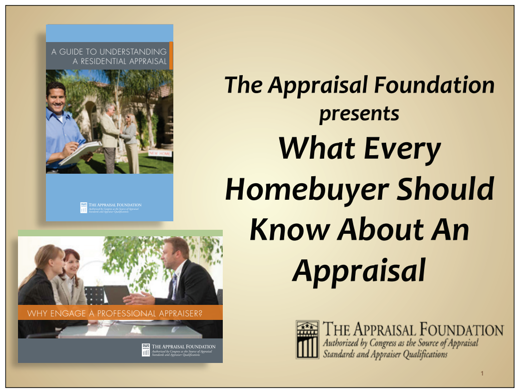
THE APPRAISAL FOUNDATION
Authorized by Congress as the Source of Appraisal Standards and Appraiser Qualifications

What Every Homebuyer Should Know About An Appraisal



Objectives

- To inform participants about the role that an appraisal plays in the home buying process
- To provide participants with information about the appraisal report
- To alert participants to unacceptable appraisal practices

A. **What is an Appraisal?**
B. **Who is the Appraiser?**
C. **How is Property Value Determined?**
D. **The Appraisal Report**
E. **Unacceptable Appraisal Practices**
(What to look for and what can you do if you think the appraiser was inaccurate)

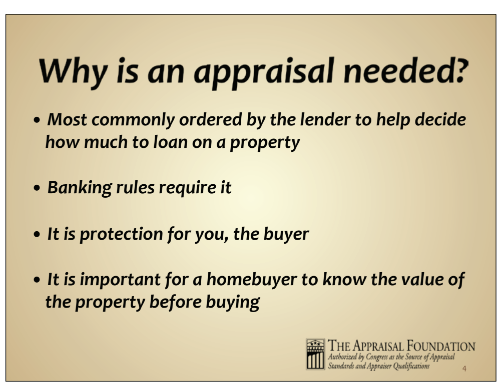
A. What is an Appraisal?

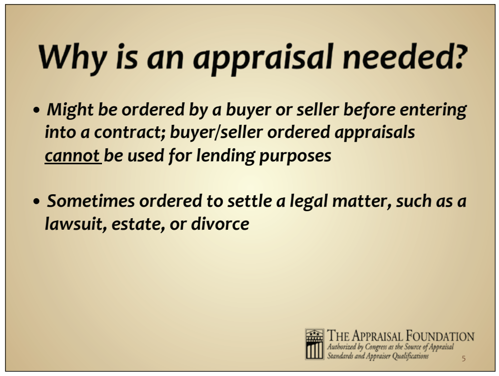
An appraisal is an opinion of the *market value* of a property, performed by a professional licensed or certified appraiser. In other words, what would a typical buyer pay for this house? An appraisal is:

- Most commonly ordered by a lender to help decide how much to loan on a property.
- Also might be ordered by buyer or seller before entering into a contract (an appraisal ordered by a buyer or seller, however, cannot be used by a lender in the loan underwriting process).
- Property owners might also get an appraisal to settle an estate, divorce, or litigation.

Why is an appraisal needed?

- Collateral valuation is a critical part of the mortgage loan underwriting process.
- Federal lending rules require it for many transactions. It is protection for the lender. If the borrower does not pay back the mortgage, the lender will have to sell the house to get its money back.
- It is protection for you, the buyer. You do not want to pay more for the house than it is worth! Be sure the purchase and sales contract you sign has a contingency clause that says that if you cannot get the mortgage you planned on (due to an appraisal that does not support the purchase price or other reasons), you will not have to buy the house.





Who hires and pays for it?

Lenders hire appraisers from their approved lists. The appraiser may be engaged directly by the lender or by an Appraisal Management Company (AMC) acting as the lender's agent, **but the home buyer usually pays for the appraisal**. You are entitled to a copy of all valuation reports no later than 3 days prior to loan settlement – ask for it!

Are all "opinions" appraisals?

Not all valuations or estimates of value are appraisals. An appraisal is an opinion of value performed only by a professional licensed or certified appraiser, and which complies with the *Uniform Standards of Professional Appraisal Practice* (USPAP). It is required for most mortgage loans.

