

Some Insights into the Appraisal Process, and Maybe Save a Deal!

by Chuck Minzenberger, SRA

We've all been there, we worked diligently to bring a deal together only to have it all derailed by a "low" appraisal. Brokers, buyers and sellers must face this fact and adjust accordingly. Most often the contract price is simply not supportable, however, there may be errors or omissions in the appraisal which result in an incorrect value opinion, it is my hope this article provides insight into the appraisal process and help rescue the deal if it can be saved.

First, the appraisal may be correct, read the appraisal objectively, are the sales chosen the best or reasonably good Comps? Are the adjustments reasonable and well supported? Is the neighborhood adequately described and well defined? Has the market conditions been adequately analyzed? If these issues are properly addressed, chances are the appraisal file is accurate.



There are a host of reasons why a buyer would be willing to over-pay for a home. For example, the buyer has lost out on a bidding war or two and is exhausted with the process, now they must buy something quickly, scrambling for a to live, they are under duress. When interest rates are at historic lows a buyer may be in a rush to buy before the rates inevitably rise; the sales price is a secondary consideration to the monthly payment. A property may be perfect for a specific buyer with features that appeal to a limited market, they are willing to pay more than a typical buyer. An affluent buyer is willing to pay above market value, to them the time lost looking for alternatives has more value. The buyer is highly motivated and shopping at a time when there are limited homes on the market - simple supply and demand. Let's not avoid the fact that buyers can overpay simply because they are not well informed, or the listing was over-priced at the onset and the listing broker just got lucky – the list can go on. We've all encountered one or more of these scenarios.

Please trust me when I say it's no fun for the appraiser when the contract price is not supportable. As appraisers we are acutely aware of the time and effort brokers put into bringing a deal together, when brokers truly believe the contract price is at market value, they are shocked the home did not appraise at or above contract price. When the value is simply not supportable it is a bit of a gut-punch for the appraiser as well. After all, who wants to submit a report that is guaranteed to anger a client? Appraisers hear complaints and threats from lenders, brokers and sometimes buyers and sellers.

Obviously it's preferable for the home appraise at or above the contract price at the onset, it's best to price the home competitively to match the current market conditions, a correctly priced home generally sells in a short period of time at or just above market value. An over-priced listing lingers on the market, the listing grows stale leaving the impression there's something wrong with the house, these listings tend to sell below market value.

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Brokers and appraisers play important roles in the process of buying or selling a home, it is critical that we cooperate. Some brokers believe that they are prohibited from communicating with an appraiser, this is false. We can discuss anything under the sun except the Value and the actual *Appraisal Report*. In fact, appraisers depend on brokers for insight into the local market. I often send inquiries to brokers requesting information on a sale. Thankfully, most brokers respond in a timely manner, often with some great information that can sway my opinion. The key takeaway is Appraisers and Brokers can discuss just about anything except the Value.

Brokers should feel comfortable supplying any information they feel is relevant, you've worked hard to bring buyer and seller together, we get it, but please, do not 'sell' us the home. Rather than 'selling' us the house, just focus on unique aspects of the home or neighborhood, recent repairs, updates, renovations and appealing amenities. Good brokers are tuned-in to their local market and know what drives value, first-hand knowledge or insight can and often does sway an appraiser's opinion. Brokers should be open, honest, and as objective as possible when sharing information, providing listing sheets with comments can be very helpful. Accurate data and good communication help the appraiser arrive at an opinion of value that accurately reflects the fair market value of a home. After all the goal is to protect the buyers and lenders – the public.

Some brokers believe if a buyer is willing to pay and the seller is willing to accept at a certain price, this equates to market value - this is a half-truth. Willingness to buy/sell only paints part of the picture. In addition, both parties must also be well informed, be acting in their own best interest, and not be under duress. Homes often sell with no exposure to the open market, either as a 'pocket-listing' or in private networks. A critical component to market value is exposure to the open market, observing how the market participants react to a listing is an important piece in estimating market value. Without all puzzle pieces more emphasis needs to be placed on the remaining pieces, be prepared to fill in the gaps for the appraiser. I always ask the buyer's broker for some sales or a CMA [comparative market analysis], many times they have not prepared one, in this case it is questionable whether their client is well informed. If the parties appear to be under duress, are not well informed and the listing had no market exposure, an opinion of market value that is below the contract price should not be a surprise.

It is best to meet the appraiser at the property, this way you can answer questions and point out unique features of the property, recent updates and/or repairs. I always ask for a list of recent repairs/updates along with dates, sales to consider, and always ask about other offers and number of showings. This helps me understand how the house was priced, market reactions to the listing as well as a myriad of other insights. I have heard stories that some appraisers refuse to take information from the broker, this behavior reflects badly on the appraisal profession, in fact this is bad appraisal practice.

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It's good practice to ask the appraiser how well they know the area, there's no need to be confrontational, a casual conversation about the area followed by a simple question, do you work in this area often? Most good agents will sense right away if the appraiser is not familiar with the area. Competency is required by USPAP [Uniform Standards of Professional Appraisal Practice – these are appraiser's rules like the Brokers Code of Ethics], knowing the market area is key to Competency.

