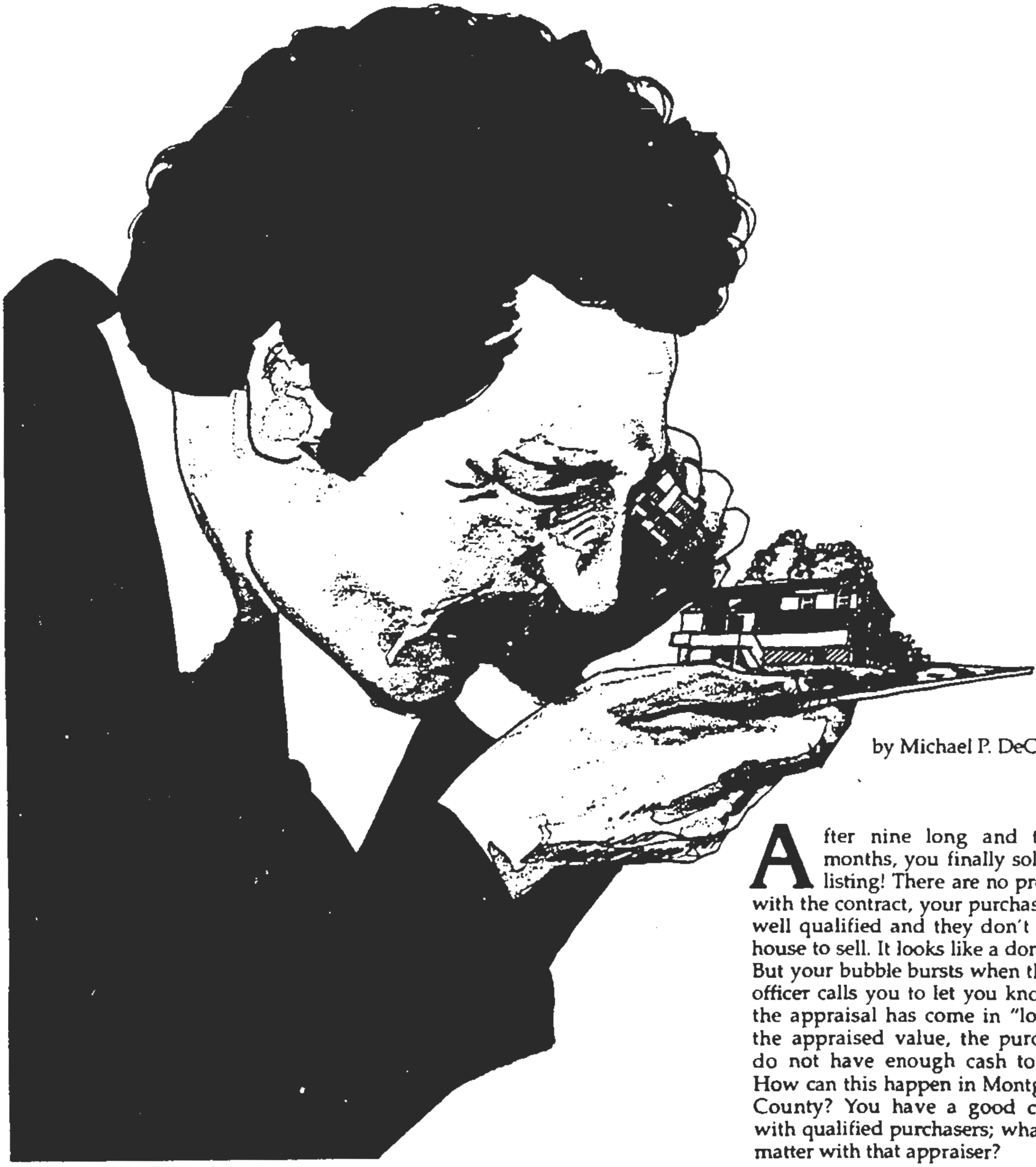
COPING WITH 'LOW' APPRAISALS

There is something you can do about it



by Michael P. DeChant

After nine long and tedious months, you finally sold your listing! There are no problems with the contract, your purchasers are well qualified and they don't have a house to sell. It looks like a done deal! But your bubble bursts when the loan officer calls you to let you know that the appraisal has come in "low." At the appraised value, the purchasers do not have enough cash to settle. How can this happen in Montgomery County? You have a good contract with qualified purchasers; what is the matter with that appraiser?

Recently, this scenario is becoming the norm and not the exception. The important thing to understand is that there is something that you as the agent can do about it. Realtors® can best help minimize this situation by understanding the fundamentals of the appraisal process. Unfortunately, there is a general lack of understanding of the process and procedures involved in providing a residential appraisal in today's market.

Understanding the basics

It is the appraiser's responsibility to "reflect the market" as of the time he is performing the appraisal on the subject property. This really means that the appraiser isolates the property, as with a "snapshot" and estimates its value at a specific point in time. The appraiser is neither expected to project into the future nor is he expected to utilize data that is considered history in order to estimate the value as of the date of that snapshot.

