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an honest appraisal

determining the bank value of an architect-designed house in a skittish economy.

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Credit: Ken Orvidas

From the bailout of failed investment banks to the deflating real estate market, the question of how to calculate value is on a lot of people's minds these days. During the joyride, houses of every ilk were routinely overpriced as appraisals became unmoored from any objective standards. As the dust settles, architects and their clients are back to grappling with the pesky appraisal issues they encountered before the boom. That is, toting up the cost of land, construction, and design doesn't always produce a loan-to-value ratio that enables clients to turn their construction loans into mortgages. And in this traumatized lending climate, the process is even trickier.

What is a house worth? To set a price, appraisers call up recent sales of homes in a neighborhood, comparing such items as size, number of bedrooms, and the quality of kitchens and baths. That checklist approach makes sense in builder-designed communities where economies of scale resulted in overall similarities. But the “comp” method on which banks base their loan risk has little to do with the expressive, one-of-a-kind residences that architects design.

The reality, sadly, is that the system is wired for the common denominator. Lenders care less about an award-winning design than they do about how quickly they can sell the house if the owner can't pay the mortgage. And while it's true that the free market ultimately determines a house's worth, architects and their clients are finding that value judgments can't be left to chance. “You can't ask someone who deals with numbers every day to distinguish a better floor plan,” says Eric Rawlings, AIA, principal of Rawlings Design in Decatur, Ga. “They don't know where to begin.”

That's why some architects are taking appraisers under their wing. Erik Lerner, AIA, an architect and real estate broker in Beverly Hills, Calif., routinely points out the subtler attributes of the architect-designed homes he sells. An excerpt from a Web site he prepared to advertise a new home by Predock_Frane Architects reads: “The home's formal street elevation gives way to open, casual interior spaces, which follow the descending contours of the lushly landscaped site to a shaded glen at the rear. The design makes much of its connection between the inside and the outdoors, using an array of skylights and windows at the perimeter and an internal court to distribute daylight and provide natural ventilation throughout.”

Those features are obvious to professional designers, but they're often overlooked by Realtors and real estate appraisers focused on granite countertops, cherry cabinets, and hardwood floors. Even if appraisers notice these qualities, they might not be able to articulate their benefits well enough to justify a higher price point. “My job of pointing out why the spatial qualities [of an architect-designed home] are superior to the builder house next door is easy,” says Lerner, who works in the market's upper echelons. “Every room in this house has daylight on at least two sides, which is a really impressive design feat on a challenging site. On a more ordinary house you'll notice a difference in the quality of light and natural ventilation.”

Anecdotal evidence suggests that more new homes are failing to appraise at a price the buyer wants to pay, Lerner says. “Banks are reluctant to make loans altogether, so the idea of a house appraising for a premium they previously didn't understand is definitely a much harder sell now. Our market favors the buyer with a lot of cash, and that's true for the general market now as well.”

a cut above

Of course, there are ways to get around the appraisal system. For the deep-pocketed clients of high-end firms like San Antonio-based Lake|Flato Architects, bank loans have barely been an issue. Those who do finance their projects are usually building on remote ranch properties (and not comparing themselves to anyone) or in areas with historically high real estate values. When problems arise, the firm shows appraisers other homes they've designed in the city or suggests they call other architects to check the construction cost of similar projects. “The lender is looking at the creditworthiness of the owner more than comps,” says partner Karla Greer, AIA. “They also realize that many areas are in transition and the project may create a market for more to come.”

Working often in the tight-knit architectural community of Venice, Calif., near his office in Santa Monica, David Hertz, FAIA, LEED AP, also steers appraisers to other homes of similar caliber. But in this rarefied housing environment, real estate rules can be broken. On a spec house for a Hollywood director completed last October, “we argued over comp value with the owner all through construction,” Hertz says. “He wanted to compromise, but we convinced him that if you go the distance with materials and make an architectural statement, you can reach way outside of averages for a buyer who's not stuck in the fray of comps.” The owner was hoping for $2 million to break even, Hertz says, and the house sold in seven days for $3.24 million (more than $1,600 per square foot) to one of the Pritzkers, of Pritzker Architecture Prize fame. “They would never have bought a house that was just run-of-the-mill,” he says.

