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Real Estate Appraisers & Inspectors

Fall 2011, Volume 28

## WHY APPRAISERS SHOULD PAT THEMSELVES ON THE BACK

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# Choosing Right Comps in Tough Market

by Philip G. Spool, ASA

**Editor's Note:** *Choosing the wrong comps means producing an unreliable appraisal report, according to author Phil Spool. Here, he explains the art of picking comps in a difficult market*

**Y**ou can have the latest map program, aerials and any other special effects to make your report look as attractive and professional as possible but if you choose the wrong comparables, your result will be the worst appraisal report possible. This article shows the best way to choose comps, especially when sales of properties are scarce or not similar to your subject.

Whether appraising a property for a lender under the Uniform Appraisal Dataset (UAD) or a non-lender, choosing the appropriate comparable sales in today's market is the single most important item in arriving at your value. Therefore, it is important to understand what criteria are important in choosing the right comparable sales, especially when good sales are few and far between.

There are many ways to begin your research and choose your comparables that will give you the best results. When selecting your comps, focus on location, similarities to the subject and date of sale. Your selection may also be restricted by your client's guidelines and not by what you believe to be appropriate comps.

What constitutes a good sale? The best answer is the sale that has the most similar attributes and the least amount of adjustments required, compared to the subject property and which meets the definition of an arm's length transaction.

## Sales in Substitute Neighborhood

What is a "substitute neighborhood"? A substitute neighborhood is a grouping of properties that have similar characteristics to your subject's neighborhood and where the houses or condominium units are similar in price range, size, age and demand. With a shortage of good sales that have few adjustments, the appraiser sometimes has no choice but to expand the research area to include substitute areas. It is important if you go beyond your neighborhood boundaries to explain the shortage of comparable sales and the necessity for looking further away. Remember, there is no "one mile" guideline by Fannie Mae, Freddie Mac or FHA. This may be a guideline by a lender or appraisal management company (AMC) but it does not come from any quasi-government entity. Fannie Mae has instructed that appraisers set up neighborhood boundaries first, and then if need be, expand the choice of comparable sales beyond the neighborhood, but it says not to expand the neighborhood boundaries to fit the selection of comps. In your text addendum, explain why you need to go beyond your neighborhood for sales. You may find there are better sales in that substitute neighborhood that should not be ignored. Remember to think like a buyer. Would a buyer only consider the subject's neighborhood or

would the buyer consider going a little further out to a similar neighborhood to look for what he or she wants?

## Older/Recent Sales

Do you consider an older sale, say over one year, that is more similar to the subject, rather than a newer sale that is not similar and requires more adjustments? Not only do you have to consider the percentage net and gross adjustments for each sale, you should also consider the number of adjustments required. Would you rather have fewer adjustments with an older comparable sale or a more recent sale with many adjustments? Perhaps you would not want to consider the older sale as one of your first three comparables but it certainly can be considered as additional support. If your *One Unit Housing Trends* indicates a declining market, then you would be making a large negative market conditions (time) adjustment, but perhaps only one or two other adjustments, like size and other features.

While a more recent sale would require a small time adjustment, it may require many other adjustments. I would rather choose a sale with the least amount of adjustments than the sale that is recent but less similar. If your sale is within the last three months but considerably less similar to the subject, is that sale truly comparable? Again, it may not be your first or second choice but with a market conditions adjustment being your main adjustment, that older sale may be your best sale. Conversely, I would not consider a two-year-old sale.

## Bracketing Sales

One of the best ways to select good comparable sales is to bracket them



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based on gross living area, site size and age/condition. If your property is under contract, do you consider bracketing the sales based on the contract price? Perhaps you shouldn't as it might be considered a violation of USPAP under the Conduct section of the Ethics Rule, which states: *an appraiser must not accept an assignment that includes the reporting of predetermined opinions and conclusions.* The fact that you are targeting the contract price might not be permissible.

In many cases bracketing the gross living area is most important. If all of your sales are larger than your subject and your price per square foot adjustment is small, more than likely, this will result in a higher value for your subject. The same applies if the gross living area for all your sales is smaller than your subject; your adjustment per square foot might not reflect an adjusted sales price appropriate for your subject. I have seen adjustments as low as \$15 per square foot for comparable sales that were significantly higher in gross living area than the subject, which resulted in the adjusted sales price of the larger comparables being similar to the smaller subject. In this situation, your adjustment for the gross living area has to be supportable.

### **Non-MLS Sales**

Would you consider the use of a non-Multiple Listing Service (MLS) sale if it is recent and similar to your subject? Perhaps you would. One should not only consider MLS sales but consider and analyze all sales to see which truly reflect the best comparison to the subject. MLS sales can be more easily verified with the listing agent and will more than likely list any sales or financing concessions. With a non-MLS sale, the appraiser must verify the sale price and any sales concessions with a party familiar to the transaction, whether it be the buyer, seller, attorney or title company (look at the recorded deed for the name of the attorney or title company).