Based on this premise, the appraiser's evaluation is only as good as the comparables that are available for analysis under prescribed procedures and guidelines. From the comparables, the appraiser must derive a market value. Fortunately, the interpretation of market value is one of the few definitions which the real estate industry, the lending industry and the appraisal industry agree upon. It is, therefore, worth providing the definition of market value by which, ideally, all appraisals should be rendered:

> **Market value**
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> Market value is the most probable price in cash, terms equivalent to cash, or in other precisely revealed terms for which the appraised property will sell in a competitive market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably and for self-interest, and assuming that neither is under undue duress.

Fundamental assumptions and conditions presumed in this definition are:

1. Buyer and seller are motivated by self-interest.
2. Buyer and seller are well informed and are acting prudently.
3. The property is exposed for a reasonable time on the open market.
4. Payment is made in cash, its equivalent or in specified financing terms.
5. Specified financing, if any, may be the financing actually in place or on terms generally available for the property type in its locale on the effective appraisal date.

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6. The effect, if any, on the amount of market value of atypical financing, services or fees shall be clearly and precisely revealed in the appraisal report.

Deviations from these six factors can cause a "low" appraisal.

It is truly the appraiser's responsibility to interpret any undue influences on true market value in order to accurately reflect "true cash value." There are circumstances which may cause a sale to be at less than market, such as the result of divorce proceedings, bankruptcy or relocation. The appraiser may determine that such sales are not really reflective of value and will not use them as comparables.

Conversely, some sales transactions may be artificially high due to considerations such as seller contributions to the buyer's costs or expenses or the inclusion of personal property in the transaction. The appraiser must adjust the price of these comparable sales to reflect the actual cash value for the real estate involved.

The best defense is a good offense

Don't wait until the appraiser shows up to deal with the whole issue of which sales are comparable and which are not. For the most part, the appraiser uses the same data base (i.e., MLS) that Realtors® use. The information used in the appraisal is gleaned from the MLS print-out and from any information that is provided by a Realtor® involved in a particular transaction. That means that the appraiser has to analyze numerous sales in order to select the three minimum required sales (in many cases up to six comparables) per appraisal.

This requires the appraiser to call the listing agents involved in those transactions whenever possible or necessary. If nothing else is provided, the appraiser will use and depend on the information that is provided in the MLS, plus a visual inspection of the exterior of the property.

This is why accurate information provided by the Realtor® is absolutely critical to make certain that the transaction being utilized is reflective of the current market. If there are circumstances which are unique or unusual, as discussed earlier, then the informed appraiser should be aware of them and evaluate accordingly.

In a difficult area or in a "soft market," Realtors® comparables and related explanations and information with regard to the condition of a property (e.g., perhaps it was a former rental property in disrepair; the fact that there was an addition which was not readily visible from the street nor mentioned in the MLS comments; or the quality of the lower level finish being inferior because the homeowner attempted to do the job himself and didn't do a job commensurate with others in the neighborhood, etc.) are especially welcome.

There has to be a balance, though, when providing information or suggesting comparables to be used. Generally, common sense prevails. For example, when appraising a custom home in Burtonsville, suggesting that comparables be selected from the heart of Potomac, "because they are the only ones with similar quality construction," is not something a professional appraiser can use nor a lender accept.

It is incumbent upon the appraiser to find comparable sales which are most similar in style, size and utility which have sold recently and are closest in proximity to the subject property in order to reflect the current market in that neighborhood. We are ethically bound to regard all data even if it means undermining the transaction. The days of the rubber stamp appraisals are gone.

Never doubt for a minute that the appraisal business is an opinion process which can be subjective. But there are perimeters which require appraisers to meet minimum requirements and standards in order to perform an appraisal in today's market.

Lenders play a crucial role in the appraisal process

Always remember the golden rule of lending, "He who has the gold makes the rules!" It is important for the active Realtor® to also have an in-depth understanding of lenders and their rules and regulations with regard to appraisals.

The type of loan has little or nothing to do with the appraisal and how it is performed. The minimum threshold that is uniformly accepted with regard to appraisal practices and guidelines has been established by the secondary market players, Fannie Mae (FNMA) or Freddie Mac (FHLMC). They deal with such things as comparables, adjustments, financing concessions and most other generally accepted rules of the appraisal process.

The problems that appraisers are experiencing in the market today, however, are related to the fact that lenders and their investors have the right to set different (and usually more stringent) conditions with regard to the appraisals and what is considered acceptable in their judgement.

Many of the investors who are making money available in our marketplace come from outside this area and have their own bias with regard to what they consider to be an acceptable rate of appreciation or an appropriate land value or the acceptable distance between a subject property and a comparable.

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The secondary market has established appraisal guidelines. These guidelines can be exceeded by the appraiser in certain cases with proper explanation. The lender, in his wisdom, may decide that even with the appraiser's explanation, certain procedures or applications will not be acceptable. For example, the issue of appreciation is hard to sell to any investor in a slow market. But there are cases easily demonstrated in our market, particularly in the outer suburbs or in the affordable markets, where prices are still going up.

