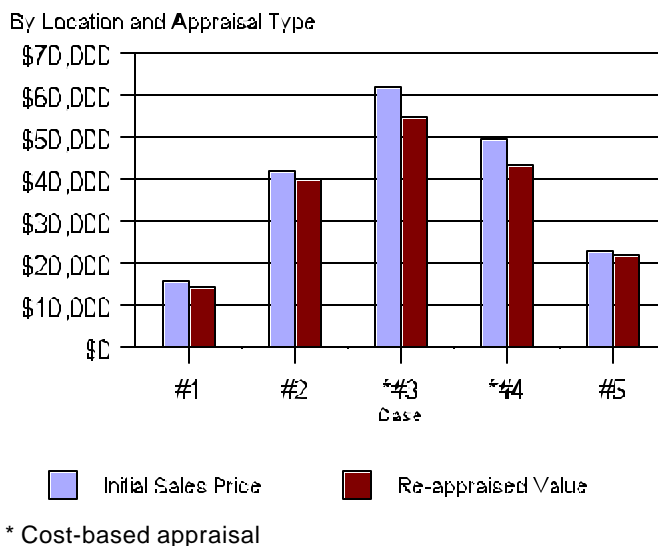
Location:	Mescalero, NM	Land Value:	\$0
Date:	1979	Initial Appraised Value	\$23,000
Appraisal Type:	Cost-based	Initial Sales Price:	\$23,000
Building Type:	Existing	Re-Appraised Value:	\$22,000
Square Feet:	1075	Value Differential:	(\$1,000)

Comments: * Foreclosure appraisal. Comparable sales were obtained from properties obtained off trust lands and value adjusted accordingly

FINDINGS

Among all five of the chronicled foreclosure transfers on trust lands, re-appraisal values were an average 8.4 percent less than the initial sales price. For the three comparable appraisals the differential was 6.1 percent below initial sales price. The value differential was higher for cost-based re-appraisals at a negative 11.8 (See Figure 7). Initial findings from the longitudinal analysis reveal that while all of the foreclosed homes re-appraised values were lower than initial sales prices, the difference was not extreme. The highest differential for a cost-based appraisal was 12.5 percent below the initial sales price.

Figure 7. Longitudinal Value Difference



Loan status is a factor possibly impacting the value differential. The re-appraised values may be even lower than a normal appraisal considering they were conducted under a liquidation (foreclosure) status. Foreclosure appraisals will almost always reveal lower values than a standard appraisal even in non depressed areas. Several appraisers interviewed estimated that a foreclosure appraisal will on average produce a value 25 percent to 30 percent below that of a standard appraisal. These lower values are generally a result of the principle of “reduced maintenance” which asserts that if a household doesn’t have the economic resources to make loan payments, they probably cannot afford general upkeep either. Subsequently, the unit is likely to fall into a greater state of disrepair resulting in a lower value. Therefore, some of the negative value differential for the preceding examples may be explained by the status of the loan and not the type of appraisal or location.

Unfortunately, the findings from the longitudinal analysis are inconclusive because of the small number of cases. However, these initial results reveal that while cost-based appraisals had a somewhat lower value than their initial sales price, they were not significantly lower than comparable re-appraisals on trust lands. Furthermore, most cases would be in line with normal depreciation from a liquidation appraisal.

DISCUSSION

There are too few examples presented in the preceding analysis to determine with any statistical significance if cost-based appraisals are effective in estimating long term value of homes built on trust lands. However, initial results from the small sample are encouraging; while the homes' values generally depreciated, they did not do so drastically nor beyond what would be expected for foreclosed properties.

The exceedingly small number of new loans on trust lands is one of the greatest constraints inhibiting the use of comparable sales appraisals in these areas. This situation has also greatly inhibited the level of research that may be conducted to more adequately inform lenders, appraisers, housing producers and tribal members on the long term value of homes on trust lands.

Other more intangible issues not addressed in the study may also impact the use of appraisals on trust lands. The lack of sales and transfer data may be influenced by the housing behavior of tribal members. One of the overriding responses from interviews with appraisers, lenders, and persons familiar with housing production on trust lands was that homes don't generally change hands often. On the rare occasion in which a home transfer does take place it is almost never an "arms length" transfer and generally stays in the family or goes back to the tribe.

While Native American trust lands are generally located in more remote rural areas, location factors such as proximity to residences, roads, and services still impact how appraisers value homes even on remote trust lands. Furthermore, the issue of tribal parity also has an impact on housing production. Among tribes there is a great deal of disparity in terms of economic situations and available resources. These discrepancies are evidenced within the small number of trust lands included in the analysis. For example, officials familiar with the Red Cliff and Bad River reservations in Wisconsin note these areas have enjoyed unprecedented levels of economic growth in the past decade due primarily to gaming and an overall stronger economy. To the contrary, the Cheyenne River reservation in South Dakota is mired in poverty and one of the poorest places in the United States. These contrasts in tribal situations further highlight the need for appraisal and overall housing development procedures that are conducive to the often complex issues confronting many Native Americans living on trust lands.

In summation several factors, such as a lack of housing production, and absence of property transfers due to socioeconomic and cultural reasons, account for a minimal number of real estate transfers on trust lands. In turn, these circumstances necessitate the use of the cost-based method in the process of acquiring appraisals and determining real estate values on Native American trust lands.

