

Real Estate Reality

Low Appraisal Values Becoming More Common in This Market



-Debbie Yost

Low appraisal values are more common in today's real estate market than anyone cares to admit. Since few buyers pay cash for a home, an acceptable appraisal is one of the key requirements necessary for a lender to approve a mortgage loan. The other main requirements include demonstrating that the buyer is credit worthy and has the income necessary to repay the loan, as well as insurable title. The standard Arizona Association of Realtors purchase contract, which is used for the majority of existing home sales in Arizona states that the sale is contingent upon an appraisal which is acceptable to the lender being equal to or greater than the sales price.

Property values have increased so dramatically during the past year that appraisers are scrambling to justify sales prices. It's easy to point a finger at the appraiser when an appraisal value comes in low. However, the appraiser isn't the bad guy. Most of them are working harder than ever to locate recent sales comparables to document rapidly rising market values.

Let's look at an example of a situation happening frequently in today's real estate market. An owner places a home on the market for sale. The market value is determined by the price a willing and able buyer offers to pay for that home, and the price the seller is willing to accept. It's a simple matter of supply and demand. In this market sellers are electing to price property higher than other pending sales, because they correctly assume that buyers who are eager to find an acceptable property may outbid each other. After the buyer and seller agree on the price and terms the lender begins the loan approval process and orders the appraisal from a list of certified appraisers, in order to determine whether there is significant collateral for the mortgage amount.

According to Debbie Talleri, appraiser and owner of Arizona Residential Appraisal (www.ARAAZ.com), the appraisal is a "thought process leading to an opinion of value. This is a formal process that typically uses three common approaches to value." The appraiser performs an inspection of the property to measure size, note amenities and upgrades, and determine that it is in acceptable condition. The most common of the three approaches includes comparing the subject property to at least three recent comparable sales. If the sales data is available, the appraiser must base their research on closed sales in the same neighborhood, not on pending sales. "In a trending market (rapidly rising or declining market) pending sales can be used as additional information to demonstrate trends, and clearly, the market is ahead of comparable sales," states Ms. Talleri.

Appraisers use "generally accepted appraisal guidelines" which offer suggestions for making monetary adjustments to the subject property's value based on size, age, condition, location, lot size, and upgrades such as pools, extensive landscaping or patio improvements, upgraded kitchens, oversized garages, etc. These preferred appraisal guidelines use sales within a 1 mile radius, no older

than six months of similar square footage, age, and architectural type. In this rapidly increasing market, there may be closed sales in the same neighborhood that won't justify the sales price of the subject property. According to Ms. Talleri, if there is a compelling reason, the appraiser may choose to use sales outside that one mile radius to validate the sales price on the subject. Or they may choose to follow the preferred guidelines which may result in an appraisal value lower than the agreed upon sales price. This generally results in a problem because it occurs usually just days or weeks prior to the scheduled closing and moving day.

When this occurs, tensions build as the buyer, seller, loan officer and Realtor attempt to resolve the problem. Many times the buyer has waived the appraisal contingency in the contract, and will be required to pay the difference between the appraised value and the sales price in cash. If this is a small sum of money most buyers will pay the difference in cash. However in the case of a large difference between the sales price and appraisal value, this can create both an unwanted surprise and fear in the buyer's mind of overpaying for the property. If the difference is significant (and I've recently heard of appraisals coming in \$40,000 to \$50,000 below the sales price) the buyer may consider not closing and may forfeit their earnest money deposit. Typically the listing broker will research additional comparable sales to submit to the lender and appraiser in an effort to have the appraisal value adjusted.

Continued on next page.



If the appraiser uses sales outside the immediate neighborhood to justify the sales price the loan underwriter may not accept the appraisal. The underwriter has the responsibility to review the complete loan package, which includes not only the appraisal but also the buyer's credit worthiness and their ability to repay the loan. While everyone involved in the sale typically gets irritated with the underwriter, it's truly their responsibility to determine whether the loan is a good risk.

Many times the underwriter will reject the appraisal value when the buyer has little or no money of their own invested in the purchase. If the buyer is using 100% or higher financing, they may finance the entire purchase price and possibly all of the closing costs. In the case of an investor purchasing a home they plan to lease, the underwriter may view a small cash investment as a risk of possible future default. Perhaps the buyer is using an interest only loan to keep their payments low. The buyer may be so highly leveraged that they may be forced to default if they meet some unexpected financial setback. Perhaps the buyer's credit score is not "golden." The underwriter must weigh all the information provided as they evaluate the loan from a risk perspective. If the appraisal is completed using comparable sales outside those "preferred guidelines" (most often outside the immediate neighborhood) this will raise a red flag for the underwriter when evaluating the loan package, and if there are any other factors (lower credit score, minimal or no down payment) the appraisal may be the item used as the reason for not approving the loan.

In the excitement of the buyer finding the perfect house and the seller's glee at selling for top market value, no one wants to hear about these possible issues that can arise at the last moment before closing. Unfortunately, this situation is occurring more and more frequently and everyone wants to point the finger at the appraiser as being the bad guy. Seldom is the problem only the appraisal. Usually the loan package as a whole is not as perfect as it could be and the appraised value of the collateral securing the loan is the easiest item to use as an excuse for not approving the loan as submitted. If the sales price is reduced, the buyer contributes more cash or is willing to pay a higher interest rate on the loan; the underwriter has approved a more lucrative loan. In a highly appreciating market, lenders will scrutinize loan packages very carefully and in situations where the buyer is investing very little cash, lenders will be more reluctant to accept appraisals that don't utilize the suggested guidelines. 🏠

Debbie Yost, CLHMS, CRS, GRI is the Broker/Owner of RE/MAX of Casa Grande. She can be reached at Debbie@YostHomes.com.