

The Most Important Step to Financing
Your Dream Log, Timber Frame or Post and Beam Home!

CONSTRUCTION LOAN APPRAISAL'S 101

As specialists with log home financing, we strive to provide excellent information to help educate customers about log home financing. While others may dabble in construction loans, we believe our expertise and service set us far apart from all other lenders. One of the most misunderstood parts of the financing process for custom log, timber frame and post and beam homes is the appraisal. Many borrowers do not understand the appraisal process, therefore they do not ask any questions of their prospective lender when they are shopping. Often people will only learn the impact of the appraisal after their chosen lender wastes weeks or months and ultimately cannot complete the financing. At Preferred Capital Mortgage Services, we take pride in our ability to analyze your planned project and discuss any potential appraisal issues. We have prepared the following tips to help you better understand the appraisal process and possibly avoid some of the common roadblocks.

Real estate appraisers are independent parties, not directly associated with the bank or lender. They act as a disinterested third party to report current real estate market conditions, based on research of recent property resale. Before the appraisal process can begin, the appraiser will need a copy of the plans, a copy of the quote/contract from the general contractor detailing the actual work to be done, a copy of the log, timber frame or post and beam package quote/contract and a copy of the deed (if the land is owned). It usually will take 7-10 business days for an appraiser to complete their report. Since the new home and land is the collateral for the loan, the lender will rely on the appraisal to determine the marketability of the home (in the unfortunate case of borrower default or foreclosure). Conventional mortgage underwriting will require receipt of an appraisal showing at least three comparable resales from the most recent twelve months.

Following are several tips to help you better understand the appraisal process and possibly help you avoid a financing roadblock. Of course, this information may not pertain to you and your project. **Also, if any situation below would apply to you, these situations would be problematic with any lender using conventional financing and are not representative of issues common only to Preferred Capital Mortgage Services.** In addition, it is important to note that the situations below would also apply to any other type of custom home construction (brick, stone, etc) – they are not related to log, timber frame or post in beam only. As stated previously, we hope this will educate and prepare you better for your appraisal.

Exclusively Log Home Comps

Many banks or lenders that do not specialize with log home construction will require exclusively log comparables for your appraisal. This requirement will severely restrict the appraisers search for comparables. There are two very common problems that can arise with this type of underwriting guideline. First, there simply may not be any other log homes in the area of the subject property. Therefore, the appraiser cannot meet the order. Second, if there are log homes in the area, they may not have been resold. An appraisal is based on resale of homes and it is normally uncommon for log homeowners to sell their dream home. As a result, you may have other neighbors with similar size log homes on similar size lots, but they cannot be used as comparable properties on an appraisal. This restriction is the most common roadblock that borrowers will experience as they seek construction financing for their log home. American Log Mortgage understands the log home business, so we will not limit the appraiser to only log home sales. Since a log home is a custom built home, we will accept other custom homes as comparables. In other words, if you are building in an area where there are no other log homes or there are no log homes that have sold in the past twelve (12) months, we will be able to accept other construction types that are considered similar in quality and appeal.

Large Acreage

It is extremely common for people to plan their dream log homes in areas away from the hustle and bustle of city life. Often, they will desire large open spaces that can provide quiet and privacy. Sometimes purchasing or owning excessively large acreage may cause trouble or difficulty when ordering a construction appraisal, though. While a log home will always be unique, the overall property must still be "common" for the area real estate market to meet conventional financing requirements. For example, let's say that you are planning to build a 2000 square foot, 3 bedroom, 2 bathroom, ranch style home and own 50 acres. When the appraisal is ordered, in order to count value for all the acreage, the appraiser will be required to find resale of other ranch style homes that are approximately 2000 square feet with 3 bedrooms, 2 bathrooms that sit on about 50 acres. The size of the home and rooms would be common in most markets, but would you normally also find them with 50 acres? If not, the appraiser may need to make excessive adjustments that would exceed acceptable limits for conventional mortgage underwriting. What is the solution? It depends whether the land is owned free and clear or not. If yes, then the simple solution is to subdivide the land to a more common lot size for the market. However, if the borrower is relying on their full land value for down payment, this may limit the amount lot equity that may be needed to cover the down payment. Many banks and lenders will only allow a 5-acre maximum for their appraisal. At Preferred Capital Mortgage Services, we are conscious of the impact of the land and will ask questions and help to make sure you avoid surprises.

Over-improvement or Overbuilding For Area Market

Appraisers will sometimes consider new homes “over-improvements” when the construction costs involved cannot be supported by area sales. Again, the appraiser needs to find comparable properties (similar square footage, similar style, similar acreage, and similar amenities) that have resold in the immediate area with the recent twelve (12) months. Many borrowers, builders and dealers do not always understand that the costs of building a new home does not establish the market value for the home. Installing expensive plumbing and lighting fixtures, flooring or kitchen will increase the cost of completing a home, but do not necessarily provide dollar for dollar market value on an appraisal. If the turnkey building costs are \$200 per square foot and comparable homes have been selling at \$150 per square foot, the borrower will find the appraised value to be less than your costs to complete. This is not a comment on the quality of the home, but an estimate based on current market sales, showing the highest price a future buyer from that area might pay for the home if it was resold. In some cases, depending on maximum financing limits, this situation may require the borrower to put more cash in to the project. It is also important to note that this would be an issue for the borrower regardless of the type of construction (brick, log, timber frame, stick frame, modular).

1-2 Bedroom Floor plan, Below Grade Living Area and Unfinished Rooms

It most markets it will be very difficult for appraisers to find good one bedroom comparables. Generally, the marketability and/or resale for this type of property are very limited. Therefore, sometimes there may not be any comparables available. More often, the comparables located will not support the value for the new log home. Sometimes the floor plan has additional bedrooms, but they are going to be below grade or in the basement. An appraisal, though, is based on the livable square footage that is above grade. Therefore, the bedrooms in the lower level will not add to the room count or total square footage. For example, a ranch style home with an 800 square foot main level, including one bedroom and a one bathroom. The floor plan also includes an additional 800 square feet with two bedrooms and a bathroom in the lower level. For appraisal purposes, this home would be considered an 800 square foot, one bedroom, one bath home (even though there is additional finished space in the lower level). Thus, the appraiser will need to locate resale for other one bedroom, one-bath properties. This same situation can occur if there are unfinished bedrooms on the main level. If the livable square footage includes three bedrooms, but only one will be finished, this again would be appraised as a one-bedroom property. Unfinished rooms cannot be included.

Unusual Power, Heating or Sewer, “In-Law Quarters” or “Guest Quarters”

Anything that would be a standard component of a completed home that would not be common for the real estate market can cause appraisal issues. For example, use of generators or solar power as the main source of energy. While it is certainly viable and cost effective, it also would force the appraiser to find other homes that have resold with the same type of energy. The same could be true for homes that have planned heating with wood or coal burning stoves, rather than a traditional heating systems.

“In-Law Quarters” or “Guest Quarters” that are self-contained living spaces, may also prove difficult for the appraisal. Now, the appraiser must find properties that have sold that not only have a comparable home, but also comparable additional separate living quarters (either attached or detached). If an appraiser can find comparable resales, there is no problem. Normally, however, these will be difficult or impossible requests.

Lack of Sales

This is a condition that no one can control. Appraisals for conventional financing normally require a minimum of three comparable resales from the most recent twelve (12) months. From time to time, some people will unknowingly plan to build in an area that has experienced limited or no activity. Of course, this is rare, but can be an issue that complicates availability of financing.

If you are unsure about the market where you plan to build, contact an appraiser and discuss the project. It is better to address these issues in the beginning/planning stages.

