

COMMENTARY

Gary London >> COMMENTARY

Appraisers Going 'Light' on Home Values



In a real estate world of seemingly endless downward spiraling of housing prices, now emerges a staggering problem of sub-professional appraisals contributing to that decline.

I was alerted to what now appears to be a common problem by Realtor Don Rood who told me a story about a listing in the Sunset Cliffs area of San Diego.

After putting a home in escrow at an agreed upon, negotiated price between buyer and seller, the deal was torpedoed by a "poorly done appraisal, which ignored the fact that we had multiple buyers."

The appraiser took the path of least resistance, utilizing comparables that were the easiest to obtain, not necessarily the most accurate.

An appraiser's job is to offer an independent opinion of value. That is all it is — an opinion. Everyone in any given transaction has an opinion.

For the appraisal system to work in the marketplace, the opinion maker has to be competent, and has to do their job.

No Digging

In this deal the appraiser didn't dig. She didn't study the market, and she used the wrong comps, ignoring (or not knowing) that their condition was inferior (mediocre location, poorly maintained, different school district, no view).

The lender representative (for Wells Fargo Bank) suggested that this was occurring more frequently.

Says Rood: "In the old days, (a year ago) a lender had the ability to pick the appraiser." This is now handled by a service not connected to the deal dubbed the AMC, an acronym for an Appraisal Management Co.

Realtor Rood doesn't think that this is an exception. Nor apparently do prominent members of the appraisal community, who, when contacted by me, also weighed in on the issue.

One prominent local residential appraiser,

Sara Schwarzentraub, told me that "Some appraisers are incompetent, to be sure.

"AMCs send appraisers to San Diego from Orange or LA County, because they'll work cheap. They are, by and large, incompetent in our markets."

Incidentally, these AMC's take 40 percent or more of the appraisal fee, which has the practical effect of raising the cost of the appraisal and lowering the standards of the appraiser who will work for a lower fee (his or her remaining share).

However, Schwarzentraub also suggested a more balanced view: "Many negotiated sale prices are just above current market indicators. Property prices are still dropping in many markets, and sometimes the brokers, buyers and sellers aren't as tuned in as the appraisers.

"We have a new 1004MC (the Fannie Mae Market Conditions Addendum) that requires loan appraisers to examine market trends more closely, including looking at absorption, something most have not done before.

In short, they are getting a clearer picture of what is going on in the market."

New Appraisal Guidelines

The biggest event in the residential appraisal business is what is called the "HVCC" (the Home Valuation Code of Conduct), a guideline now followed by Fannie Mae, Freddie Mac and the Office of Federal Housing Enterprise Oversight, which changes how appraisals are processed in the mortgage industry.

The HVCC just took effect on May 1, dictating new rules in ordering appraisals, and in particular, outlining strict rules of independence so that they are not unduly influenced by people in the deal, including the lenders or mortgage brokers.

However, I read nothing in the HVCC that suggests that the appraiser not do their job, which should include interviewing the "players" in the market, such as realtors.

In fact, to not go into the field and review the comparables, to not talk to the people most knowledgeable, is tantamount to not doing their job.

The point is, an appraiser should have the ability to do their job, such as interviewing knowledgeable people in the market, and still maintain their independence.

What happens when you don't do your homework? Well, the result is what we have, too many inaccurate appraisals.

After all, if a willing buyer and seller agree to a deal, who is the appraiser to sabotage the deal?

Valuing Light

Here is one possible explanation: the lenders have taken a big hit in the market, and now they want to be protected, and the AMC's and appraisers know it. Whether explicit (this is against the HVCC) or implicit (which isn't) appraisers know that this is a risk adverse lending environment.

Lenders are probably not pressuring appraisers to come in "light" on value. But in a peculiar way, it makes sense if they do. If the appraiser values light, it means that the seller must drop the price or the buyer must come up with a higher down payment.

Both scenarios protect the lender. But they also contribute to the continued downturn in the market.

"Short" appraisals are a problem right now and will continue to be until a more stable market environment is achieved.

The very existence of the short appraisal, however, delays the stability.

So, in an effort to prevent the obvious abuse during the market run up from 2003 to 2005, when too many people cheated to get a deal to close, the HVCC has overcompensated.

Independence is a good thing. But it should not be an excuse for incompetence.

The appraiser needs to be able to do his job and needs to know how to do it. They need to enter the house. They need to communicate with the listing agent.

Says Rood, "In this case we had two offers at the price. The appraiser didn't know that because she never talked to me."

Gary H. London is president of The London Group Realty Advisors, which provides real estate consulting and economic analysis. Check him out on the Web at londongroup.com.

Gary F. Terry >> COMMENTARY

Don't Be Caught Holding a Financial Time Bomb

Bob's doctor just told him he had advanced Lyme disease. He would be disabled — indefinitely. Bob's financial time bomb was about to explode!

Bob, 48, was an executive making \$700,000 — \$400,000 base salary and \$300,000 bonus.

There's no cure for the disease and his doctor advised him that the condition would make it impossible for him to handle the mental demands his job placed on him.

Bob also knew his employer had a disability insurance plan and recalled reading something about it covering 60 percent of his income. With such protection, he wasn't overly concerned with the financial implications of his disability. Even so, he and his wife, Carolyn, scheduled a meeting with the human resources director.

When they sat down with the HR director to discuss the process of initiating the disability insurance benefit, they assumed that they would receive a benefit based on 60 percent of his compensation, or \$420,000.

It came as a shock when the HR director explained just how the plan worked. She indicated that the benefit's limited to 60 percent of Bob's base salary, with a maximum of \$20,000 monthly. Based on the provisions of the plan, Bob was entitled to a \$240,000 yearly benefit.

The irony is that even if someone recognized what would happen if executives were disabled, there would have been little that could be done to change the outcome. In most instances, their income is inadequately protected. This may seem negligent, particularly when the largest financial exposure an individual faces is the inability to earn an income due to a long-term disability caused by accident or illness.

Limitations

The causes of the problem are two serious limitations of employers' group disability insurance plans.

First, the benefit formula for most corporate group disability plans protects the base salary only and leaves bonus income exposed.

Second, the maximum monthly benefit caps are essentially the same as they were 15 years ago, although incomes have increased dramatically.

Fortunately, there's a solution that makes it possible for executives to avoid having to settle for a highly diminished disability benefit. This can be accomplished by taking a product designed to meet the disability income requirements of highly compensated athletes and entertainers and modifying it in appropriate ways to fit the income objectives of executives.

Thus, a product is created that can give Bob the level of disability income he originally thought he had. With his compensation package, the 60 percent figure would be \$420,000 instead of \$240,000, or 34 percent.

If the income source stops or becomes drastically impaired by injury or illness, the result can be more catastrophic than death.

Gary F. Terry has 27 years of corporate planning expertise associated with executive benefits.

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