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What different factors do appraisers use to determine current market analysis?

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According to the Standard & Poor's/Case-Shiller 20-city index of home prices there was a drop of 15.8% in May compared to a year ago. This is the highest decline since the index was started in 2000. Home values have fallen 18.4 % since the high point of the 20-city index in July 2006.

The Warren Group reported that in Mass. foreclosure deeds rose to 1,405 in May 2008 compared to 677 in May 2007.

According to the Boston Globe 1,200 homes in Mass. were seized in March 2008. This represents approximately a 140% increase from March 2007.

With this type of news being reported on a regular basis it is not surprising that many lenders expect appraisers to indicate that the property being appraised is in a declining market. On the relatively rare occasions when an appraiser indicates that market conditions are stable there is concern on the part of the lender. The appraiser may be asked to change the report to show a declining market at a minimum provide support for the conclusion that the market is stable

Such a request is not unreasonable nor should it cause any concern to the appraiser. Regardless of what the appraiser's conclusions are of market conditions they must be supported conclusions. Providing that support to the client simply involves writing a quick note. An even better option would be to include the support for any such conclusion in the appraisal report.

A part of the market analysis is deciding if property values are declining, stable, or increasing. This is an important decision for a number of reasons. The first reason is that it is part of the market analysis that appraisers are required to develop for each appraisal. The second reason is that it aids the client, particularly a lender, in developing a risk analysis of the subject property. The third reason is that it directly relates to any adjustments for market conditions. The fourth reason is that it can have significant impact on a borrower.

As of January 15th, the Fannie Mae Freddie Mac guidelines changed relative to a "declining market." The guidelines state "When a property is located in an area indicated as declining, Fannie Mae will now require the lender to offer financing at LTV and CLTV ratios that are five percentage points below the maximum ratios allowed for the selected mortgage product. For example, when the highest LTV allowed for a particular mortgage product is 100%, maximum financing would be 95% if the subject property is located in an area identified as declining." Fannie Me guidelines expect the appraiser to describe trends in property values and when declining values are identified the reasons for the decline and the effects on value should be discussed. They state that the "appraiser's assessment of property trends is one of the most important parts of the appraisal assignment."

Fannie Mae identifies declining markets by county. The form is dealing with the neighborhood. It is not uncommon within New England for values in a county to be declining at the same time values in a neighborhood are stable. It could also be that while overall values are declining the values for a particular property type or at a certain price point are stable. When this is the case the appraiser must be able to site their rational and support. They must also make it clear exactly what they are referring to, i.e. neighborhood, market area, community, county.

The best possible support is from closed sales of properties similar to the subject in the same neighborhood or market area. The most recent prior sales of the comparable properties might serve as a good indicator of what is happening with the market.

When, for what ever reason, closed sales can not be used there are other possible tools.

The listing history of various similar properties (including the sales used in the sales comparison approach) can be studied to see what they indicate. Alternatively, the average listing prices of sales of similar properties that closed in the past six to twelve months can be compared to the average listing prices of properties presently for sale. A significant difference might indicate a change in market conditions. Other possible indicators could be the present absorption rate (present listings divided by sales in the past year). As the supply increases values tend to decline. Days on the market can be another indicator. A significant change in the average time on market tends to indicate a change in market conditions.

The methodology we use to determine what is happening is less important than the fact that we support our conclusion and discuss that support within the appraisal. This is an import issue that has significant consequences.

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