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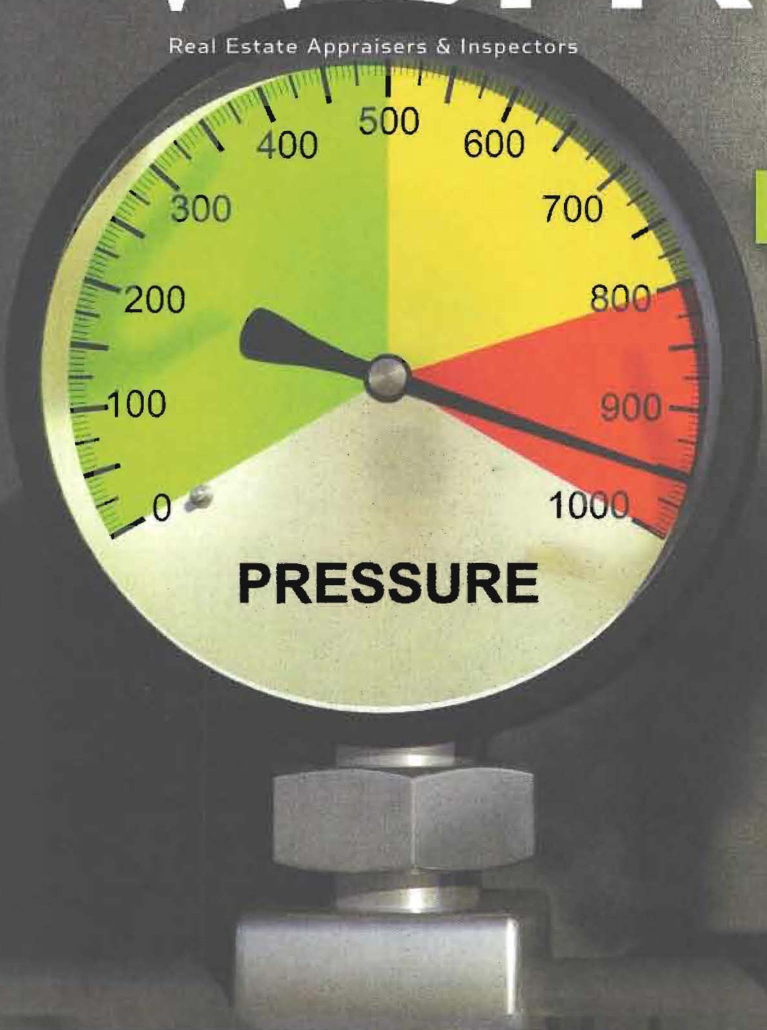
Winter 2010, Volume 23



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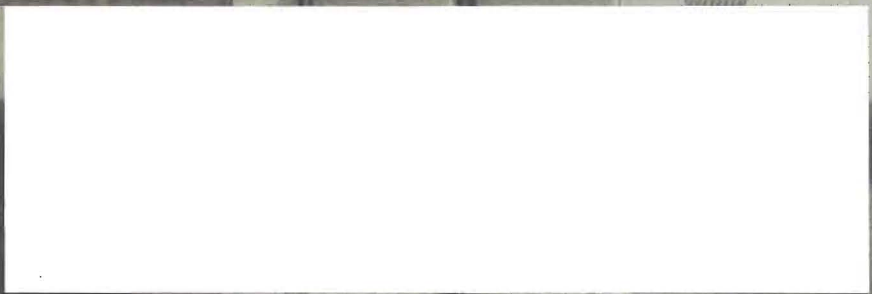

Eight Most Common Appraisal Mistakes

By Phil Spool, ASA

This article is about common mistakes in appraisal reports, whether the appraisal is for a mortgage transaction or other intended use. Most mistakes are not violations of USPAP but errors caused by a lack of common sense, trying to satisfy a client or not following Fannie Mae guidelines.