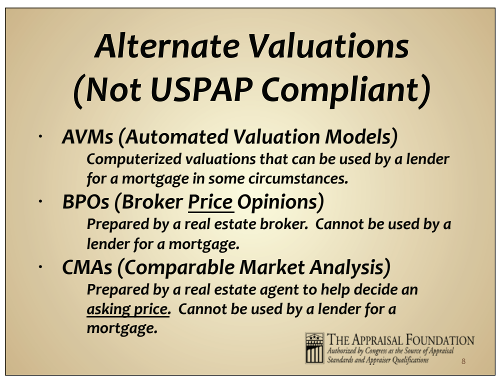
Alternate valuations include:

An **Automated Valuation Model** (AVM) is a computer-generated value estimate that a lender may use in some circumstances to support a mortgage.

A **Broker Price Opinion** (BPO) is prepared by a real estate broker, sometimes used when the loan is small compared to the property value. It does not comply with USPAP, and cannot be used by a lender to support a mortgage.

A **Competitive Market Analysis** (CMA) is prepared by a real estate agent to help decide on an asking price. It also does not comply with USPAP and cannot be used by a lender to support a mortgage.

Generally none of the methods above involve an interior survey and some do not even require a "drive-by."



B. Who is the appraiser?

An appraiser is a professional expected by all the parties to perform valuation services competently and in a manner that is independent, impartial, and objective. They must be licensed or certified by the state in which the property is located.

That means they have met requirements for:

- Special qualifying and continuing education
- Passing a national examination
- Experience
- Compliance with competency and ethics of USPAP

Licensing Categories

<u>Licensed Appraiser</u>

Can appraise non-complex 1-4 unit residential properties up to $1 million in value.

Has:
- 150 hours of specified professional education
- 2000 hours (+/-2 years) of supervised appraisal experience
- Passed a 6-hour exam

<u>Certified Residential Appraiser</u>

Can appraise <u>any</u> 1-4-unit residential property.

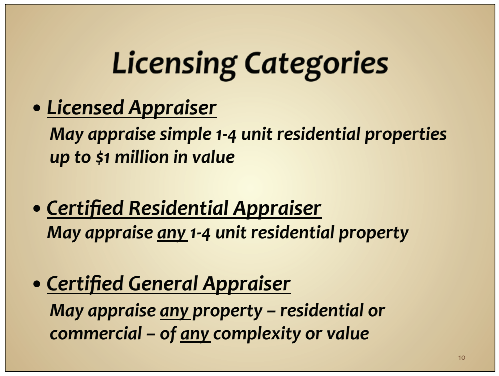
Has:
- 200 hours of specified professional education
- 2500 hours of appraisal experience
- Passed a 6-hour exam

<u>Certified General Appraiser</u>

Can appraise any property – residential or non-residential – without regard to complexity or value.

Has:
- 300 hours of specified professional education
- 3000 hours of appraisal experience, of which 1500 must be in non-residential assignments
- Passed an 8-hour exam

In addition, all appraisers must complete at least 14 hours of state approved continuing education each year.



Who develops the requirements?

The minimum qualifications and standards for licensed appraisers are set by the independent boards of The Appraisal Foundation. The Foundation is a private, not-for-profit organization that is authorized by Congress as the source of appraisal standards and appraiser qualifications. Each state may add stricter requirements. The requirements are then enforced by each state's appraiser regulatory agency which can discipline appraisers for violations by fines, suspension, or revocation of licenses.

USPAP Requirements

Independence: the appraisal fee cannot in any way be affected by the final opinion of value or whether the loan closes.

Objectivity: the appraisal opinions must be based solely on the data and analyses, not on predetermined conclusions.

Impartiality: the appraiser cannot be an advocate for any of the parties to the transaction.

Credibility: the appraisal must be worthy of belief – the value opinion has to be supported by evidence and logic.

