APPENDIX N

Appraisal of Single-Family Homes On Native American Lands

Introduction

Emerging markets are always a challenge for appraisers and others involved with processing real estate mortgages. How does an appraiser accurately reflect the present value for the future use of an asset whose price has not been tested in the market place? Matched pairs of sales may not exist or sales so infrequent their reliability is questionable. It is an appraisal problem encountered with many special use properties, rural properties, or architecturally unique dwellings. While the profession has developed tools which assist in the analysis, provide a basis for documentation, and develop parameters for the results, ultimately the conclusions rely on the judgment of the appraiser who must develop a creditable report.

In the continental United States and Alaska there are over 550 Native American Nations and Villages in addition to the Hawaiian Homelands and State recognized tribes. A growing number of Native Americans have the resources to purchase homes within these tribal communities. Mortgage programs are now available to facilitate such purchases, and lenders are eager to make such loans. However, the property may be remote, the market limited, the land restricted to a specific market, or the family's income may limit the ability to purchase housing. The appraiser's challenge is to gather the data, document a systematic approach and develop logical conclusions that measures these forces.
To develop accurate conclusions the appraiser must:

- Understand the land use patterns and market conditions that are typical within Native American communities and be respectful of the local tribal culture within which the appraiser is working.
- Understand the governmental limitations established by the tribe and Federal restrictions enforced by the Bureau of Indian Affairs (BIA) and how these differ from local governments or neighboring tribes.
- Understand the accurate application of the appraisal tools to develop the various approaches to value, including the analysis of residential leases and valuing leasehold estates, obsolesce and depreciated costs, and the requirement of the Uniform Standards of Professional Appraisal Practices (USPAP) to provide an accurate and understandable report.

A caveat must also be given. Guidance contained herein is general. Tribes and markets may reflect different characteristics which the appraiser must explain. Lenders and underwriters must also understand the unique challenges of tribal lending. Reports may be structured differently and require review by experienced professionals. Also government agencies, lenders, or the secondary market may request additional information. Such requests or policies should be in writing and become part of the appraiser's report and underwriter's review.

Land Status And Property Rights To Appraise

Within designated Native American communities, treaties and Federal laws have created a variety of ownership patterns. Some parcels may be fee simple, other parcels restricted tribal trust or allotted trust land. In addition, each Tribe develops its own codes and structure for doing business which will vary from neighboring Tribes or local governments. The appraiser must be familiar with the different restrictions and develop a reasonable value estimate for the subject property. Following are the general designations of land status commonly encountered in Indian Country and a limited explanation of the impact on the appraisal process and lending program.

FEE SIMPLE

Fee Simple ownership is an estate without limitations to any particular class of heirs or restrictions, but is subject to the limitations of eminent domain, escheat, police power, and taxation.

Fee simple is the land status typical in residential ownership and *is encountered* within most Indian areas. It is real property ownership which may be bought, sold and transferred between Native American or non-Native American purchasers. Establishing value on Fee Simple property within a reservation or Indian area would follow general appraisal and lending practices.

INDIAN LAND IN RESTRICTED OR TRUST STATUS

Indian land which has Federal limitation on the transfer of ownership or encumbrance is typically referred to as being held in trust or restricted. There are differences between the two land status designations, but for the purposes of mortgage lending and appraisal they are treated the same.

Trust land: The title to land or any interest in land is held by the United States of America for the use and benefit of the Indian Tribe or individual Indian(s).

Restricted Land: The title to land or any interest in land is held in the name of the Indian owner subject to the condition that the land cannot be alienated or encumbered without the consent of the Secretary of the Interior either by a limitation contained in the conveyance instrument pursuant to Federal law or because a Federal law directly imposes such limitations (25 U.S.C. 177).

- TRIBAL LANDS—Tribal Trust land is held by the United States of America for the use and benefit of Indian Tribe. Title on restricted tribal land is seldom transferred. Typically tribes will lease tribal trust land, but ownership, restricted by the Federal trust, remains with the tribe.

  Mortgages are available for leaseholds subject to a tribal lease. Mortgages on tribal trust sites must include the lease signed by the mortgagor and Tribal authority and approved by the BIA. Any exceptions should be supported by the tribal attorney and accepted by the lender

  Several types of tribal leases exist around the country. Leases involving government residential loan programs available to tribal members typically have simple terms. For these properties, leases will generally be subject to a long-term ground lease (for example 50 years or a 25-year lease with a 25-year renewable term). Rents are usually minimal with predictable increases (if any). Other tribal leases involving non-tribal or non-Indian lessees are generally more complex. They typically will involve rents close to or at market, with possible cost-of-living adjustments and perhaps shorter terms. Some are subject to a master lease. The variations make it mandatory for the appraiser to review the lease and all documents pertaining to it.