Many lenders, both public and private, who produce housing on trust lands already accept cost-based appraisals. Admittedly there are still uncertainties associated with the cost-based approach, and comparable appraisals are favored when available. However, to use a common phrase, "special circumstances often require special actions." Undoubtedly the dire housing conditions experienced by many Native American households on trust lands is a special circumstance that cannot continue to be overlooked. Therefore, if lenders and housing

producers are genuinely committed to improving housing conditions on trust land, “special actions” such as the use and acceptance of cost-based appraisals must be implemented.

RECOMMENDATIONS

From the preceding research, the following recommendations are presented to help address the issue of cost-based on Native American trust lands.

- ▶ *Lenders should be willing to accept cost-based appraisals on trust land where comparable sales are lacking.* Many housing producers are familiar and comfortable with the use of cost-based appraisals on trust land. Acceptance of properly conducted cost-based appraisals by lenders will remove a significant barrier to affordable homeownership in these areas.
- ▶ *Appraisers should conduct cost-based appraisals in a manner as to appropriately inform lenders.* Because the cost-based method lacks comparable sales to significantly support value conclusions, the appraisal process should be documented more thoroughly than a typical market appraisal. To avoid confusion or ambiguity it is recommended that appraisers communicate analyses, opinions, and conclusions in a manner that is not misleading. To achieve this appraiser should document their search, information and conclusions clearly.
- ▶ *Cost-based appraisals should take into consideration special costs associated with housing production on trust land.* Many trust lands are located in remote rural areas. As such, obstacles such as a lack of contractors, proximity to suppliers, and inadequate infrastructure often drive up production costs which may be overlooked in a standard cost-based appraisal procedures. Currently HUD single family appraisal regulations (for Section 184 and 248) permit for a 10 percent allowance for these special costs which may be encountered on trust lands. It is recommended that all appraisers adopt similar policies to adjust for the appropriate upward calculations and accommodate these additional costs.
- ▶ *Continued and expanded research should be conducted on appraisal methods and other housing issues for Native Americans.* As is common with many studies of Native Americans, data is sparse and limited. The small number of appraisals and transfers in this study makes us hesitant to draw firm conclusions on the ability of cost-based appraisals to predict value. Thus, further data collection and longitudinal analysis of this issue is recommended for a more definitive conclusion to the value of homes on trust lands.

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APPENDIX :
SELECTED DATA FOR SECTION 502 APPRAISALS ON TRUST LAND

Location	Date	Type Appr.	Type Bldg.	Sq. Ft.	Land Value	Appr. Value	Sales Price	Comments
Rio Arriba, NM	1/1/90	comp. sales	existing	1100	\$0	\$45,000	\$45,264	a
Mescalero, NM	8/8/79	comp. sales	existing	1075	0	23,000	23,000	a
Elko, NV	8/13/91	cost	existing	1012	3,000	24,000	24,000	
Ft. Hall, ID	6/9/87	comp. sales	new	1056	1,000	45,000	39,425	a,c
Pine Ridge, SD	9/22/95	cost	new	864	13,000	69,700	70,000	a
Cheyenne River, SD	8/23/94	cost	new	1198	0	62,500	61,900	a
Cheyenne River, SD	10/25/94	cost	new	988	500	52,400	49,500	a
Cherry Creek, SD	6/28/95	cost	new	1002	0	44,800	40,051	a,d
Eagle Butte, SD	6/26/95	cost	new	1002	0	45,300	43,120	a,d
Eagle Butte, SD	8/29/95	comp. sales	existing	e	1,000	46,000	45,065	a,f
Eagle Butte, SD	8/29/95	comp. sales	existing	960	1,000	46,000	45,065	a,f
Bayfield, WI	4/9/91	comp. sales	existing	1152	0	16,100	15,778	a,b
Ashland, WI	4/10/92	comp. sales	existing	1008	0	42,500	42,000	a,f
Ashland, WI	10/13/93	comp. sales	existing	1056	0	17,000	17,001	a,f
Bayfield, WI	12/28/95	comp. sales	existing	1104	0	16,000	14,112	a,g,h
Ft. Yates, ND	6/3/94	cost	new	1092	9,500	74,900	59,500	a,i
Ft. Yates, ND	6/3/94	comp. sales	existing	1264	0	44,000	70,000	
Cannonball, ND	7/25/95	cost	new	1277	0	69,000	67,585	a
Window Rock, AZ	9/7/95	comp. sales	existing	1056	0	38,000	38,000	a,b
Window Rock, AZ	8/21/92	comp. sales	existing	1200	0	49,500	49,500	a,j
Tuba City, AZ	4/25/95	cost	new	1092	\$0	\$51,907	\$60,000	a,k

a Loan made.

b Inventory property.

c Appraisal \$36,600 w/o added land.

d Manufactured (mobile) home.

e Sq. foot data not provided.

f Extensive rehabilitated house.

g Appraised as improved. Cost \$5,200.

h Inventory property.

i 80 acres lienied.

j Appraiser gave more weight to cost approach due to lack of comparable.

Shaded cases were involved in a transfer and included in the longitudinal analysis.

Obtaining accurate and sufficient real estate appraisals has traditionally been a problem in remote rural areas. Factors such as a lack of comparable sales, proximity to infrastructure and supplies, and minimal or non-existent markets, often preclude the use of traditional appraisals in more remote areas. Difficulties with appraisals are most apparent on our nation's Native American trust lands, which are often characterized by the qualities listed above. This study investigates issues contributing to a lack of comparable properties on trust lands and the use of cost-based appraisals in their absence. In a longitudinal analysis of homes built on trust lands, the units' appraised values were obtained several years after construction to determine how values compared with initial sales price.

ISBN 1-58064-099-0