Confidentiality: the appraiser must protect all confidential information, including the appraisal results, by not disclosing it to anyone other than the client lender without client authorization. Because of this, the appraiser cannot discuss the report with the borrower without the lender's permission.

Competence: the appraiser must possess the knowledge and experience to complete the assignment competently and credibly. For example, this may relate to familiarity with the geographic area, the specific market, the type of property, or any special laws or regulations that may apply.

Performance:
The appraiser
- must not commit a substantial error that significantly affects and appraisal, or be careless or negligent,
- must identify all the characteristics of the property that affect its value,
- must consider and analyze all data that is available, placing greatest weight on that which is most relevant.

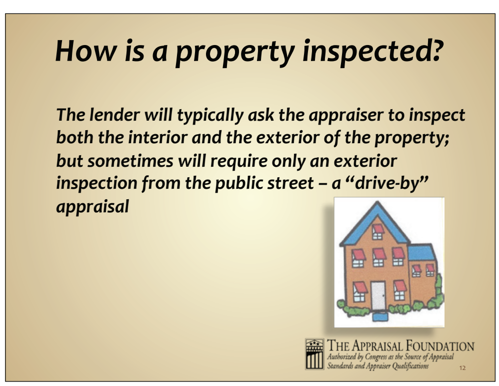
C. How does the appraiser determine value?

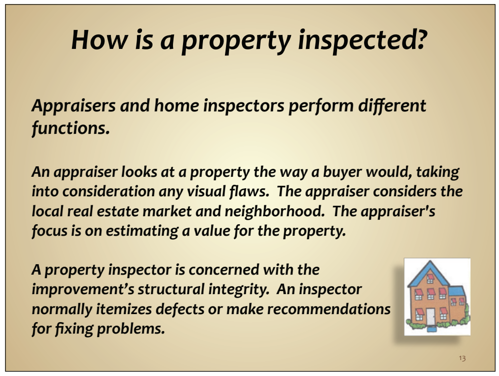
How is a property inspected?

The lender will typically ask the appraiser to inspect both the interior and the exterior of the property, but sometimes will require only an inspection of the exterior from the public street – a "drive-by" appraisal. Appraisers and home inspectors perform different functions. An appraiser looks at property like buyers do. A home inspector takes into account the structural integrity of property. An appraiser is not a home inspector!

- Does not take apart the furnace
- Cannot say whether wiring and plumbing is good
- Does not do termite inspection
- Cannot determine whether cracks are serious
- Cannot decide whether mold is dangerous

An appraiser, however, should report what he/she sees! A *Home Inspector* will inspect for those things and decide whether there is a potential problem with them.





How does the appraiser determine value?

It is important to note that appraisers do not set property values – the market does. The appraiser analyzes sales and listing data and where applicable, income and cost data to form an opinion of what value the market would place on the subject property. The principal methods of estimating value for residences:

Sales Comparison Approach: Compares your property to others that have sold recently.

Cost Approach: How much would it cost to replace it?

Income Approach: May be used in the case of 1-4 unit income producing residential properties.

How does the sales comparison approach work?

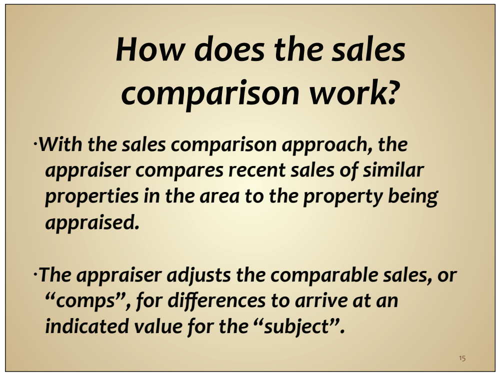
The appraiser compares at least 3 current sales:

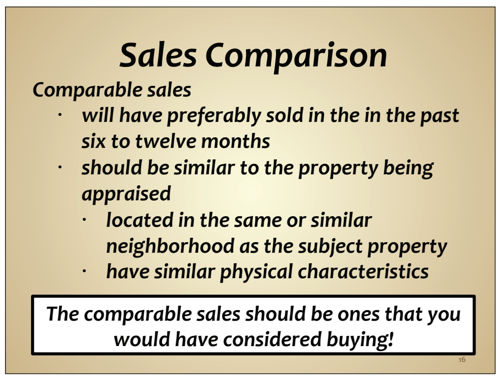
- They should be similar to the property being appraised
- They should be from same neighborhood – or one just like it
- They should be ones that a typical market participant might have considered buying