Other times, appraisals do matter. When a recent European client wanted a minimalist house with open rooms and cabinetry rather than closets, Hertz explained that it wouldn't appraise well without a closet in every bedroom and full baths. “People hate full baths because they take up space and the tubs are never used,” Hertz explains, “but we end up putting them in, because some appraiser 50 years ago said a bathtub makes it a full bath, or a closet makes it a full bedroom. We end up giving the bank sets of drawings that have closets, but the client can choose not to build them out.” Still, he allows, it's not the ideal solution.

To ensure bank values align with construction costs, Michael Ryan, AIA, Loveladies, N.J., provides quantifiable market data in the form of plans and materials costs when asked. He occasionally gets calls from appraisers seeking to validate the costs quoted by the homeowner. “A lot of times they're looking to us to tell them how to value the house,” Ryan says. He's noticed that while many appraisers simply drive up to the house, those who go inside quickly grasp the intangible merits like daylighting and layout.

Like Ryan, Lerner runs construction data with appraisers when necessary. And making the case for existing homes often involves casting a wider geographic net. Coming up with a number on a Neutra home, for example, might mean comparing 10 other homes by the architect outside the customary one-mile radius and adjusting for neighborhood to establish a price that better reflects the architecture. In some regards, iconic homes have become an easier sell to banks, Lerner says. Most people recognize pedigree and the premium that goes with it. “They know who Schindler, Wright, and Gehry are but not necessarily the younger architects who are doing good work—a Warren Wagner, AIA; Jesse Bornstein, AIA; Lorcan O'Herlihy, AIA; or Studio Pali Fekete architects, for example.” In those cases, Lerner is quick to point out the use of innovative, yet practical materials such as rainscreens that protect the exterior, engineered wood floors that save natural resources, or the extra care the architect took to create sight lines.

Even though such research can be done on the fly, appraisers are supposed to inform clients if they don't have experience with unusual properties or haven't worked in a particular community. “Not every appraiser should take an assignment like this; they'll miss something and get it wrong,” says Lawrence Netterville, executive vice president of the National Society of Real Estate Appraisers in St. Louis. He explains that valuing a unique property means drilling down to submarkets to see who's competing for it and what kinds of characteristics they're looking for, and then looking at comparables and adjusting for differences. He advises owners to check the appraiser's credentials. On the other hand, a house that costs more than $100 per square foot more to build than its neighbors raises a red flag about the market's ability to absorb it. “The way we look at it is that banks are taking a defensive position: What if I can't move my money?” Netterville says. “They don't care how hip or cool it is from an ecological or other standpoint, if the design is so unique and nonconforming that it will narrow the field of buyers.”

Appraiser Alan F. Simmons, SRPA, LEED AP, Colorado Springs, Colo., agrees that a property's uniqueness cuts both ways. “The estimate is based on market value, not on the one out of 20 homeowners who might appreciate something super-personalized the architect did,” he says. “The further you get from the standard norm, the higher the chance that some of the costs won't translate into value.” The average buyer, he adds, is still most influenced by kitchens and baths. However, Simmons recognizes that “dealing with an unusual house is a two-way street. We would need to get plans or specs and interview the builder, architect, or cost estimator to find out what makes it different, and would figure in the architect's fee.”

