

MAKING SENSE OF THE NONSENSE Providing Credible Appraisals in a Declining Market

*Appraisers have been accused of prolonging the nation's real estate downturn by developing value opinions that are below proposed sale prices. Specifically, they've been criticized for including foreclosure sales and so-called short sales among the comparable sales used in the valuation process. But **foreclosures and short sales can provide important information for appraisers**, who develop valuations based on market data and market forces. Here are some of the basics:*

Appraisers exercise sound judgment when gathering and analyzing information.

- The appraiser must consider all relevant transactions that have occurred in the market area and then determine which of those transactions should be used in the analysis to arrive at a *credible value opinion* for the subject property.
- The **best comparable sales** ("comps") are those that are *most similar* to the subject property in terms of location, size, condition and other features that buyers and sellers believe make a difference to price.
- A property or a property feature (such as a kitchen remodel) might cost X, but that doesn't mean it's worth X or adds X to the value. Especially in distressed markets, cost may be higher than value.

Appraisers make adjustments based on market research and analysis.

- The appraiser must analyze each comp to ascertain what adjustments are needed.
- After selecting the *best comps*, the appraiser adjusts for material differences between each comp and the subject property. Factors that may require such adjustments include atypical buyer/seller motivations and sales concessions.

Appraisers adhere to basic principles when analyzing distressed sales.

- An appraiser **should not ignore** foreclosure sales and short sales if consideration of such sales is necessary to develop a credible value opinion.
- As is *always the case* in selecting sales to use as comparables, the appraiser must investigate the circumstances of each transaction ... including whether atypical motivations or sales concessions were involved, or whether the property condition was compromised.
- A short sale or a sale of a property that occurred prior to a foreclosure might have involved **atypical seller motivations** (e.g., a highly motivated seller) and so might not be an ideal comp.
- A sale of a bank-owned property might have involved typical motivations, so the fact that it was a foreclosed property would not render it ineligible as a comp.
- Some foreclosed properties are in *inferior condition*. An adjustment for condition may be needed.

Appraisers abide by professional standards.

- The Uniform Standard of Professional Appraisal Practice's (USPAP) Competency Rule says *geographic* and *market area* competency are needed for an appraiser to complete an assignment.
- An appraiser must have sufficient understanding of the **local market conditions** – including supply and demand factors relating to the specific property type – in order to make *reasonable judgments* about what factors influence value.

*The use of qualified, experienced appraisers – such as those carrying the SRA or MAI designation from the Appraisal Institute – helps ensure the **highest quality** appraisals.*