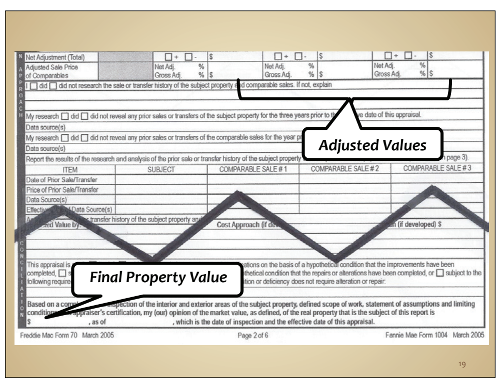
The sales price of each of those properties is then adjusted for differences between that house and the one you are buying to find out how much that buyer would have paid for your house.

- If that "comparable property" is better than yours, then a dollar amount is subtracted from the sales price.
- If it is not as good, then the adjustment is added.
- The adjustment amounts are not necessarily the cost of those features, but the value the resale market places on them – determined by the appraiser based on his/her ongoing analysis of market actions.
- The adjusted total values for each of the comparable sales represent a range of value.

- The amount of that range – the difference between highest and lowest – should be within a reasonable range of each other.
- The appraiser then reconciles the adjusted data to reach an indicated value within that range.







How does the cost approach work?

The appraiser calculates the cost to build that house today and then subtracts <u>depreciation</u>. Appraisers break this down into three parts:

<u>Physical Depreciation</u>: wear and tear to the house and its various heating, plumbing, and other systems from weathering and from simply being lived in.

Functional Depreciation: Unusual features that most buyers don't find desirable or aren't willing to pay much for, like a bad floor plan or luxury cabinets and appliances.

External Depreciation: things near by the house that make it worth less than others in the neighborhood, such as a gas station across the street.

The appraiser then adds the depreciated cost of site improvements to the lot, like a fence or driveway, and adds the value of the land.

The land value is typically determined by comparing and analyzing sales of similar vacant residential building lots with the Subject lot. This analysis is much like that used in the sales comparison approach for improved properties. After adjustments are made for significant differences, the appraiser arrives at an indicated value for the Subject lot. The result should be a value that is supportive of the value indicated in the Sales Comparison Approach.

When is the income approach used?

- The income approach may be used for small 1-4 family income producing residential properties
- There are typically three different methodologies that may be employed
    - **Gross Rent Multiplier** (GRM)
    - **Gross Income Multiplier** (GIM)
    - **Income Capitalization**

Because sale and rental prices are subject to the same market influences, they tend to move proportionately in the same direction.

In other words, if rental prices go up or down, sales prices will usually follow suit and to the same degree. This relationship can be expressed as factors which are the Gross Rent or Gross Income Multipliers

Gross Rent Multiplier (GRM) is simply a number that expresses a ratio of the sale price of a residential property to its gross monthly rental. **Sale price/gross rent = GRM.**

Gross Income Multiplier (GIM) is a number that expresses a ratio of the sale price of a residential property to its gross annual income**. Sale price/gross income=GIM.**
Neither calculation includes expenses.

In order to establish reasonably accurate GRM's or GIM's, the appraiser should have recent sales and income data from at least 3-4 similar properties that have sold in the same market area and were rented at the time of sale.