Green homes will soon be getting the credit they deserve, thanks to coursework Simmons recently developed for the Appraisal Institute in Chicago. An online seminar on how to value green residential properties debuted last November, and this year Simmons will take the show on the road. Energy efficiency, the most quantifiable component, is weighted the most heavily. So far, benefits such as better indoor air quality and the use of recycled materials don't directly translate to value in an appraiser's book. “The biggest factors are utility cost, water usage, durable materials, and low maintenance, which translate to functional utility,” Simmons says. “We try to look at the life-cycle analysis and return on investment, but the pattern is still emerging. Five years from now we'll have more market evidence on the value of green homes.”

award-winner or white elephant

The comp method is the easiest way to value a house, but it's not the only way. An alternative is to look at a house's components and consider their replacement value, like an insurance company does, suggests Jeremiah Eck, FAIA, a partner at Eck MacNeely Architects in Boston. In the old days, he half-jokingly offered his clients the option of giving him a percentage of the house's increased value in lieu of a design fee. “The truth is that if they'd taken me up on it 20 years ago, I'd be richer than I am now,” he says. “Architects' houses are better built, sited, and detailed. And they generally hold up, as long as the style—and I hate that word—is consistent with the tradition in New England in our area.”

These days, though, even a small deviation from the norm can be a sticking point. “Even in my genre, which is a mix [of modern and traditional], some banks are saying that they don't feel it's a house they could underwrite because it's a little too different from the rest of the houses in the neighborhood,” Eck says. “I find that extraordinary.” A recent example is a post-and-beam house he designed with living spaces on the second floor to catch a better view of the swamp. The client is searching for a mortgage, and in this skittish economy, the bank didn't want to touch it.

Given the experience of the past five years, Eck is dubious that appraisals offer a reliable standard of worth. In perfect hindsight, he says, using the comp system alone to justify the worth of a house has been a wholesale failure. “If appraisers had been more honest and professional during the last five years, some of these increased values would have had more realism to them,” he says. As a case in point, Eck recently purchased a house for $300,000 less than what he estimates it cost the owners to build four years ago. He put a good chunk of money down, and the house was appraised at slightly more than the value of the mortgage. “The number didn't reflect anything except safety to the bank,” Eck says. “If he'd asked what was put into it—construction cost, value of the land—it would have been much higher. Appraisers in this climate are reluctant to say a house is worth $100,000 more than you paid for it. Either that, or they need to get with it and look at the value of houses in a hard sense, because now more than ever, people are looking for real value.”

But in a subjective world, the value of some one-off homes will always be in the eye of the beholder. Tom Kundig, FAIA, a principal at Olson Sundberg Kundig Allen Architects, Seattle, tells the story of a client who spent $1.1 million on her house and land. Shortly after completion, the property was judged to be worth about $600,000 by an appraiser who viewed it as an ugly concrete bunker—a teardown. Six months later, though, a prospective client of Kundig's walked through the house and offered her $3.5 million in cash. “It's a strange marketplace,” he says. “On one hand you have an appraiser who doesn't know what he's looking at, and on the other, it doesn't matter how much it costs to people with means. It's not a financial matter: They just want what they want.”

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show and tell

Oil prices, climate change, and the credit crisis all will fundamentally change the way in which cities are built, and the value of real estate,” predicts John Brown, RAIC, an architecture professor at the University of Calgary in Alberta. He's also the founder of housebrand, a design/build/furnish firm that gives middle-class consumers an alternative to mainstream production homes, and a companion Web site called Slow Home (www.theslowhome.com).

Since embedding himself in the housing market by adding the Realtor hat 14 years ago, Brown has been talking to appraisers about such things as the difference that $30,000 worth of windows makes, and why that should be reflected in the home's value. His firm, housebrand, builds or renovates about 40 dwellings a year in inner-city Calgary (ranging in construction cost from $150,000 to $3 million), and they're starting to resell for 10 percent to 50 percent higher than others on the block. In addition to their superior design, Brown chalks up the success to his relationship with a bank and the three appraisers whom he trusts to value the projects. “My role as Realtor and contractor and architect erases the perception—rampant but not true—of the flighty architect,” he says. “Your work carries some weight if you can provide market data and tangibly [explain] why a house sold for $50,000 more.” It's akin, Brown adds, to changing a value determination based on a better lot, view, or street, and appraisers get that shift. But whether they feel comfortable putting their name on the line is a matter of time and experience.

“We're at the beginning of a pretty radical shift in the way the housing market works,” he says, “and it's a huge opportunity for architects to get involved and not just complain.”

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