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“Appraising in an Overheated Market”

Special Guest Article by Melanie J. McLane, RAYAC Real Estate School Instructor

To call the market ‘overheated’ is not, for most of us, an exaggeration. 2020, with all its twists and turns, has brought us a very robust real estate market. Whenever I talk to agents and other appraisers, in most markets the situation is the same: very limited supply and very large demand. This is leading, inevitably, to multiple offers above list price, and in some cases, appraised value being less than the negotiated sales price.

When the appraised value does not equal the contract price, many people are unhappy. The sellers are unhappy, because they had a contract at \$XXX,XXX, and made their plans, moving forward, based on selling the house for that amount. The listing agent is unhappy, because much of the time the buyer’s agent will use this opportunity to renegotiate the sales price. The buyer and buyer’s agent may see it as an opportunity to renegotiate, or they may both be of the opinion that the negotiated price is reasonable, in light of current market conditions. There may be another buyer waiting in the wings, and the current buyers and their agent may or may not know this. In my practice, when there are multiple offers, I often have one of the agents whose offer did not succeed ask me to let them know if for some reason the sale falls through.

When the appraised value is below the negotiated price, one of three things will typically happen:

- 1) The price is renegotiated, which may require the sellers coming down *and* the buyers bringing more money to closing, so each side gives a little.
- 2) The buyer is adamant and the seller refuses to sell at that price, and the sale falls apart.
- 3) The buyer agrees to ask the lender for a reconsideration of value (ROV).

If the financing is VA financing, you are in luck. All VA appraisals can be appealed. VA actually has something called “The Tidewater Initiative”, which requires appraisers who realize that their appraised value will not equal the negotiated sales price to alert the lender before they submit the report to VA. This gives the lender an opportunity to reach out to both agents, and ask them for comparable data.

A lender does not have to agree to a ROV request. The buyer (borrower) has to negotiate this with the lender, because they have a relationship.

Agents can and should assist their clients by reviewing the appraisal, and looking for several things:

- 1) **Incorrect Information.** Under Dodd-Frank, any errors in an appraisal **must** be corrected. So, if the appraiser transposed two numbers, and comp. #2 actually sold for \$297,000, not \$279,000, that must be corrected, and in this example, that would make a significant difference in the adjusted value of that comp.

- 2) **Comparables.** In their certifications and limiting conditions, appraisers state (#7): “I selected and used comparable sales that are physically, functionally and locationally the most similar to the subject property.” Is that correct? Are the sales as recent as possible? Are they in the same neighborhood or a competing neighborhood? Are they properties that the buyer of this property would have considered buying? If you find that there were better comparables not used in the appraisal, meaning: geographically closer, more recent, more similar, these should be presented to the lender with a request to have the appraiser review these comparables and comment on why they were not used, or possibly amend the report by using them.
- 3) **Adjustments.** The adjustments will generally be market-derived, as opposed to based on cost. So, an adjustment of \$1500 for a half bath does not mean you can install a half bath for that amount, it means that the typical purchaser, in this price range for this age and type of home, will typically pay \$1500 for a half bath. Are the adjustments consistent across the board? If not, they should be explained as to why they were not consistent. An example might be: “Although the subject property has a 2.5-acre site, only about .75 of an acre is flat and usable land, the balance is quite steep and not useful for gardening, play area, or additional buildings. So, although the comparables all have smaller sites, no adjustment was made because the usable area of the subject’s site compares with the site sizes of the comparables.” If there are inconsistent adjustments without an explanation, ask the lender to have the appraiser clarify this. Under Dodd-Frank, this is a very reasonable request to make of the appraiser.
- 4) **“Double Dipping.”** This is when the appraiser makes two adjustments for the same thing. An example could be a 2-bedroom home, where the appraiser adjusts for room count, and again for functional obsolescence, citing ‘it only has two bedrooms’. Again, have the lender point that out to the appraiser and ask if this was an error, or can they justify adjusting twice for this feature, or lack of a feature?
- 5) **How was the reconciliation done in the market approach?** In the market approach, the appraiser looks at the comparables used, and reconciles to one value. Most of the time, appraisers find that the comparable which required the least net and gross adjustments is the most reliable. If the reconciled value is to a comparable sale which required the most adjustments, that’s a logical question to ask the appraiser to explain.
- 6) **Is the appraisal logical?** Whether you agree with the appraiser’s opinion of value or not, it should be logical and make sense. At the end of the report, can you understand how the appraiser reached their conclusion? Examples of an illogical appraisal would include one where the indicated value of the subject property was lower than all the adjusted comparables, or had been reconciled to the lowest or highest adjusted comparable, which **also** required the greatest percentage of adjustments. The appraiser should be able to explain the logic of the reconciliation of the comparable sales data.

If the original appraiser reviews what is sent on, and still refuses to reconsider value, the borrower can ask the lender for an additional appraisal. Some lenders will do this. Some will not, but might change their minds when a borrower threatens to change lenders.

Finally, try to be proactive, not reactive.

If your market is very hot, provide an information packet for the appraiser. Include comparables you used, and comparables that may not be suitable, for a valid reason that may not be apparent in MLS. Example: “The sale at 123 Main St was handled by my office. It was a messy divorce, and the spouse occupying the house made showings almost impossible. They refused reasonable offers early on, and then were forced to sell quickly, at a lower price.” If you have multiple offers, share the details of them (without buyers’ names) with the appraiser in a grid, so the appraiser can see that you had several offers above list price, and which one the seller selected. This helps the appraiser realize this is not just an outlier, but a reflection of supply and demand in the market.

This article touches on some of the points of the CE class “Appraising in an Overheated Market.”

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