- ALLOTTED (OR INDIVIDUAL) TRUST LAND—Allotted trust land may be owned by an individual or as a family in undivided interest (fractionated). The land is held in trust by the United States government and is restricted against non-tribal sales or encumbrances without the BIA's approval.

  Mortgages on allotted (or individual) trust sites normally do not involve a lease, and the mortgage will encumber the land. A specific mortgage rider or approval is required. Binding loans must have a Deed of Trust Rider (or similar document) approving the mortgage pursuant to 25 U.S.C. 483 (a) and approved by the BIA. This Rider provides for the land status to be moved into fee simple if a default occurs.

  Because the land is owned by the individual and is encumbered by the mortgage and the lender is able to prefect its lien, the value given for the land should be consistent with other allotted or fee simple land sales. Processing includes consideration of all applicable approaches to value and documentation of the assumptions and conclusions developed.

  Fractionated heirship occurs when multiple owners have an undivided interest in the same parcel. It is created when family members inherit an interest in allotted trust land from a Native American ancestor. Most mortgage programs require the encumbered homesite to be subdivided out and recorded in a single mortgagor's name. Occasionally a tribe and lender will develop a special loan program that will utilize a long term lease to the individual. In either situation all multiple owners must agree.

- TITLE INFORMATION ON INDIAN LANDS—Information concerning ownership and encumbrances involving restricted Indian lands must be obtained from the BIA or Tribal Realty Office. The limitation against alienation prescribes a process under the administration of the Secretary of the Interior, Bureau of Indian Affairs (BIA). Title information is maintained by the BIA at their Land Title and Records Offices and is documented in the "Title Status Report" (TSR). Lenders are encouraged to make contact with the appropriate BIA and Tribal realty officers early in the loan processing because underwriters and appraisers need to review the TSR during loan processing. Any questions about the trust or ownership status should be clarified by the BIA before processing the appraisal. Upon the conclusion of loan processing, the encumbrance is approved by the appropriate BIA designee, recorded, and the Land Title and Records Office will issue a certified TSR. All loans must comply with this requirement and lenders are encouraged to maintain such verification in the loan file.

Approaches To Value

The appraiser must review the TSR and be familiar with the different restrictions to develop an appropriate value estimate for the subject property. The availability of comparable sales and rental transactions vary between locations and by tribes. In addition to the typical data sources, the appraiser may obtain sales information from the local tribal or Bureau of Indian Affairs (BIA) realty office. To the extent the markets are similar, sales from other reservations within the region may be considered.

The appraiser may need to rely on other value indicators to support a reasonable value conclusion. If similar or paired sales are not available to significantly support the value estimate, the appraisal process must be documented more thoroughly than a typical market approach USPAP Standards #1 and # 2 are effective to allow the appraiser to "correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal." And "in reporting the results of a real property appraisal an appraiser must communicate each analysis, opinion and conclusion in a manner that is not misleading." The appraiser must document the search, information developed and conclusions clearly for the intended users.

DETERMINE THE IMPACT OF TRIBAL TRUST LEASEHOLD ESTATES

Prior to developing an appraisal, the appraiser must determine the real property interest being appraised. On leasehold estates, the appraiser must review the TSR and the lease to analyze their effect on value and on the use of the property.

As stated earlier, lease rents may vary from a basic $1.00 per year to a monthly or annual rent that reflects the local market. Some leases require an upfront lease acquisition fee. Appraisal methodology provides different processes for estimating the impact of the land rent on the value of the leasehold. They typically involve determining an estimate of market value of the site as if it were fee simple; the term; a competitive rent; and a capitalization rate. A present value is determined, adjusted by any “upfront lease acquisition charge” and then consistently applied to each of the three different value approaches. The appraiser should be familiar with the processes used in the local market and discuss variations with their lender.

The appraiser should comment on any unusual limitations noted in the lease that would effect the property’s use, marketability, or value.