There are local lenders that literally will not accept an appraisal with an appreciation adjustment regardless of the circumstances. This is somewhat of an untenable position for the appraiser in that it is his professional responsibility to report anything that affects the value of the subject property. The lender, however, in an effort to be conservative and in that way offer a very competitive rate, may decide to minimize the risk involved with reported appreciation which may not be realistic.

Please understand that the lenders have a right to be concerned due to the instability in the market place and because of appraisal abuses that have been rampant in some parts of the country. Unfortunately, this mentality then often permeates any market in which that lender may be doing business.

Most lenders in the market place today have a bevy of investors to whom they sell their loans, each of whom may have his own idiosyncrasies or requirements with regard to the appraisal process. There are other lenders who are locally based and who have the ability to portfolio a loan and not sell it in the secondary market. This generally allows greater flexibility in underwriting guidelines with regard to appraisals.

How to handle an appeal of a conventional appraisal.

I will share with you my recommendation for handling a residential appraisal appeal. Initially, the request has to come via the appraiser's client who, in most cases, is the lender who has been asked to generate a loan.

At the client's request, the appraiser will discuss with the Realtor® involved any additional information or relevant and acceptable comparables that were not initially considered. It should be noted here that a copy of our appraisal is not available to the Realtor® unless it is procured from the lender directly.

The appraiser will at that point analyze the additional comparables which will more than likely entail an additional trip in the field to view the comparable and talking to the agents involved in that transaction. The guidelines alluded to earlier in this article have to be adhered to and the comparables provided would have to be considered better in the appraiser's judgement than the ones used initially before they are used in lieu of those originally provided by the appraiser.

It is at this point that the appraiser will make every effort to discover, through agent contact or through other means available, items or issues of significance regarding the new comparable sale and not necessarily defined within MLS information. This might be something such as the difference in size or condition or a sale under duress, etc.

It is certainly plausible that the appraiser could have missed some very relevant information that would have an impact on the ultimate value conclusion. Appraisers have absolutely no motivation to intentionally "kill" a deal based on value. It is merely the appraiser's responsibility to report the value, under the prescribed guidelines, as he sees it, good or bad.

It is important to understand in any appeal process that the additional information provided cannot be speculative in nature and must be verifiable by some source. For instance, appraisers are regularly referred to the FISBO that sold in the neighborhood that would support the sale price of the subject property. That information would have to be confirmed by a seller or purchaser in direct contact with the appraiser.

In some instances, I have requested and received copies of settlement sheets and have had direct conversation with one or both of the parties involved in the transaction. This is then considered an acceptable comparable which can be utilized in an appraisal.

I regularly suggest to people who are unhappy with an opinion to seek a second opinion. This is relatively inexpensive. But be careful, not all appraisers are qualified and approved to do work for all lenders. Check with the lender to determine who else is on his approved list and determine if a second opinion/appraisal is an acceptable technique.

Condition problems

Another common reason for "low" appraisals is the condition of the subject property. Appraisers are really experts in the field of estimating value only. There are many situations that an appraiser runs into during the course of performing his duties that exceed his experience or expertise and should be the responsibility of a third party expert to make a determination.

This could be in the areas of major components of the house such as roof, wet basements, electrical system or appliances, etc. The value that appraisers estimate is typically rendered "as-is" as of the date of inspection. If there is work to be done as a part of the contractual provisions then the ppraisal can be made subject to that work being done.

If, however, there is a situation where the seller is selling the property as is, and it is truly a "fixer-upper," there may be conditions that are considered unacceptable to the lender which translates into the property being rated in below average condition. Average condition will vary by different areas and neighborhoods and should reflect what is considered the norm for the immediate market area of the subject.

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A good example of what will generate a "low" value is when tenant property is sold and reflects deferred maintenance which has accumulated over the years and which translates into the property being in need of things such as interior and exterior painting, replacement of carpets, thorough cleaning and a site that needs extensive grooming.

Any or all of these conditions will have an adverse effect on the value of the subject property if, in the appraiser's opinion, the relative condition is below what is considered average for the neighborhood.

Unfortunately, there are circumstances where the seller does not intend to do any further work on the property and the purchaser is not able to perform any work until such time as settlement has been made. The "as is" value is then made based on the work still needing to be done. This does not constitute a "low" appraisal. It does reflect the value of the property in need of work. At the time this work is completed the value could be adjusted accordingly.

As a Realtor® it is in your best interest to avoid the pitfalls of an appraisal that does not meet the buyer's financing needs. A straight-forward approach to establishing a sales price without extraordinary seller concessions and an honest effort to recognize and deal with problems within the property to be marketed will keep trauma out of the emotional transaction of buying a home.

The real estate appraiser of today and tomorrow will continue to maintain the high professional and ethical standards necessary to assure a responsible appraisal of a property.

Even in a fluctuating market, real estate and financing professionals can sustain a partnership of cooperation that will encourage the growth of trust and continue to assure the confidence of the public.

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