OK, so you've met the appraiser, provided all the relevant information and a week later the Value Opinion comes in below the contract price; ironically, sometimes this is not a surprise to the brokers, sellers or buyers. If this is the case, renegotiate the contract. While this may upset the seller, the buyer saved some money and paid market value for the home, as a buyer's agent you are a hero. If you believe the contract price is supportable, at this point it is critical you understand the appraisal report is a confidential document with a specific intended use and intended user[s]. Due to Confidentiality rules dictated by USPAP, appraisers can't discuss the appraisal file with anyone but their client. However, the buyer is entitled to a copy of the appraisal file, in fact the lender is required to provide a copy at no additional cost. Reading the report is highly recommended even if the value opinion supports the contract price; it's shocking to me many don't read the file. After reviewing the appraisal you believe the appraiser did not consider critical information about the subject property and/or omitted some relevant sales, discuss the matter with the lender. Do not call or email the Appraiser, again, we are not permitted to discuss the file. Concerns should be sent to the lender like errors in the report and/or alternative sales you'd like to be considered. If the lender believes the concerns have merit, they will pass those along to the appraiser. The appraiser is required to address these concerns and will generally provide a dated response in the addendum of the report. This can result in corrections and/or a change in the appraisal. If the concerns do have merit and a good comparable was missed, a sale or two can be added to the report and the value opinion revised, however, a revised report may or may not result in a change in the value opinion.

Brokers should be aware how Appraisers reach a value opinion. Appraisal reports are lengthy, but the meat and potatoes of the file can be broken down into four main categories: market analysis, comparable sales selection, applying supportable adjustment and reconciliation, it's best to focus on these areas. To over-simplify, we consider the relevant Elements of Comparison, choose sales that are most like the subject, the salient features, make the adjustments [if necessary and supportable], and do the math. If we are lucky we find 2-3 good sales that required minimal adjustments to support our value opinion.

Pending sales and active listings are also considered in the analysis, especially in a declining market [*Principle of Substitution* - the principle that states when several similar or commensurate commodities, goods, or services are available, the one with the lowest price will attract the greatest demand, this is the primary principle upon which the cost

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and sales comparison approaches are based]. When the best comparable sales available do not support the contract price, the appraiser has no choice but to value the home below the contract price.

So, what are important Elements of Comparison? It can be frustrating, the most common response an appraiser will give to just about any question is, "it depends." One thing that is not an element of comparison - sale price. Sale price is the result of the market's reaction to the elements of comparison. Look at an appraisal report grid, the elements are on the left side [Location, Site, Design, Quality, etc.]. Agents often pick their "Comps" based on the sale price, these sales may or may not be good Comps, more often they are not.

Not all markets are the same, an element may have a dramatic impact on value in one market area and have a minimal impact in another. Good brokers know what their clients prefer and when they are willing to pay a premium, good appraisers are also acutely aware of what drives values in a specific area. It's imperative the broker submit comparable sales for consideration that are truly similar to the subject, otherwise the alternative sales are very easily dismissed by the appraiser.

The purpose of this article is to make you aware of the appraiser's thought process, and to help you formulate a reasonable rebuttal to a faulty appraisal report; and maybe rescue a deal. Consider the elements of comparison for any alternative sale you present, then compare them to your subject. Is your subject superior or inferior? What effect do these differences have on value? If you present a sale that is superior to your listing, but sold very close to or at your listing's contract price, you just provided support for the appraiser's opinion, this can be embarrassing for the broker and does nothing to advance your case.

It must be said most appraisers will gladly amend their value opinion if presented with compelling evidence to do so. If the appraisal report was faulty it can easily be corrected, but the correct protocol must be followed. We all make mistakes, and we all want the transaction to go smoothly.

In short, what do buyers expect in the specific market area for their hard-earned dollars? Most areas have a wide value range and variety of housing choices. Each submarket may have its own elements that drive value. The best comparable sales are selected from the specific submarket. Bottom line, do your homework, be well informed and guide your clients, in the end they will be appreciative. The fallout from a 'low' appraisal can be devastating to a deal, the fallout from an inflated appraisal can be devastating to a homeowner/buyer, we all saw what happened in 2008-09, prices can go down and often eat up a down payment very quickly, an upside-down homeowner is stuck and unhappy.

If after submitting your rebuttal, alternative sales and your rationale as to why the contract price is supportable, and the appraiser will not budge, you can request a *Review*. There

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are two types, a *Desk Review* or a *Field Review*. In either case a second appraiser reviews the appraisal file for compliance. The review appraiser can agree or disagree with the value opinion. If they disagree the review appraiser will choose additional sales and/or do their own analysis of the sales used in the original appraisal. The review appraiser may disagree with the original value opinion, and then provide a value opinion that is lower than the original opinion, it's a possibility. The *Review* always involves an additional fee as the second appraiser must be compensated for their time. You can always order a new appraisal, however, this requires a new fee to a third appraiser, a loss of time, and may result in the same outcome. On high value homes the lender will often order two or three appraisals and review all files at once. If the Appraisers are skilled the value opinions will be very close, say within 2-3%, however, the comparable sales and the analysis may be slightly different, after all, it is just an Opinion.