After reviewing countless appraisal reports, I noticed a pattern of common mistakes. The most include:

1. Market Area/Time Adjustment Inconsistency

In a residential appraisal report form, within the Market Area Description section, if you check the box that indicates property values are declining, then a negative time adjustment is in order for your comparable sales. Awhile back residential appraisers were hesitant to indicate that property values were declining as lenders or mortgage brokers were letting appraisers know that if they checked the "declining" box, the loan would not get approved. The bottom line is that an appraiser is held responsible for what they write in their report and should not be persuaded by anyone telling them what to write. Therefore, if you check the box that indicates property values are declining, then truly consider using a negative time adjustment for the comparable sales. Conversely, if property values are increasing and if that box is checked, the appraiser should consider using a positive time adjustment for the comparable sales.

2. Improperly Describing Neighborhood Boundaries

As sales become more scarce and similar type properties are located further away, in comparison to when sales were plentiful and nearby, appraisers have a tendency to expand the neighborhood boundaries in order to accommodate the utilization of sales in adjoining neighborhoods. This is wrong. If a comparable sale is located in an adjoining or nearby neighborhood, the appraiser should simply state that the comparable sale is in a substitute neighborhood. This is explained in the Fannie Mae *Selling Guide*, Part XI, Section 406.02: Selection of Comparable Sales, where it states: "As a reminder, although it is preferable for the appraiser to provide comparables from the subject's neighborhood, Fannie Mae does allow for the use of comparable sales that are located in competing neighborhoods, as these may simply be the best comparables available and the most appropriate for the appraiser's analysis. If this situation arises, the appraiser must not expand the neighborhood boundaries just to encompass the comparables selected. The appraiser must indicate the comparables are from a competing neighborhood and address any differences that exist." While this is a Fannie Mae guideline (Announcement 08-30 dated November 14, 2008), it is also considered appropriate for non-lender appraisals.

3. Misunderstanding the Difference between Data and Verification Sources

The most common data sources include public records, Multiple Listing Service, HUD 1 statements and deeds. Verification is picking up the phone and speaking to either the buyer, seller, listing agent, selling agent, attorney involved in the transaction or the title company that handled the closing. The most common verification source is the listing agent, followed by the selling agent. Verification would include confirming the sales price, any sales concessions, condition and renovation of the property, etc. The key word is *confirming*.

4. Misrepresenting the Line Item in the Sales Comparison Approach Where It Asks Sales or Financing Concessions

Some appraisers have the tendency to state that the comparable sale has a conventional mortgage, ignoring that the line item is requesting any sales or financing concessions. The two most common examples of sales or financing concessions are (1) the seller contributing money toward the closing whereas the buyer usually pays his/her portion

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of closing costs and (2) seller offers a below-market interest rate purchase money mortgage. Stating that the comparable sale has a conventional mortgage does not necessarily guarantee that there is not a sales concession. If there were no sales concessions, then state "no sales concessions" or "no known sales concessions" but don't put "conventional mortgage" as that is not what it is asking.

5. Improper Mathematical Adjustment for Time Adjustment

This relates to the appraiser making a negative time adjustment after determining that property values are declining and an adjustment for sales concession for that comparable sale. Basic appraisal theory dictates that when using quantitative adjustments, which is what you do in the residential appraisal form each time you make an adjustment, there is a specific order of adjustments, especially if they are percentage adjustments. If you look at the Sales Comparison Analysis section of the grid, the first possible adjustment that could be made is for Sales or Financing Concessions so that the sales price reflects the cash equivalent sales price. The second possible adjustment is Date of Sale/Time (also referred to as Market Conditions). Therefore, if there is a sales concession for one of your comparable sales that also had a time adjustment, the sales concession adjustment has to be made first and then the time adjustment would be based on the adjusted sales price after the sales concession was made. Both of these adjustments are usually percentage adjustments (i.e. sellers contributing a percentage of the closing costs typically paid by the buyer, and time adjustments as a percentage per month basis).

