Foreclosures weigh on home appraisals

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LOS ANGELES – It wasn't the first time that Katherine Scheri ruined a real estate agent's day with a low property appraisal.

Scheri, a real estate appraiser, had sized up a three-bedroom, two-bath house in Santa Ana, Calif., for $30,000 less than what the buyers offered to pay. A typical deal-killer for a seller.

The agent urged the lender to force Scheri to consider several other properties that could back up the original $310,000 sale price. Then he tried good old-fashioned guilt, telling Scheri her appraisal was going to ruin the buyers' shot at the American Dream.

"That's what he laid on me," Scheri recalled. "And I said, 'Don't you care they could be potentially spending $30,000 too much for a house?"

Across the country, agents and homebuilders are complaining too many appraisals are coming in low, scuttling deals.

The National Association of Realtors says nearly one in four of its members has reported clients losing a sale due to botched appraisals. The National Association of Home Builders, meanwhile, said low appraisals were sinking a quarter of all new home sales and argues it's not fair to compare distressed properties to brand-new homes.

And that gets to the heart of the problem.

Roughly 40 percent of all home sales this year were foreclosures or short sales, meaning the property sold for less than the mortgage. In some markets, like Las Vegas and Phoenix, they've hit more than 50 percent.

Appraisers determine the value of a property by looking at recent sales of comparable homes. They take an apples-to-apples approach, excluding or making adjustments for certain features, such as a swimming pool or finished basement. And generally, a foreclosure isn't used as a comparison for a standard sale.

But in some areas, appraisers like Scheri contend they are only sizing up homes according to the reality of the market, though they concede its becoming increasingly harder pinpoint what a home is worth.

Home prices in many large metro areas, including Los Angeles and San Diego, hit bottom earlier this year and are recovering, data last week showed. Yet there are many neighborhoods across the country where foreclosures and other financially distressed sales are still rising.

"It used to be a very infrequent thing that you did an appraisal and the value wasn't supported," says Scheri, who is based in San Diego. "Now, it's more common than not."

So, if you're trying to sell your home in a neighborhood where foreclosures and short sales are predominant, an appraiser could determine your home is actually worth less than what some buyers may be willing to pay.

Part of the problem, critics contend, is that many real estate appraisers are now hired under new industry rules. Designed to limit conflicts of interest that can bias an appraisal, the rules bar mortgage brokers from ordering appraisals themselves, forcing them to do so through a mortgage lender.

Lenders may order appraisals through in-house staff or appraisers hired by outside firms known as appraisal-management companies. But neither may talk to the appraisers about the value of the property they're evaluating.

The result, however, can mean that low-cost appraisers are hired from outside the area and don't have the local knowledge to find homes that can be a better benchmark for regular homes.

Chris Heller, agent-owner of Keller Williams Realty in northern San Diego, recently had the sale of a home nearly botched for the second time because of a low appraisal.

The three-bedroom, two-bath house in the Poway suburb of San Diego was appraised for $55,000 less than what the buyer agreed to pay. The seller wasn't willing to drop the price down to $400,000, but knocked off $20,000 when the buyer agreed to come up with $35,000 in cash.

"The seller is taking less because of the appraisal," Heller said, noting that almost all of the comparable homes used to gauge the property's value were distressed sales.

Still, the buyer is paying a premium not to have to deal with the risks involved in buying a foreclosed home or a short sale, which can take several months to close.

So, should distressed homes sales be compared with other homes? Is one inherently worth more than the other?

A new analysis of foreclosure and non-foreclosure sales by Zillow.com found that even when most of the market is made up of bank-owned homes, non-foreclosures sell for as much as 30 percent more. Another study by Harvard's Joint Center for Housing Studies came up with a similar conclusion.

In Las Vegas, which has one of the highest foreclosure rates in the nation, the median sale price for bank-owned homes sold in September was about 23 percent less than other types of properties, according to the Zillow study.

"There are two markets, two very distinct markets," said Zillow economist Stan Humphries.

That doesn't mean foreclosures don't weigh down the value of nearby homes, although there's loud disagreement on how much.

The Joint Center for Housing Studies examined home sales over 20 years in Massachusetts and found that a foreclosure within less than 100 yards of a home lowers the price of that home by 1 percent.

So it appears that in neighborhoods with high foreclosure rates, values for all homes are being pulled lower than in areas where there are few or none. That means you can live in one area of Las Vegas and values can be down twice as much as they are in another neighborhood just a few miles away.

When it comes to appraisals, that leaves a lot of room for interpretation.
