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Decoding the Wide Variations in House Appraisals

By PAUL SULLIVAN

I RECENTLY decided to refinance a condominium my wife and I owned in Florida and quickly got caught up in the frustrating and often baffling world of real estate appraisals.

The appraisal for the condo initially came in at exactly the dollar amount we needed to refinance it without putting up any more money — something I found fishy but did not question since it worked to our advantage.

But a week later, the appraisal management company that had sent out the appraiser reviewed his valuation and revised it downward, determining that instead of 20 percent equity in the condo, we had only 10 percent.

That's when I called up the loan officer at the bank and basically asked the question homeowners everywhere are asking: How are you determining the value of my home? After all, both numbers seemed to me to be rather arbitrary.

I eventually prevailed and got the refinancing.

But around that time, I got the renewal letter for the homeowner's insurance on our house in Connecticut and was shocked to see that it was being insured for a value 14 percent higher than we paid in 2008. I know homeowner's insurance is meant to cover the cost of replacing the house, but the price we paid for our home in 2008 was not just for the house but included the yard, the street where we live, the property taxes, the schools and other intangibles. And the price I could get for the house now is less than I paid back then. So why the high appraisal?

The question isn't a new one. After all, appraisals seemed to be just as subjective when the market was moving up. Why is the process so opaque? I set out to try to figure that out. Here are a few things I've found that can improve the outcome, though I can't promise that you'll be entirely satisfied.

SELLING AND BUYING One component of selling a home has always been gauging the emotion of a prospective buyer. But several brokers told me that buyers and sellers who need financing for a home should be concentrating instead on the temperament of the bank lending the money.

"Over the past two years, houses are not worth what the owners want or what the buyers will pay for them," said Peggy Bates, a broker with William Pitt Sotheby's International Realty in Stamford, Conn. "A house is worth what the appraiser says it is."

She says she makes prospective clients have their house appraised before she will list it. If they insist on determining their own value, she said, she makes them sign an agreement to drop the price in four weeks if the house does not sell.

Her tough-love approach may be hard for some to swallow but it just reflects banks' caution in making new mortgages with so many bad ones on their books.

But don't assume that the appraiser will return with a value for your house that you agree with. First, banks are increasingly bringing in appraisers from other towns, if not other states. While this is done to comply with provisions in the Dodd-Frank act aimed at establishing objectivity and preventing agents and mortgage brokers from influencing the outcome, it often produces results that fail to fully account for the central tenet of real estate: location.

Joseph C. Magdziarz, president of the Appraisal Institute and an appraiser outside of Chicago, defended his industry's work but said many appraisers were now pressed to write their reports more quickly and for less money. In cities like Chicago, he said, local knowledge is crucial because prices can vary from block to block and also floor to floor in high-rises.

Even if the appraiser is local, Mr. Magdziarz advises people to review a copy of the report. "The appraiser who did my house talked about my fireplace, but I don't have one and he got the size of the living area all wrong," Mr. Magdziarz said.

REFINANCING The lure of incredibly low mortgage rates has piqued interest in refinancing existing mortgages. After all, going from a rate of 6.5 percent to 4.5 percent means significantly lower payments each month.

But lending requirements are strict even for people with an existing mortgage who have no problem making their current payments.

Frederick Peters, president of Warburg Realty Partnership, spends his days dealing with appraisal problems on sales in New York City. But he said he was baffled when he tried to refinance his weekend home in Litchfield County, Conn.

The first appraisal in February was what he called an "absurdly low number even knowing the impact of the past few years," so he asked the bank to send out another appraiser. That came in only slightly higher and left him unable to refinance.

So he waited until this summer, when the flowers were blooming, and he and his wife walked the appraiser around the property. And that one? "It came in 50 percent higher than the previous ones," he said.

Stan Humphries, chief economist at Zillow, the Web site known for its real estate estimates, said people should not be shocked by wide ranges. The company's "zestimates," which are reached through a proprietary algorithm, currently have a range of accuracy of plus or minus 8.5 percent when compared with actual sale prices.

Mr. Humphries said he experienced this firsthand when he refinanced his home in Seattle last year. The Zillow value was $530,000, which a broker said he could get if he waited up to six months. If he wanted to sell it immediately, she told him to price it at $500,000. The appraisals for the refinancing were $570,000 and $581,000.

"It was interesting to see it arrayed against my own home," he said. "It made sense to me. Appraisals generally come in a little bit higher than zestimates because an appraiser is trying to think of longer-term value."

Such a wide range also shows just how important it is to educate appraisers when they come to your home. Owners, the experts said, should provide comparable listings, walk appraisers through the house, and point out improvements and unique features.

INSURING The appraisal for insurance purposes is perhaps the most enigmatic. While a mortgage for buying a home or refinancing is based on some combination of market pricing and a lender's stomach for risk, the insurance appraisal is based on the cost of rebuilding the home from scratch.

In some cases, this number is pure fiction. Mr. Peters's house was built in 1796, so how do you value materials you can no longer buy? Add to this that the insurance appraisal is likely to be higher than a home's market value.

"There's a lot of confusion about this issue," said Stephen R. Bitterman, vice president in the private client group at Chartis, an insurance firm. "We are appraising the house for rebuilding cost. Our promise is we're going to put you back exactly the way you are."

But what irked me with our house was that the initial coverage was for the exact amount we paid for it, and it has only gone up. Yet none of the insurers I spoke with would explain how that worked. When asked to address the discrepancy between rising insurance prices and falling home values, they attributed it to increasing costs for raw materials.

In our case, the insurance company actually raised the replacement cost of our home even more after the appraisal. To add insult to injury, the appraiser noted in his report the market value of our house: 31 percent less than the replacement cost.