It should be shouted from the mountain-top, the appraiser is not the only professional touching the report. Review appraiser[s], underwriter[s] and investor[s] read the file, and most are sent off to the Government Sponsored Entities [GSEs] to be securitized further. We also must follow guidelines set by the GSEs, the selling guides are hundreds of pages long with laundry lists of rules and regulations, any additional client requirements must also be honored – it's a thin line to walk.

Lastly, the oneness is on the appraiser to write a well-organized report that can stand up to scrutiny, after all, the other parties reviewing report do not know the area and certainly have not viewed the property, it is our job to show them they are making a sound investment. We are on the hook for 5 years after the effective date of the appraisal, on occasion reports come back several years later with questions, it's understandable why the appraiser relies on solid methods and practices in developing a solid well supported value opinion, otherwise, we risk the loss of license. Careers can be lost over a bad appraisal or two. While it is the broker's job to put the subject in the best light and sell the home at the highest price, it's the appraiser's job to ensure the property is selling reasonably close to market value.

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As a side note, many of the 'rules' you hear about such as, sales must have closed within the past six months and be within a mile radius of the subject, etc. are specific client/lender/investor requirements, overlays and assignment conditions; some engagement letters and lists of appraisal requirements can be shockingly lengthy. This subject is far too complex to address in this article, just be aware the appraiser is free to choose what they believe to be the best comparable sales, it is only an opinion after all. A well written reconciliation is critical when the appraiser selects sales they feel are the best but are outside the lender's perimeters. We generally get significant resistance from the lender/client when the opinion of value appears aggressive, however, good appraisers are willing to push-back if they have presented a well written report and well supported value opinion; I for one stand by my work product.

Here are some brief examples as food for thought:

- Be wary of making unsupported assumptions. Some believe a condo unit on a higher floor is worth more. Builders often build this into their pricing and people pay it without question. This premium tends to dissipate in the resale market; the builder's "price" often does not reflect market value. The real element of comparison in this case is the view, not the floor level, there is no rule of thumb.
- Be wary of adjusting twice, or 'double-dipping' for related elements of comparison. Brokers will often site a larger lot as having a significant impact on value. While this may be true on occasion, it's generally not supportable after closer consideration. In high value areas where land is scarce builders tend to build the largest home allowed. If two sites are 2750 sf and 3600 sf and the zoning is the same the builder will construct a larger house on the larger site, the value difference is reflected in the house size not the land, not both. Just because a site is bigger doesn't necessarily equate to a higher value. The extra land may have no practical use, well-informed buyers generally do not pay extra for something they can't use or enjoy. Also, larger site may mean higher taxes.
- Two homes of similar size, age and bed/bath count may seem comparable, however, one home does not have a master bath. In most areas this is a significant difference in functionality, appeal and value. Some buyers will not consider a home without a master suite. It is critical the broker uses their local knowledge as they consider the relevant elements of comparison.
- Is there a big difference between a 3-Car and 4-Car garage? It depends on the market area, if there is a difference be prepared to support it. How about a home with no onsite parking? This certainly impacts value and marketability, some buyers would not consider this house, even if it meets all other needs.
- It's not uncommon for an owner to over-spend on a renovation, installing fixtures and finishes that go well beyond what a typical buyer in that area is willing to pay, in appraisal-speak this is called super-adequacy, and is a form of depreciation, cost does not equal value.

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- Be wary of \$/square foot. Many brokers price their listings this way, this is a big mistake. This is a simple calculation of the sale price divided by the above grade living area, this asserts there is no value in any other features of the home. In areas where site values are very high you can see how this simple calculation can be very misleading. A 900 sf condo with a spectacular water view will obviously have a higher \$/square foot than a unit with a city view. The best comparable shares most features with the subject, small differences in living area usually do not have an impact on value.

As a Broker please be aware:

- Many Lenders and AMCs specifically forbid appraisers from discussing things like driving distance to the home, appraisal fees, mortgage rates and even comparable selection. This is one of the many downsides having an AMC involved, so if the appraiser simply says they can't discuss issues due to client assignment instructions please understand.
- The appraiser is engaged on the buy-side, as the seller's agent you have no say in who appraises the home, but if you sense the appraiser was not familiar with the area alert the buyer's agent.
- Since the housing downturn in 2008-09 most appraisers are hired through Appraisal Management Companies [AMCs]. This issue is far too complex to address in this article, and frankly, has been a big problem for the appraisal industry, but be aware some AMCs send appraisers to areas that they are not familiar with simply because they offered the lowest fee, again, if you sense the appraiser does not know the area simply alert the buyer's agent.
- In this new age of Hybrid/Bifurcated Appraisal Reports, the person inspecting the home is likely not an Appraiser. This new style of report was approved by the GSEs in the Spring of 2022, the process is still being tested, since approval over half the loans purchased by the GSEs were appraised this way.
- To protect your client, always get a business card, if there are problems with the appraisal this heads-up to the buyer's broker may be helpful down the road.