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The Trouble with Appraisals

What is it about a bank appraisal that the average person finds so authoritative?

Is this status deserved...or not?

Consider this scenario. A homeowner meets with three Realtors for a price opinion. Let's say his property is worth \$1 million, and all three agents assess its value close to that number, using recent comparable sales as rationale. But the homeowner just refinanced. He pulls out an appraisal from ABC Bank dated last month that valued his property at \$1.3 million. There's no question in his mind that the agents are wrong and the bank is right – and not just because the bank's number is higher. After all, what the Realtors say is just their opinion. A bank appraisal is official. Right?

Not so fast.

The purpose of an appraisal is to value property, for several reasons. First is when buying a new home, so the lender can confirm the property is worth what you're paying for it before approving your mortgage. Second is when refinancing your current home, for the same reason. Third is when applying for a home equity line of credit, so the lender can determine the size of the equity line it will grant based on the value of your property minus outstanding mortgages. Appraisals are also used in divorce and estate settlements.

There are good reasons why an appraisal may seem more official than an agent's price opinion. First, appraisers are state licensed in this specialty area. Second, appraisal is a more quantitative process than the comparative market analysis or CMA that agents provide. Whereas CMA is a "soft" analysis – based on qualitative comparison to similar recently-sold properties – an appraisal

is more mathematical, with specific dollar deductions from a home's value for deficiencies versus recently sold comparable properties, and additions to value for aspects that are superior. At least in theory.

Unfortunately, despite the public's reverence for appraisals, my experience is they're not all they're cracked up to be. Here are some recent real-life examples.

1. *A client to whom I sold a house five years ago called me in a panic, because an appraisal done in conjunction with a home equity line application valued his house at just about what he paid for it back in 2003.* I assured him this could not be true. When I looked at the appraisal, the comparables used to value his house were not appropriate. I could easily debunk all five comps that the appraiser used, and I just as easily identified six comps that the appraiser should have used instead. Bottom line, a big-name bank appraised my client's property at least \$200K lower than it would bring in the current market.

2. *A friend had a similar experience with an appraisal from another big-name bank.* This time valuation was low by about \$300K, based on comps selected by an appraiser who clearly did not know our local market. It was only after I sent her to a mortgage broker who uses an appraiser with local market expertise, that her house was fairly valued.

3. *A homeowner with land to sell in Greens Farms was confident her property was worth \$2 million, based on a recent bank appraisal.* When I looked at it, I could not agree – and neither could the builders she talked to. Although it was a lovely, well-located parcel, it had significant wetlands which limited what could be built on it. Also, the land was subject to 2-acre setbacks even though it was only 1.6 acres, so its future use was even more limited – and its value further reduced. The appraisal did not address either of these important issues. Imagine how the owner felt when she sold her property for \$1 million less than the

appraisal had led her to believe it was worth.

4. *While answering phones at my office, a woman stopped in who identified herself as an appraiser from Rhode Island sent here to value a local property.* She asked for my help identifying comps. When questioned, she admitted that she never appraised a property here before...that she was unfamiliar with our local market...and that she did not have access to the local multiple listing service. I declined to help her, stating that she had no business doing an appraisal under those circumstances. I pitied the poor property owners whose lender arranged for Out-of-Town Sally to value their house, because there's no way she could possibly do so.

Appraisals are serious business. They are used to make decisions involving large sums of money. And a concerning high percentage of them are not worth the paper they're printed on.

There are really good appraisers out there. But, as the preceding examples show, there are some really bad ones. It's hard to know what you're getting.

The moral of this story is to be careful how much stock you put into appraisals. If they serve your purpose, fine. But if those three Realtors from the anecdote at the beginning of this column disagree with your bank appraisal, I think you would be wiser to listen to them instead.

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