RE26R20 - The Residential Appraisal Process for Non-Appraisers

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1. **What is the Objective of an Appraisal?**

- Understanding the process of residential appraisal and appraisal report for financing, establishing current market value and other purposes
- Impacts lending and transaction negotiations
- Price is not value and value is not the price
- There are many objectives to a residential appraisal determined by the client (probate, divorce, sale of property, refinancing, tax abatement, insurance, etc.)
- Each objective can employ a different appraisal method. There are many methods and over 30 types of value
- Not all appraisals are about determining market value

2. **What is an appraisal? Court definitions and Appraisal Institute definitions**
    a. Appraisal is the act or process of estimating value
    b. One person's opinion is based on research in the appropriate market and applying appropriate analytical techniques
    c. An appraisal can contain descriptions of any positive and negative influence affecting the value of the real property. Any appraiser on any given day can reach a different conclusion: Part art and part science.
    d. A BOV (broker opinion of value) or BPO (broker price opinion) is NOT an appraisal but often confusing to consumers
    e. A real estate agent cannot mislead a consumer that a BPO or Broker Opinion of Value (BOV) is an appraisal
    f. Discussion throughout module on how a broker can have a role in the appraisal process
    g. **Definition:** An appraisal is an unbiased estimate of the nature, quality, value or utility of an interest in, or aspect of, identified real estate.
    h. Appraisal is a valuation and an evaluation.
    i. **Definition** Valuation is the process of estimating market value, investment value, insurable value, or other property defined value of an identified interest in a specific parcel at a given date.
    j. **Definition:** Evaluation is a study of the nature, quality, or utility of a parcel of real estate without reference to a value estimate
3. **Appraisal License Process and Selecting or Recommending the appropriate appraiser to a Consumer**
    - **The different levels and requirements of a licensed appraiser and recommending the appropriate level to your client:**
    a) Licensed trainee
    b) Licensed appraiser
    c) Certified Residential
    d) Certified General
    e) Trade designations: MAI, SRA, SRPA (Member, Appraisal Institute; Senior Residential Appraiser; Senior Real Property Appraiser)
    k. Home Value Code of Conduct (HVCC) of 2009 federally regulates appraiser recommendations that apply to conventional loans sold to Fannie Mae and Freddie Mac but not FHA or VA. HVCC prohibits mortgage brokers and real estate agents from selecting or paying appraisers on residential appraisals. Appraiser must be selected by a third party. Discuss further.

4. **What are the federal regulations for an appraisal? How is an appraisal different from a broker's Comparative Market Analysis?**

a) Comparative Market Analysis (CMA) are now being regulated in some states: it is not a valuation but a "suggested listing range" so that the consumer understands the differences.
b) Uniform Standards of Professional Appraisal Practices (USPAP). What is it and how does it regulate appraisal reports?
c) Background on Savings and Loan Crisis of 1989 and the formation of the Appraisal Foundation, the Appraisal Standards Board and FIRREA (Financial Institution's Reform, Recovery and Enforcement Act) that created federal regulations and state oversight on appraisers. Licensing and federal regulations did not exist prior to 1989. States were independently responsible for appraisal regulations.

5. THE APPRAISAL PROCESS

- Discussing the process in advance to educate either the seller or buyer, how it affects contingencies in offers, timing to conduct an appraisal, why value agreed may not equal the appraised value, how it affects financing and why.
- **Definition:**

a) Definition of Market Value: most probable price in a competitive and open market
Buyer and Seller are typically motivated, well-informed or well-advised, property has reasonable exposure to the market, parties are unaffected by special or creative financing and its arms-length transaction.
b) Fair Market Value: What is "fair"? How does "fair" differ from "current market value?"
c) It's an estimated value at "this point in time." The value can change the next day.
d) Law of Supply & Demand is the basis for the 3 appraisal approaches.

6. THE LAW OF SUPPLY AND DEMAND

a) Assumes that the market is "perfect"
b) Assumes perfect knowledge of the product
c) Assumes An Active market with no monopolies of buyers/sellers or large enough to affect prices
d) Assumes homogeneous product: that all comparables are the same
e) Assumes all cash transactions, no financing
f) Assumes Easy Entry into the Market by All Interested Buyers
g) How is the market performing in your area? How does the market impact values?
h) Supply and demand impacts value

7. APPRAISAL INSTITUTE'S DEFINITION OF THE STEPS OF THE APPRAISAL PROCESS

a. Concepts of Land
   . Geographic
   i. Legal
   ii. Social
   iii. Economic
b. Appraisal
   i. Discipline of Appraisal
   ii. Real Estate, Real Property and Personal Property
   iii. Definition of Appraisal
c. Valuation Process
   i. Definition of the Problem
   ii. There are over 32 types of value and a number of methodologies. Each value dictates a different appraisal methodology and approach.
   iii. Preliminary Analysis and Data Selection and Collection
      - General
      - Specific
   iv. **Highest and Best Use Analysis**: How is this analysis to the foundation of valuation? What is legally permitted?