COST APPROACH

In markets with limited sales data available, the cost approach may become the primary indication of value. The appraiser should use a cost approach which conforms to industry standards. It is important to remember to include the cost of water, septic, and any other on-site costs in the cost approach. In remote areas, the standard construction cost estimating guides or manuals may require adjusting for higher transportation, labor or other costs not included in the basic estimate. Any unusual adjustments must be fully discussed in the report.

Typically the impact of trust status would be reflected in the estimate of land value as part of the development of the cost approach. Allotted land should reflect the market value of other allotted land sales (if available). If the site is a leasehold, the land value section should be modified to clearly State the site estimate reflects a leasehold estate value of the site.

Unless there are ample market transactions available to support the Sales Comparison Approach, the cost approach should be completed on all appraisals involving restricted or trust sites. It may provide the support for value on existing construction as well as new homes. When used with existing construction, the approach must include a credible estimate of depreciation. Curable depreciation such as deferred maintenance should be discussed with the lender and reflected as agreed upon. The appraiser must attach an addendum explaining the assumptions supporting the indication of value by the cost approach.

SALES COMPARISON APPROACH

Native American communities are developing economies at varying rates and degrees. Some communities have sales which reflect a market; others do not. Where sales are limited or non-existing, the appraiser may not be able to complete the market approach like the typical appraisal.

Whatever the situation, it is important for the lender to understand the economic factors which affect value. Therefore the appraiser must communicate the local tribal housing market. The sales comparison approach will generally be completed, but may reflect non-similar sales. Where no credible comparables are available, a narrative that discusses the market and provides any sales, rental or vacancy information pertinent to the subject must be developed within the context of supporting the value estimate developed from other value indicators.

Each situation will have unique factors and the appraiser should explain deviations from the typical sales comparison approach.

The impact of any trust status on the property's value must be included in the Sales Comparison Approach. If sales have similar status trust, minimal adjust is required. When the comparable sales include land, and the subject is a leasehold, an adjustment is required to reflect differences. The order of selection preferences for sales would depend on the type of property rights being appraised.

- Tribal Trust Leasehold sales (market sales between tribal members).
- Sales of allotted land trust between tribal members.
- Fee Simple within the Reservation.
- Fee Simple proximate to the Reservation sales.

INCOME APPROACH

The income approach is generally not developed with regard to Native American trust land appraisals. However, if the appraiser determines it may be is relevant, the appraiser should complete the income approach.

If the subject property includes a rental unit(s), the appraiser must provide an estimate of monthly rent for each unit(s) and note whether or not the rent is limited to the tribal sub-market. The appraiser should discuss the rental market and impact on value with the lender.

Reconciliation Of Value

The appraiser must determine a credible value estimate for the restricted trust properties from the limited data available. Underwriters and reviewers must recognize information may be limited and the report may take on characteristics of a narrative report rather than the typical form reports common in residential appraising. Where market information is limited, greater weight must be given to the replacement cost approach and the appraiser must document the decision process and the logic for the value determined. The appraiser must report if an approach was not developed and insert the rationale for exclusion of the approach.

Reporting Requirements

The appraiser must communicate the analysis and conclusions in a way that is not misleading. Typically the purpose of the appraisal is to determine the value for the restricted allotment or leasehold estate with its subsequent use to provide supporting documentation for a mortgage. The format used to report the appraisal should be discussed between the lender and the appraiser to assure it will meet the lender's needs. Regardless of the form, the report must comply with the requirements of USPAP, Standard 2.

To the extent necessary the assumptions and decision process must be documented. A partial list of issues includes:

- On restricted land, clearly indicate the limitations involved with the land.
- Assure easements for utilities and access to the property are provided and recorded as necessary for the lender or third party to use the property (especially critical on allotted homesites).
- Indicate the standard of construction that must be meet if the Tribe has an incomplete building code.
- Discuss issues like health and safety, obsolesce and deferred maintenance with the lender; and document any repairs that are basic to the property's long term use, or value.
- Provide the final conclusions that are clear and not misleading.

Create An Information Handout

This document has stressed it is an <u>introduction</u> to Indian lending and appraisal issues. Each tribe has a history and structure that will influence the use of mortgage lending within it's community. A suggested next step is that lenders and tribal representatives prepare an attachment to this information. The attachment could include such information as a short history of the tribe, discuss the land issues involved, and provide a list of name and telephone numbers of offices or individuals who could provide information during the appraisal or lending process. Such a summary would facilitate the process and encourage more appraisers to become involved.