### **Distressed Sales**

Distressed sales are a non-arm's length transaction, such as a sale via an auction or bankruptcy. Some short and foreclosure sales can be considered distressed but not always. The use of a short sale or a foreclosure may be appropriate and meet the definition of arm's length. What if a property is listed for sale that was not a short sale originally but became one due to it not selling? What about a property in foreclosure with a physical condition that is comparable to non-foreclosed properties and is listed for a period considered adequate, such as three to six months? If the property has an adequate marketing period and is in similar physical condition to the subject, then more than likely the short or foreclosure sale is not a distressed sale and should be considered as a comparable sale.

Distressed sales should not be considered in your analysis but perhaps should be in a narrative discussion in your text addendum, to indicate that these sales do exist in your neighborhood but were not considered. Discussion of the sales not considered is very important. This may include sales that you considered well beyond an appropriate sales price. Overinflated, possibly fraudulent sales may still be taking place. Hopefully, the appraiser will not consider a questionable sale but just the same, he or she should not ignore it either. That is why discussing the sales in your neighborhood is important.

### **Abundant Foreclosures and Short Sales**

Many appraisers face the problem of having a majority of sales in their area as foreclosures or short sales. If the norm in your area is foreclosures and short sales, they cannot be overlooked and more than likely represent your market. If you explain this in your text addendum and they meet the criteria mentioned above (adequate marketing time and comparable physical

condition), hopefully your lender will accept them as bonafide sales.

### **Active Listings/Pending Sales**

Many lenders, clients and AMCs require the appraiser to utilize listings or pending sales, especially in a declining market. Pending sales may appear to be a better choice than a listing that is not under contract, but remember that if you don't have verifiable evidence of the contract price of that pending sale, it is no different than using a listing. No matter if it is a listing or a pending sale, the most important thing to remember is that the active listing or pending sale must have a reasonable exposure time in the market to assure that it is not overpriced as a comp. You would not consider a property that was just listed equally with a property that was listed many months ago with no recent price change. An active listing should reflect a price change within the past few months, otherwise the listing is not reflective of the current market.

A good example would be a date of value of October 1, 2011. You have a choice of three listings: which one do you pick? Listing 1 was just listed on September 15, 2011. Listing 1 is not a good listing to use because it is too recent to test the market. If it resulted in a pending sale (sales contract entered into) within 15 days on the market, it does not have adequate exposure in the market.

Listing 2 was listed in March 2011 and its most recent price change was May 1, 2011 or five months ago. Listing 2 is not a good listing because either the seller is in denial, refusing to lower the asking price, or the agent is not doing a good job keeping abreast of market conditions.

Listing 3 was listed in April 2011 and its most recent price change was in September but it is a short sale. Would you use it as a listing? The answer depends on additional information about

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the short sale listing. Is it an "approved" listing by the bank? Sometimes a short sale is listed at a very low price by an agent to attract potential buyers. The short sale listing has to be approved by the bank as a bonafide short sale. Would you then consider it in your report? The answer is stated in the March 23, 2009 Mortgagee Letter 2009-09, addressed to all FHA Roster appraisers. It states, under Appraisal Reporting Requirements in Declining Markets, appraisers must "insure that active listings and pending sales are market tested and have had reasonable market exposure to avoid the use of overpriced properties as comparables. Reasonable market exposure is reflected by typical marketing times for the neighborhood." What this means is that your listing should be listed a minimum of three months in order to have enough time exposed in the market. Any time less is not enough.

### No Similar Sales

With a market that has been slow with few sales taking place, there is a greater chance that your subject property might not have similar comparable sales. What if your subject property is unique to the extent that there are no similar sales within the past year or in your neighborhood? In this case, you have to lay out the facts and place them in the order of importance. Consider what is the most important line item adjustment: gross living area, site size, bedroom/bathroom count, design or location. Talk to the local Realtors to see what features are most important. Choose your sales with attributes most similar to the preferences of the buyer. What if your gross living area is most important yet your subject's site size is considerably larger than other houses? Try selecting sales with a similar gross living area but with a smaller lot size. The same can apply to any attribute and

select your comparables based on the most important attribute.

In conclusion, choosing appropriate sales in today's market is more challenging than when the market had an abundance of sales with few short or foreclosure sales and plenty of comps similar to your subject and in the same neighborhood. We did not choose to be in this situation, but following good and sensible procedures will make your selection of supportable comparable sales that much easier.

I would like your feedback to this article. Please email me at [pgspool@bell-south.net](mailto:pgspool@bell-south.net) and a follow-up article on the selection of comparable sales will be published based on your comments. It is always good to get differing opinions, especially if your client restricts you to the type of comparables you select or if the review appraiser has a different opinion. **WRE**

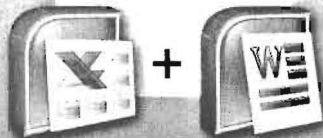
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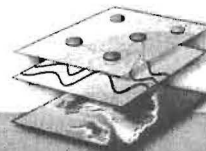
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