v. Land Value Estimate
vi. Application of the 3 Approaches
- Sales
- Income
- Cost
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vii. Adjustments, the process and singling out the property with the least adjustment
viii. Reconciliation of Value Indications and Final Value Cost
ix. Report of Defined Value
x. Review any updates necessary due to new Federal, USPAP or Congressional changes

8. There are 3 Approaches in Basic Appraisal Theory

A. SALES MARKET APPROACH

- **Definition:** Price that equates the supply of real estate to the demand for real estate

- Fannie and Freddie want comps that are closer to the subject property; comps up to 12 months and required adjustments for location, market and physical characteristics
- Veterans Administration (VA) has different criteria: discussion

. **Close Comps**: Want within one mile of subject property.
Current: Sold within the past 3 months.
Clone: Similar Features

a) How does an appraiser find market information? Discussion
b) Discuss how a broker can help an appraiser with data and market information.
c) Appraiser should be researching the market through discussions with market area brokers.
d) When comps are difficult to find: **Dissimilar**: Do not share the same dominant features**. Dated**: Up to 12 months. **Distance**: Competing markets to the subject property. How far away can an appraiser seek comparables?
e) Then the appraiser makes adjustments by using: Matched Pairs or Bracketing
f) **Match Paring**: Determining a value for a specific feature by comparing two properties that are alike in all features except for the feature in question. No "set" adjustment for a feature, you have to know and read your market. Even in the same market, adjustments change.
g) **Bracketing**: A technique of selecting some comparables that are slightly superior to the building and others that are slightly inferior regarding significant characteristics. Bracketing every minor characteristic of a building is virtually impossible.
h) This appraisal approach is more applicable to single family home sales.

B. INCOME APPROACH

- **Definition:** Price that equates the supply of income streams to the demand for income streams

a) This approach works better for investment property rather than owner-occupied
b) Calculate net income
c) Impose any variations in operating expenses with vacancy rate and reserves
d) Impose a capitalization rate
e) Determines potential value to investor
f) Research information from sales comparables, talking to investors, researching alternative investments, talking to investment brokers, etc.
g) Would be applicable for multi-family but what about single family dwelling units?

C. COST APPROACH

- **Definition:** Price that equates the supply of material and labor to the demand for material and labor

a) Strictly "bricks and mortar" approach

b) Cost to rebuild the same structure on the same site
c) Estimates from brokers, construction firms, architects, trade journals

9. INDUSTRY STANDARDS FOR REPORTING

- The Appraisal Institute sets minimum requirements for its own members on content, facts, descriptions and statements of work and purpose in all types of appraisal reports.

- **The report should include the following:**

a. Complete description of the appraised real estate.
b. Who is the Intended User, Purpose and Distribution? Scope of Work
c. Explanation of assumptions, limitations and disclaimers.
d. Competency of Appraiser for the assignment. How can an out-of-state appraiser be engaged? What is the definition of competent and how does the appraiser disclose competency?
e. All significant facts used.
f. Reasonable complete summary
g. Statement of the Interest Appraised.
h. Disclaimer Statements and why they are important to the reader and appraiser
i. Clear Statement of any smaller parcels of larger parcels.
j. That the appraiser has no interest or personal bias to the parties involved.
k. Certified statement that the appraiser did or did not inspect the property and the facts reported are true.
l. Statement of report distribution and intended use.
m. Date of valuation and report

10. REPORT WRITING in GENERAL

a) Function of a report is to lead a reader from the definition of an appraisal problem to a specific conclusion through reasoning and relevant descriptive data.
b) Appraiser's facts, reasoning, and conclusions must be presented clearly and succinctly.
c) Length of report is not as relevant
d) Can be oral or written but usually decided by client
e) If oral, still must have detailed documentation.
f) Must be meaningful to a client and not misleading in the market.

11. FINDING IMPORTANT INFORMATION IN AN APPRAISAL

a) Read the beginning pages defining the client. What is the purpose of the report and objectives?
b) Is the subject property on the market for sale or contemplated to be on the market?
c) Read the neighborhood description
d) What are the sample market conditions at the time of the appraisal?
e) What is the zoning, utilities, lot size and external issues?
f) Read the improvement section for physical deficiencies and conformity
g) Read the Disclaimers, Hypothetical and General Assumptions
h) Read the appraiser's noted process, market area reviewed and comps
i) Read the adjustments and reconciliation
j) What is the date of the appraisal, not the appraisal report?

12. **RED FLAGS IN RESIDENTIAL APPRAISALS**

a) Above predominant value for neighborhood?
b) What is the zoning? Residential I, II, Mixed-Use, Gen. Business?
c) Comps outside the market area?
d) Dated sales?
e) Across the board adjustments?
f) Many adjustments to comps?
g) Condition?

h) Large Lot Size? Public or private utilities?
i) Dissimilar comps (Year built, design, size)?
j) Need to check prior sale date and price
k) Comps adjusted in one direction (adjusted/unadjusted range)?
l) Client should be aware that a drive-by or desktop appraisal is limited and must be disclosed by the appraiser that they did not inspect the interior of the building and that if done so, could change the value of the property

13. **Use Example of Residential Appraisal Report**

- **And use examples of residential real estate valuation throughout this module**