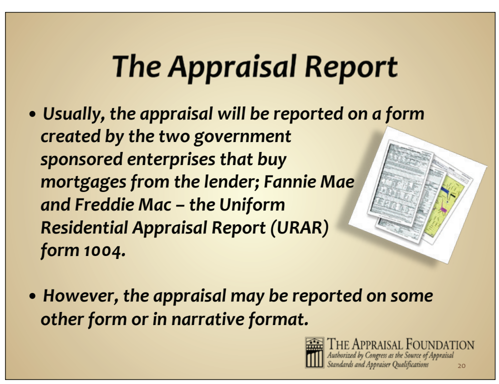
The resulting GIM or GRM can then be applied to the actual or projected rental of the Subject property to provide an indication of its market value

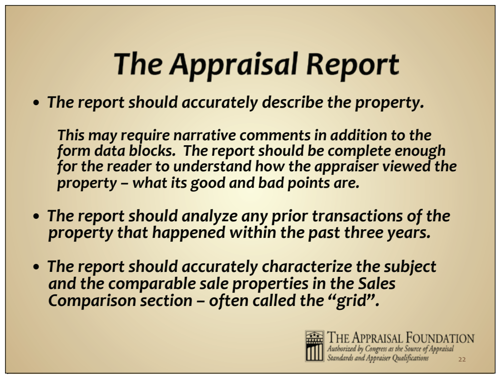
Income Capitalization involves projecting what rents can be expected over the next year and then deducting expenses. The "net" cash flow that remains will provide a "return" to the investor and it is this return expectation that will guide the investor as to how much to pay for the property.

D. The Appraisal Report

Most often, the appraisal will be reported on a form created by the two government-sponsored enterprises, Fannie Mae and Freddie Mac, the Uniform Residential Appraisal Report (URAR) form 1004. It may, however, be on some other form or be in narrative format. The USPAP requirements are the same regardless of the format of the report:

- It must not be misleading.
- It must have enough information so the intended users can understand how the appraiser reached the conclusions and opinions.
- The report should accurately describe the property.
- This may require narrative comments in addition to the data fields in the report – they should be complete enough for the reader to understand how the appraiser viewed the property and the rationale for unusual adjustments.
- It should analyze any prior transactions of the property that occurred within the past three years.
- It should accurately characterize the subject and the comparable sale properties in the Sales Comparison section (often called the "grid").
- The report may contain strange abbreviations and codes. If so, that's because the lender required the appraiser to comply with the Uniform Appraisal Dataset (UAD) developed by Fannie Mae and Freddie Mac. To interpret them, look through the appraisal report for the *UAD Definitions Addendum*. If it's not there, request it from the lender.
- The report should be signed by an appraiser who inspected the property. It may also be signed by a supervisory appraiser, who must *indicate whether he/she a*lso inspected the property.





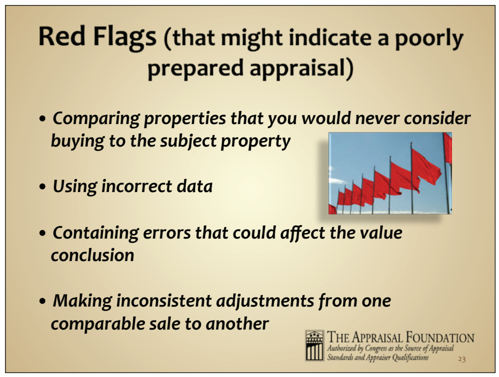
E. Unacceptable Appraisal Practices

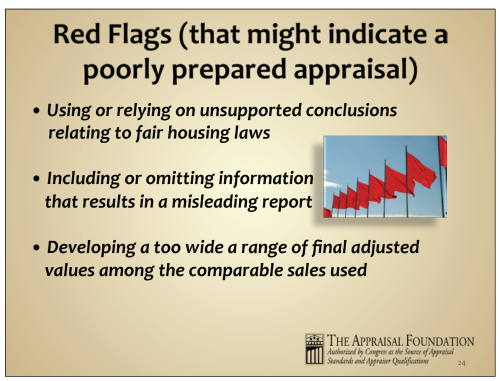
Red flags that might indicate a poorly prepared appraisal

Appraisals are not directly covered under the Fair Housing Act. However, USPAP requires appraisers to comply with essentially identical provisions of that act, and lending institutions using discriminatory appraisal reports to deny loans to members of protected classes can be held responsible for the appraisal. Both lending institutions and individual homebuyers should be aware of the following unacceptable practices:

- Inclusion of inaccurate objective data about neighborhoods, the subject property including all site improvements or comparable sales
- Failure to comment on negative factors regarding a neighborhood, property, or the proximity of a property to adverse influences, e.g. hazardous waste
- Use of inappropriate comparable sales
- Use of incorrect data
- Errors that could have affected the value conclusion
- Inconsistent adjustments from one comparable sale to another
- Inclusion or omission of information resulting in a misleading report (insufficient
- comments)
- Too wide a range of final adjusted values (should be within a reasonable range) amongst the sales used
- Use of data that was provided by people who have a financial interest in the sale or financing of a property unless the information has been verified

- Development of a conclusion that is based, partially or completely, on the race, color, or national origin of the prospective or current owners or occupants of the property or of the neighborhood
- Development of a valuation conclusion that is not supported by available market data
- Use of euphemisms or buzz words that may indicate the racial composition of a neighborhood
- Using inaccurate neighborhood boundaries that impact the value of a property
- Has the property transferred in a relatively short period time at a significantly increased price without adequate explanation?





What do I do if I think the appraisal is inaccurate?

First, contact your lender in writing, describing the problem and providing any evidence you have. You can ask for the report to be independently reviewed or for a second appraisal to be performed (but the lender is not required to do either). Be persistent but respectful of the independence of the appraiser. No party to the transaction can unduly influence an appraiser to change the opinion of value. An appraisal that results in an opinion of value below the proposed purchase price may assist the homebuyer in renegotiating the terms of the deal.

You may also file a complaint with the appraiser regulatory body of the state in which the property is located. They will require that you identify specifically what you believe is wrong and why – disagreement with the value conclusion is not enough. Try to provide factual data.

If the previous steps do not resolve your concerns, you can contact the following hotlines below.

Contact the Consumer Financial Protection Bureau (CFPB) by e-mail or telephone:

- www.consumerfinance.gov/complaint
- 855-411-CFPB (2372)

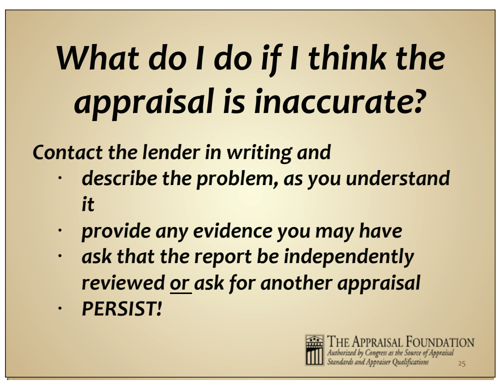
Contact the Appraisal Subcommittee (ASC) National Complaint Hotline (they do not resolve complaints but will refer you to the appropriate body for resolution):

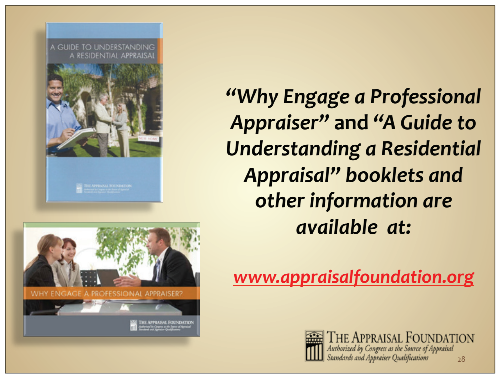
- http://refermyappraisalcomplaint.asc.gov
- 877-739-0096

Additional Information

- *Why Engage a Professional Appraiser* by The Appraisal Foundation
- *A Guide to Understanding a Residential Appraisal* by The Appraisal Foundation

Both of these booklets are available for free download from the Foundation's website at www.appraisalfoundation.org.





SUMMARY

A professional appraisal is the best protection that a buyer has against overpaying. The appraisal must comply with the nationally accepted standards of the appraisal profession. Whether the value conclusion is what you were expecting or not, a careful reading of the report should let you understand what data the appraiser used and how he/she arrived at the final opinions and conclusions.