“Anatomy of an Appraisal”

If you were going to dissect an appraisal, where should you start? What would you look for? How do you tell if an appraisal is “good” or “bad?” Why do appraisers look at the sales contract, anyway?

These are the questions I get from students whenever I teach and they discover I’m bi-lingual—I speak both appraiser and agent. And, because I still both sell and appraise real estate, I understand the frustration both sides have with the process. Many well intentioned regulations have had a negative effect on the entire appraisal process, resulting in the “travelling appraiser” (also known as the geographically incompetent appraiser) and the untrained underwriter with bizarre requests and questions. None of this is positive for the real estate industry. Agents need to know how to look at an appraisal and determine if it has been competently prepared, and meets the Uniform Standards of Professional Appraisal Practice (USPAP) requirement that it be “credible,” which is defined as USPAP as being “worthy of belief.”

There are several things an agent can look at when reviewing an appraisal. But, having just used the word “review,” let’s talk about some of the language associated with appraisers and appraising. The first word is *client*. The appraiser’s client is the person or entity who orders the appraisal. In the case of an appraisal being done for a lender, the client is the lender. They are also the *intended user*. In fact, when you look at a Fannie Mae appraisal report, this is printed on the form and cannot be changed by the appraiser. So, the audience the report is being prepared for is the lender not the borrower, and certainly not the agent. Borrowers get copies of appraisals because a federal law requires this. That fact still does not make the borrower an *intended user***.** If an appraisal is confusing, or thought to be faulty, or just as part of the quality control process, an appraisal may be *reviewed***.** But, a *review appraisal* is performed by another appraisal. So, you are “reviewing” the appraisal (as an agent) but the appraiser not only will not discuss the report with you, he or she *may not discuss it with you* unless permission is obtained from their client (the lender). However, after you review the appraisal, you may be urging the lender to get a formal review, done by a review appraiser.

The first thing you should look at is page one. This describes the property, including age, style, condition, site, and amenities; the neighborhood, the ranges of value for the neighborhood, and the overall marketing conditions in the neighborhood. Start with the facts by checking the following items for accuracy: address, parcel number, legal description, census tract number, flood plain map number, name of neighborhood, type of house, description of the house and the site. Many times, when reviewing an appraisal, I first discover numerous errors in these areas which leads me to a fuller review—and a lot more problems in the appraisal report.

As you read through this page, ask yourself if it makes sense. Did the appraiser describe the neighborhood the way you would? Understand that neighborhood boundaries can be any and all of the following: natural boundaries, man-made boundaries, governmental boundaries, and change in use or type of house. An example: a residential subdivision which has a public road and then three sides bounded by farmland would typically have a description which reads: "North to River Road, east, south and west to farmlands." An urban description would take into account changes in both property use and age, style and size of home. An example might be: "South to the campus of the Williamsport Hospital, east to Cherry Street, north to Grampian Boulevard, west to Campbell Street," particularly if the homes in the area as described are similar in age, size, style and type.

Does the description of the house fit? Appraisers often clone reports; a process by which they use an existing appraisal report of either a very similar property, or another property in the same neighborhood, to create the new report. This is okay, as long as they carefully redact and replace the information about the *other* house with the information about *this* house. You will notice at the bottom of page one the appraiser answers questions about whether or not the property has been remodeled or updated and in which time frame was that completed.

Page two is the grid on a standard Fannie Mae appraisal report. On the far left of the page is the information about the subject property. Then, there are the columns for three comparables as well as adjustments to comparables. The first thing to look at is whether or not the comparables selected and used are appropriate for the subject. It is not a complicated test: ask yourself whether or not the buyer for the subject property would have considered the comparables used as potential houses to buy. If they are good comparables they are similar in style, age, and condition; located in either the same neighborhood or a competing neighborhood (or both); and the sales are both recent and arms-length. Generally, appraisers do not use non-arm's length transactions as comparables. However, I often get the question: "The appraiser used short sales and/or foreclosures—why?" The answer is that it depends, but if this segment of the market is sufficiently affected by distressed properties to the extent that there are enough distressed sales that they are bringing the market down, the appraiser would have to use them to adequately reflect what the market is doing at this time. This all comes down to supply and demand. If the supply of distress listings is high enough, the buyers will all gravitate to those listings which can generally be purchased at a discount, and they will not buy the non-distressed listings.

Then we look at the adjustments made to the comparables. Here are the basics about adjustments: if the comparable is *inferior* to the subject, the adjustment is a positive (plus). The appraiser is essentially saying "If comparable #1 had had this additional feature which the subject property has, in my opinion, it would have sold for $X more money." If the comparable is *superior* to the subject, the adjustment is a negative (minus). Again, the appraiser is essentially saying "This comparable had something superior to the subject; if it had not had that feature, in my opinion, it would have sold for $X less money." Knowing this, the first thing you look for is whether or not the adjustments have been made in the right direction. Believe it or not, I have reviewed appraisals where the adjustment was a plus when hit should have been a minus, and vice versa.

Check the adjustments to make certain that they are consistent. For example, if the adjustment for the difference in square footage is $30 a square foot, it should be the same across the board. If the adjustment for an additional full bathroom is $5000, it should be consistent across the board. How appraisers make adjustments is a lengthy topic all by itself; however, keep in mind that *any* adjustment should be defensible by the appraiser if challenged. While you are checking the adjustments and the grid section, you will notice at the bottom of the report it shows "net adjustments" and "gross adjustments." Fannie Mae prefers that overall net adjustments not exceed 15% and overall gross adjustments not exceed 25%. This will not always be the case, particularly if the property has unusual features which require large adjustments such as additional acreage, outbuildings, etc.

The appraiser should have reconciled the comparables. Reconciliation is *not averaging.* The appraiser should generally pick one comparable to reconcile to, and the statement might read "Comp. #1, which required the least net and gross adjustments, is also the most recent sale; we have accordingly reconciled to this adjusted value of $300,000."

At the end of the process, per the Uniform Standard of Appraisal Practice (USPAP), the appraiser should produce *credible results.* USPAP defines credible as: "worthy of belief." When you finish reading the appraisal it should make sense; it should be coherent; it should be believable. If it is not, then it may be a flawed appraisal. In that case, your client may want to appeal to the lender to order either a review of this appraisal, or a new appraisal. I cover this topic extensively in my course "Anatomy of an Appraisal".

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