Appraisals

An appraisal is a professional opinion of the value of the home you are buying. Your lender will order the appraisal from an independent, licensed appraiser. Although the appraisal report technically belongs to your lender, we will provide a copy to you as soon as we receive it.

Appraisers have three methods they may use to develop an opinion of the value of a property. It is up to the appraiser to determine which approach(es) are appropriate for a given property. Within the report the appraiser will talk about which approaches were developed, why and how they were reconciled.

1) Sales Comparison Approach

The Sales Comparison Approach is the backbone of every appraisal. The appraiser searches all of the homes that have sold recently and nearby, looking for those that are as similar as possible to the one you are buying. The appraiser selects five to seven comparable properties (or "comps"), systematically adjusting for any differences. Even when an appraiser develops other methods, the Sales approach will receive the most weight in the final reconciliation of value.

2) Income Approach

When evaluating a property you are buying to rent out, appraisers do some additional work to determine the market rents—almost a report with a report. Similarly to the sales comparable approach, they search for nearby, similar rental properties to determine the likely market rent for the property. Then, using a formula they'll describe in the report, the appraiser works backwards into a value based on the property's income-generating potential, called the Income Approach.

There is no central database for rental data, so appraisers generally rely on larger property management companies for rent comps. Our experience has been that the rents an appraiser reports tend to be at the lower end of real world rents.

3) Cost Approach

Appraisal forms also provide a space for the appraiser to estimate the cost to build the property. Unless the property is proposed construction, many appraisers don't complete this section. If they do, they usually give it very little weight in their final reconciliation of value. This method is, you guessed it, the Cost Approach.

As-Is or Subject To

When the appraiser states an opinion of value, he or she will check a box, marking the report either "as-is" or "subject to". "As-is" means the appraiser finds the property to be safe, habitable, marketable and compliant with all lending guidelines. "Subject to" means repairs are required and the value stated assumes completion of these items. The report details the repairs. These may be things the seller already agreed to do as a part of your negotiations—but not always. The appraiser must re-inspect to verify completion prior to closing.

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Construction loans and rehabilitation loans, like Fannie Mae, HomeStyle and the FHA 203(k) are treated a bit differently. The appraisal will always be "subject to" the proposed construction or repairs, but the work doesn't start until after closing.

Appraisal Independence

During the housing crisis Fannie Mae & Freddie Mac with guidance from the Federal Housing Finance Agency (FHFA), developed a set of appraisal rules called the Home Valuation Code of Conduct (HVCC). Eventually Congress enacted a new section of federal law under the Truth-in-Lending Act (TILA) called Valuation Independence that prohibits certain interested parties (i.e., production associates for lenders/brokers, sellers, buyers, realtors, etc.) from having any influence in the selection of an appraiser. TILA's Valuation Independence also ensures that appraisers can be truly independent and free to draw value conclusions without pressure from certain interested parties in the outcome of a completed appraisal/valuation. Some lenders comply by outsourcing appraisal requests to third party Appraisal Management Companies (AMCs); others formed internal departments to manage appraisal requests. Either way, by design, there is a firewall between your lender and the appraiser. We can't even talk to our old appraiser friends anymore.

Realtor vs. Appraiser Valuation

For the most part, appraisers and real estate agents think about property values the same way. Both look to comparable properties to estimate value. But where appraisers are held to a rigid a set of standards and procedures (Uniform Standards of Professional Appraisal Practice or USPAP), Realtors have more freedom to intuit value based on nuanced and subjective factors.

The majority of the time, a Realtor and appraiser will reach a very similar value conclusion, but occasionally… not so much. When the market is appreciating rapidly, appraised values can lag, because appraisers can only look back in time to closed sales for comps. Unique properties can also pose a challenge. If the property is unlike all of the recent closed sales, appraisers can struggle to complete a report that satisfies USPAP and underwriting standards. Realtors can get creative, using pending sales, older sales and their experience and instincts about the value of a property.

Head-Scratchers and FAQs

Most of the potential for questions lies in the "grid" where the comparable sales are adjusted and reconciled. The adjustments appraisers use can look just plain weird to the untrained eye. Read the notes provided in the report for a roadmap to the assumptions the appraiser made, but don't expect them to make intuitive sense.

Real estate agents and online home valuation tools (Zillow and such) rely heavily on the price per square foot as a quick, easy rule of thumb for assessing value. Appraisers also use the cost per square foot to adjust but in a far different manner. Adjustments for extra bedrooms, bathrooms and

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those for other features will seem really low, but they already assume an underlying value for the square footage, neighborhood and quality of construction.

Below-grade square footage is never counted as part of the living area of a home. This can be perplexing. Consider a 3 bedroom, 2 bathroom daylight ranch with a bedroom and a bathroom in the basement.
To an appraiser, this is a 2 bedroom, 1 bathroom house. Why? Because one bedroom and one bathroom are in the basement. They adjust for the value these rooms add, but show it on the "basement & finished rooms below grade" line of the grid. In fact, if any wall on a level of a property touches soil, it is considered below-grade. As a result, room counts and square footage for a daylight ranch or split-level home always look off.

Finally, you may see an adjustment, near the top of the grid, for "sale or financing concessions". For each comparable sale, the appraiser is required to determine whether or not the seller paid any closing costs for the buyer. If they did, these concessions are adjusted out of the price. This one drives a few of our Realtor friends crazy, but from an appraiser's perspective the portion of the price that went to paying the buyer's closing costs isn't part of the inherent value of the home and must be backed out.

The Process and the Forms

The appraisal is the most time-consuming part of the loan process. We will let you know the date by which we need to order the appraisal. You'll pay a deposit equal to the anticipated cost. The cost and form used varies depending on the type of property; the reports for a single-family home, a 2-4 unit property and a condo each come on a distinct form.

Appraisals are a big, big subject. Just ring us up and we'll be happy to answer your questions.

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