



ISSUES IN COMPARABLE SALES

What is a true comparable sale?

In looking at a sale to see if it may be used in an appraisal, the appraiser must make sure that the sale reflected an arm's length transaction. There are generally five elements of an arm's length transaction.

1. The buyer and seller are typically motivated.
2. Both parties are well informed or well advised, and each is acting in what they consider their best interest.
3. A reasonable time was allowed for exposure in the open market.
4. Payment was made in terms of cash in United States Dollars or in terms of a financial arrangement comparable thereto.
5. The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions.

If any of these tests are not met, the sale may only be used with appropriate discussion and adjustment. A client may have additional requirements, such as that the sale must be less than 6 months old or within a certain distance from the subject. It is the appraiser's responsibility to be familiar with and comply with those guidelines.

Source of data

Your source of data for your comparable sales must have sufficient information so that you can understand the conditions of sale, existence of financing concessions, physical characteristics of the subject property, and whether it was an arms-length transaction. Competency requires that you have the ability to locate home sales information available from many sources, not just a Multiple Listing Service. A local MLS is a good source of data, but should not be considered the only source an appraiser may utilize in selecting comparable sales. In some areas, tax records or private databases provide more comprehensive data. A FSBO (for sale by owner) property could be a reasonable comparable sale if it had been properly marketed. Some builders do not utilize the MLS for their subdivisions, preferring to do some or all of the sales themselves. This is especially true in some "green" subdivisions. If a property has not been marketed on MLS or another regional database, the appraiser must make sure that the property was exposed to the open market for a reasonable time before it can be used. Also remember that Fannie Mae requires you to state the specific source of your data; they do not allow the use of a broad category such as "public records".

Verification

Remember, Standards Rule 1-4 of USPAP requires that you collect, verify and analyze the data used in the report. For example, if you collect comparable sales information from MLS, you then verify the information by checking with the listing or sales agent, the tax office, or another source. If there is any discrepancy between these two sources, you must continue to research the sale until you are confident that the information you will use in your analysis is correct. This is especially important if you receive verbal information or a HUD-1 that conflicts with public records.

An appraiser cannot state that the verification source is "inspection".

Information in MLS may not be accurate and may report a sale that was not arm's length. There are some instances where real estate agents may report a land/home package sale on MLS. Sometimes you will see a remark that the sale is for information purposes only and is not to be used as a comp. Even if the sale is reported on the MLS, that does not make it a legitimate, arm's length transaction.

Using foreclosure sales

In the current economy, foreclosures have skyrocketed and REO sales have become common in many areas. Lenders may be more willing to accept a short sale to avoid foreclosure. The problem with using these sales is that in many instances the buyers and sellers are not typically motivated. The seller may want to unload the property as soon as possible, not caring about the final price receives. The buyer may take advantage of this and make an offer much lower than what they are willing to pay. The properties themselves are often sold "as is", without any repair or inspection contingency. Given these problems, FHA and other lenders "strongly discourage" the use of foreclosure sales or short sales as comparables.

In areas where there are only a few distress sales, it is easy to ignore them as comparable. In some areas, however, there are so many foreclosure sales that they have become the market for that area and buyers will not pay full price for a home absent special financing or concessions. As a result, there could be a longer marketing time and resultant decline in value in the area. These factors should be noted in the marketing conditions section of the appraisal report or on the 1004 MC. In this circumstance, using a foreclosure sale might be warranted, if adequate research is done and the use of the sale is explained in the report.

Recordkeeping

You should also be careful to correctly identify both your data source and verification source, and to keep in your workfile a copy of the information relied upon for the appraisal. For example, if you use MLS as your data source and tax records as your verification source, you should have a copy of the MLS sheet and tax record in your file. MLS and tax records may be changed or deleted before the end of the 5 year retention period for the workfile, and it is important that you can show what information you relied on in your appraisal. Sometimes you may receive information orally, such as from the listing broker over the telephone. You should make a note for the file of your conversation, including the name and telephone number of the source of information and the date, as well as a summary of the information received. You do not have to keep a paper workfile. You may keep your entire workfile in electronic form.

Summary

The choice of comparable sales is crucial to the valuation process. Make sure you have done the necessary research to choose the best sales available, and then verify the data until you are confident that the data is accurate. Make appropriate adjustments as warranted. Keep good records, including documentation of the source of your comparable sales, in case your appraisal is questioned in the future.