Should a Lender Rely on a Appraisal Ordered by a Borrower

There are different methods of establishing real estate opinion of value: a real estate sales agent may assist the seller to establish a listing price based on a comparative market analysis (CMA) and should be established from objective data, which may include closed sales, pending sales and available listings. The Realtor must operate within the course and scope of their license. Fiduciary duties apply.

An appraiser will establish the opinion of value based upon the analysis of comparable closed sales. It will base the opinion of value conclusion of income-producing properties on the capitalization approach, replacement cost, and comparable sales. (Note Article on Capitalization rate)

Other valuation methods, which are purpose driven may include residual value method for new construction, insurable value for getting property insurance, value settlements for an estate, and assessed value for property taxation purposes.

When a realtor is approached by a prospective seller, the realtor will usually take the time to create a comparative market analysis. In this process the realtor will compare properties with similar characteristics and amenities that have sold, or are on the market for sale, to establish an estimated opinion of value for listing purposes. The seller and his/her agent will make a negotiated decision about the listing price based on multiple factors, including the seller’s motivation, market conditions and general level of sophistication by all parties.

Many variables contribute to establishing an opinion of value: location, property condition, age, interior and exterior amenities, pools, views, trees and hard-scape, noise, site variables such as topography, ingress/egress, garages, appurtenant structures, on-site vs off-site parking, access to utilities, above ground vs. below ground electrical and telephone lines, ability to produce income. Zoning, community covenants, conditions and restrictions, architectural style, and land size also contribute to the analysis. Building setbacks which are local government ordinances that govern distance from curbs, property lines, bluffs, and waterways are considered. It is reasonable to expect a 10% fluctuation to a resulting asking price in attributing the various factors to the conclusion.

The prospective buyer and his/her agent assess all the above characteristics, including their personal circumstances, timing needs, access to shopping, medical facilities, community amenities, schools and the availability of reasonable and acceptable financing.

The licensed appraiser has a different task to be less subjective and more objective analysis. The appraiser operates mostly from information from past closed transactions, with considerations of all the above property characteristics, to establish what he/she considers an appropriate opinion of value. The appraiser will skip distressed sales and non-arm's length transactions. Most licensed appraisers are trained to use the Uniform Standards of Professional Appraisal Practices regulations which promote quality control standards applicable to appraising the real property, personal property, intangibles and businesses in the United States and its territories. This is a resource that most mortgage professionals use when evaluating a property and deciding whether there is a need for a review of an existing appraisal or if it requires a new independent appraisal.

Using USPAP standards and resulting in an appraiser's opinion of value can be flawed because of a lack of competence or negligence of the appraiser. Extraordinary assumptions and hypothetical conditions reported by the appraiser may blur objectivity. Two appraisers cannot both be correct when they are over 100% apart on the value determination.

Here is an example I observed recently: a lender received a call from a mortgage broker representing a property owner with a request for a new loan in a community of Ranchettes, with a distant view of the ocean. The property totaled 20 acres with an older home, a barn and equestrian riding arena, and distant ocean views. The borrower submitted an appraisal he had ordered to his broker, who presented it to the lender. It was reported the borrower ordered that appraisal and had been made out to a law firm, for the expressed purpose of a property settlement in a divorce. The borrower requested a cash-out second lien based on their personally obtained appraisal.

The funding lender/broker explained that it was a custom and practice not to use a borrower's appraisal unless there was assurance it was an arm's length appraisal. The funding lender/broker required a new opinion of value independent, third-party appraisal, or a review appraisal from a qualified appraiser.

The opinion of value appraisal obtained by the borrower was from an MAI licensed appraiser who appraised the property at $3,400,000. MAI means Member of the Appraisal Institute, a high-level designation. The new appraisal ordered by the funding lender/broker a licensed general appraiser, rather than an MAI, was for $1,400,000. This radical difference in value leads to the prospective borrower threatening to sue all parties, including the new appraiser.

The question becomes whether there was negligence and/or incompetence by the first appraiser, or the second appraiser? Or, did the extraordinary assumptions and hypothetical conditions blur objectivity?

Appraisal #1

Most of the comparable sales were over 1.25 miles away from the subject property. Most of the comparable sales were closer to the beach than the subject property. Most of the comparable was in existing high-value luxury residential neighborhoods. Two of the comparable's included plans and permits for 10,000 square foot un-built luxury homes, citing arbitrary adjustments. All the comparable's had high-value un-obstructed ocean views.

Appraisal #2

All comparables were close to the subject property. All comparables had a more Ranchette and rural setting, with a distant ocean view. Because the subject property was on the outskirts of the more metropolitan areas, these comparables provided a more accurate assessment of the valuation. There were no absolutely, unobstructed ocean views, which are of high value.

Appraisal #2 was unacceptable to the prospective borrower who threatened to sue all parties as though the first appraisal was correct. The funding lender/broker decided not to originate the loan.

Funding Lender/brokers will accept proposed loan transactions for review to establish the creditworthiness of the borrower and verifying the protective equity and suitability of the collateral property. They have the responsibility to read appraisers opinion of value carefully. Absolutely never rely on an appraisal ordered by a borrower unless it is a complete a thorough review appraisal. The funding lender/brokers should also make certain they select the appraiser in an arms-length fashion with no pressure from the borrower to increase the value.

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