Real Estate

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Upheaval In Air Over Appraisals

WASHINGTON — If you're a home-buyer, seller or sales agent, you may have heard about one of American real estate's growing complaints this spring: that appraisals are becoming too conservative — sometimes conservative enough to reduce the mortgage amounts available to would-be purchasers and knock the closing off schedule.

Behind the less-generous appraisals, say real estate-industry critics, are appraiser worries about pending congressional and state legislative initiatives designed to regulate them. On top of that, mortgage lenders are demanding more rigorous valuations on homes — with no tears shed when the appraisal doesn't add up to the purchaser's price on the sales contract.

What's going on? Are tougher appraisals a fact of life for buyers and sellers this season? And what's the bottom line for you?

Ask the man whose position at the nation's largest lender gives him a sizable impact on appraisals, and here's what he tells you: Tougher appraisals are indeed a force to reckon with in the home real estate marketplace this year, says Robert Englestad, vice president of mortgage standards for Fannie Mae, the Federal National Mortgage Association. Fannie Mae provides billions of dollars worth of mortgages every year to home-buyers across the country by purchasing new loans from local lenders.

Along with its competitor, Freddie Mac (the Federal Home Loan Mortgage Corp.), Fannie also exerts vast influence on the market by announcing the detailed standards for types of mortgages it will buy, including the nature and quality of the appraisals backing up the loans. Fannie Mae has toughened up its underwriting standards in a series of moves stretching back over two years, the cumulative effect of which has been (in Englestad's words) "to encourage more enlightened appraisals" in 1988.

"For a long time people couldn't put much faith in (home) appraisals," Englestad said in an interview last week, "because appraisers were relying on inflation to support" their numbers. The results for lenders, mortgage insurers and others turned out to be painful: Large numbers of properties were over-appraised and triggered sharp losses to lenders when they went into foreclosure. A year's worth of investigations and hearings by a congressional subcommittee documented widespread slipshod and fraudulent appraisal practices on conventional and federally insured mortgages.

In the wake of these criticisms, Fannie Mae, Freddie Mac and the appraisal industry's professional organizations all have instituted reforms. The bottom line of these reforms, industry analysts agree, is to rein in overly generous, rose-tinted appraisers.

Fannie's changes in particular "have sent a message" to appraisers, according to Englestad, "that we want you to spend more time and effort" documenting and defending valuations, rather than cranking out appraisals that automatically support contract prices.

"There's always a lot of pressure on the appraiser to meet the price listed on the contract," said Englestad. The pressure comes from the people crowded around the table who want to see the deal go through with no hitches, at the agreed-on price: real estate agents, loan officers, and the buyer and seller.

But Fannie Mae's interest is different, he noted. Since the corporation's ultimate security for handing over mortgage dollars to a borrower is the value of the house itself, Fannie wants to be certain that the price truly reflects market reality, not a real estate agent's persuasiveness.

Hence the moves toward tougher standards and policing. In an effort to make this entire process clearer and more understandable to appraisers and lenders, Fannie's revised standards have just been summarized in a newly released "Appraisal Guide" for real estate professionals and the public. Although portions of it are technical, the 68-page guide offers a rare plain-language look at what adds to market value — and what detracts from it — from the viewpoint of the nation's biggest mortgage investor. Some highlights:

- Fannie Mae frowns on the relatively common practice of real estate brokers providing "comparable" house sales data to appraisers. Fannie wants no such data backing its loans unless "the appraiser verifies the accuracy of the data with another source and makes an independent investigation that the comparables provided were the best ones available."
- Sales concessions, creative-financing incentives from sellers to buyers, repair "hold-backs" and similar above- or below-the-table agreements accompanying sales contracts are getting increasing scrutiny. Fannie now requires appraisers to actively search for such arrangements on all sales treated as "comparables" to support a current appraisal. The information must come "from an individual who was a party to the transaction" — not always an easy source to tap after the fact.
- Homeowners who "over-improve" their properties may be reducing their future purchasers' abilities to obtain mortgage financing through Fannie Mae. Over-improvements can take a wide variety of shapes — in-ground swimming pools or tennis courts in neighborhoods with none, a $40,000 gourmet kitchen in a neighborhood of $80,000 houses and similar highly personalized renovations or features. Fannie Mae warns appraisers that on over-improved properties, "The loan terms ... should be more conservative because the property may not be acceptable to typical purchasers."

Keep that in mind before adding that $50,000 state-of-the-art wine cellar to your $75,000 townhouse.

(Copies of Fannie's Appraisal Guide are available free by writing Fannie Mae, P.O. Box 1492, Alexandria, Va. 22313.)

***Editor's note:** The 800 number listed in last week's Harney column for American Homestead's reverse mortgage does not apply to the Midwest. Readers can call for more information at this number: 609-866-0800.*