For example, a house sells for $750,000 and there is a three percent seller's contribution sales concession and you indicate that there should also be a negative 10 percent time adjustment due to the continuing declining market. The proper way of making the adjustments would be to adjust for the sales concession first: $750,000 minus three percent ($22,500) equals $727,500. Then the negative time adjustment of 10 percent would be applied to the adjusted sales price of $727,500: $727,500 times negative 10 percent equals negative $72,750. Assuming no other adjustments are to be made, the Adjusted Sales Price of the comparable would be $654,750 ($727,500 minus $72,750), rounded to $654,800. The improper way would be to take the $750,000 purchase price and subtract $22,500 for the sales concession and $75,000 for the time adjustment to arrive at the Adjusted Sales Price of $652,500.

6. Line-Item Adjustment for Actual Age and Condition

The most common mistake for these two line-item adjustments are when the appraiser uses the Effective Age of the subject and the comparable sales instead of its Actual Age. If the Effective Age is utilized, this would already take into consideration the condition of the improvements and only one adjustment would be made for Age and Condition. But that is not what the form asks for. The form wants the adjustment made for the Actual Age difference and then separately, an adjustment, if needed, for

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Condition. The key words are *Actual Age*, not Effective Age.

7. Retrospective or Prospective Value

This relates to the Intended Use for an estate, tax assessment appeal or a property that is either proposed or under construction. When the effective date of an appraisal is prior to the date of visit (inspection), this would be considered a *retrospective* value, not a *current* value. For example, if the appraisal is for an estate, usually the retrospective value date would be the date of death or the alternative date, six months thereafter. If the appraisal is for a tax assessment appeal, the date of valuation would be January 1 of that tax year. So be sure to call it a retrospective value. However, if you are appraising a proposed property or a property under construction, the value would be considered a prospective value as of a date in the future (completion date). When doing a prospective value, it would be a good idea to get the estimated completion date (month and year) from either the builder/contractor or client. USPAP's Standards Rule 2-2 (vi) requires the appraiser to state the effective date of the appraisal and the date of the report. If there is substantial difference in time between the effective date of the appraisal and the date of report, then that would indicate either a retrospective value (i.e.: date in the past) or prospective value (i.e.: date in the future).

8. Improperly Putting Listing(s) along with the Sales

I have noticed that many appraisers who utilize listings add them at the end of their sales grid as if it were an additional sale, giving it a false or misleading indication that it is a sale and not a listing. While the appraiser does state that it is a listing, the listings should be on a separate page by themselves and hopefully the software program the appraiser utilizes has a heading "Listing" and not "Sales."

Summary

I hope this information is beneficial to you. Just remember, anything you write in the report has to be supported. Just don't assume that an adjustment you make is appropriate due to your many years of experience. It is better to explain any unusual or questionable adjustment within a Text or Supplemental Addendum and do as much explaining in this addendum as it takes to leave little doubt as to what you did and why you did it. It is easier to explain what you did than to explain afterwards why you did not explain it. **WRE**

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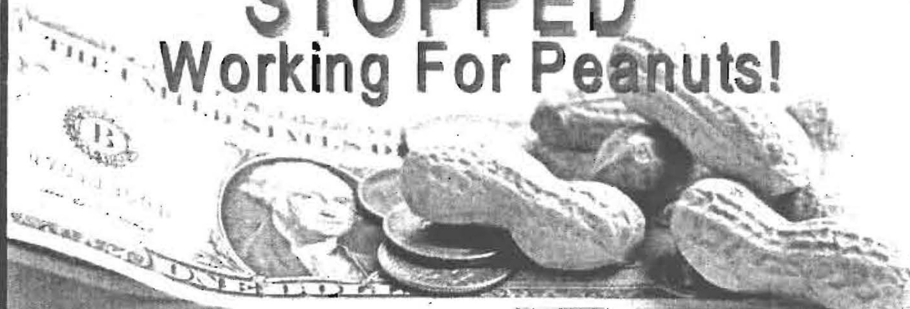

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