

The Massachusetts Homeownership Collaborative

HOMEBUYER COUNSELING CORE CURRICULUM

SECTION VII: APPRAISALS

Section 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

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A. WHAT IS AN APPRAISAL?

An appraisal is an opinion of the market value of a property. An appraiser estimates the market value of your prospective home based on its condition and the selling prices of comparable homes recently sold in the area.

Several parties to a real estate transaction may request separate appraisals:

- The seller may use the market value estimate to select a price at which to sell or list the property.
- The buyer may want to know the property's value to decide on an acceptable offering price.
- The financial institution needs to know the market value to decide a reasonable loan amount for the mortgage (federal and state laws and current banking regulations require lenders to obtain an appraisal in conjunction with most loans secured by real estate).

Typically, an appraiser is asked to estimate the price at which a property would most likely sell in the market under certain, specific conditions. The appraiser's estimate of market value is a reflection of the probable price that would be agreed upon between knowledgeable parties acting without duress, i.e. an agreement that is entered into voluntarily, without force. Appraisers do not establish value; rather, they estimate the most likely value that a competitive market would set.

The Appraisal Foundation (TAF) sets the congressionally-authorized standards and qualifications for real estate appraisers. TAF has a code of ethics with which real estate appraisers who are licensed and/or certified by the state must comply.

TAF also has an education module titled "What Every Homebuyer Should Know About an Appraisal" that can be found here: https://www.appraisalfoundation.org/imis/TAF/Resources/Consumer_Resources/Homebuyer_Module/TAF/Homebuyer_Module_Consumer_Resources.aspx?hkey=83c29c85-dced-4eb1-93c8-49e3cefb444c . The module includes vital information and resources for consumers on what an appraisal entails, how an appraiser determines value, and how to interpret an appraisal report.

B. WHY IS AN APPRAISAL IMPORTANT?

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A house is probably the largest investment that you will make. It is important that you have the information you need to make an informed offer and that you do not pay more for a home than it is worth.

For this reason, it is important that the appraisal accurately represent the true market value of the property in question. If an appraisal is too high, it may support a purchase price that is more than the house is worth. If an appraisal is too low, it may be difficult to secure a mortgage.

You can hire your own appraiser to help determine the property's value before making an offer. If you decide to hire your own appraiser, you should get a list of approved appraisers from your mortgage lender and ask if the bank will accept an appraisal performed by one of these appraisers. If it will not, you will end up paying twice, once for your appraisal and again for the appraisal performed for the bank.

Appraisals are typically initiated by the lending institution considering a mortgage application and that appraisal may have an impact on your ability to secure a mortgage since lending institutions must base mortgage calculations on the sale price of a property or the appraised value, whichever is lower. For example, if the appraisal report indicates a market value lower than the purchase price of the home, the lender may reject the mortgage application on the grounds of "insufficient collateral" or offer you different mortgage terms based on the appraised value. Under the Equal Credit Opportunity Act, your lender must provide you with a copy of the appraisal report upon your written request. If you are dissatisfied with any information contained in your appraisal report, you should contact your lender immediately.

C. THE APPRAISAL REPORT

The appraiser is responsible for providing a thorough, accurate report that provides a reliable estimate of the property's market value. While there are several kinds of reports, all are intended to communicate the market value of the property and to provide objective explanations and evidence of the appraiser's findings. The report should include:

Property Analysis

The appraiser should personally inspect the subject property. Appraisers do not perform a structural inspection of the house but they do provide information on the house and property (e.g. size, living space, number of rooms, etc.) and on the physical condition of the property (e.g. the state of

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the property's roof, garage, exterior paint, etc.), age, type of construction, etc.

Neighborhood Analysis

The neighborhood analysis should be based on a visual inspection of the neighborhood and on data from public records.

The neighborhood analysis also addresses the price range of other properties in the neighborhood to determine how the subject property compares. A neighborhood analysis helps provide an appraiser with an understanding of the market preferences and values affecting the neighborhood and should include an explanation of declining property values and other negative trends.

Market Data Analysis

Market data analysis helps the appraiser determine the value of a subject property by comparing it to similar properties. This analysis can have a significant impact on the value reported by the appraiser.

To perform the market data analysis, the appraiser finds three or more properties that have sold recently and are as similar as possible to the subject property in construction, location, special features, square footage and type of financing. The appraiser should personally inspect the exteriors of the comparable properties.

Other Information

To support his/her estimates, the appraiser should also include:

- A street map that shows the property and all of the comparable properties used in the analysis
- A sketch of the exterior of the building that shows improvements and indicates dimensions. The sketch should also have calculations which show how the appraiser estimated gross living space
- Clear, descriptive photographs that show the front and back of the property and the property in the context of the street
- Clear, descriptive, labeled photographs that show the front of comparable properties
- Certifications of completion and value, when applicable

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- Certification attesting to the appraiser's non-biased relationship to the property

D. UNACCEPTABLE APPRAISAL PRACTICES

Appraisals are not directly covered under the Fair Housing Act. However, 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 a neighborhood, 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 comparable properties without personally inspecting their exteriors
- Selection and use of inappropriate comparable sales
- 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 by a disinterested party
- Use of adjustments to comparable sales that do not reflect the market's reaction to the differences between those sales and the subject property
- 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.

Underestimating Property Values

Professional appraisal associations adhere to the legal requirements of the Fair Housing Act prohibiting the use of data on the racial composition of the neighborhood to determine the value of home located there. However, some appraisers continue to undervalue properties in minority and mixed neighborhoods by using:

- *Negative Commentary.* Appraisers have an obligation to note features and factors that are negative or may negatively impact the value of a property. However, they are also required to note positive factors and to provide an accurate depiction of the subject property and the

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neighborhood. Appraisal reports that present only the negative aspects of a property may be discriminatory.

- *Use of “Buzz Words.”* The use of euphemisms and code phrases may indicate the racial composition of a neighborhood and thus an adjustment of a subject property’s value. Some reports may refer to the “desirability of the neighborhood,” the “pride of ownership displayed,” or an “exclusive area” to imply a majority white community, while phrases such as “blue collar” area, “graffiti-ridden,” or “possible drug infestation” refer to neighborhoods of mixed minority populations.
- *Inaccurate Data.* The inclusion of inaccurate information about the property, neighborhood or the comparable properties is often considered merely a mistake. However, if the incorrect data negatively influences the market price of the subject property, discrimination may be occurring.
- *Neighborhood Boundaries.* A neighborhood’s boundaries can significantly impact the value of a property. However, an appraiser’s definition of a neighborhood can be a subjective decision. An inaccurate definition can cause a property to be valued much lower than it deserves.
- *Familiarity.* Appraisers often are not familiar with the neighborhoods in which they work. If an appraiser does not attempt to become informed about the development plans for an area, an inaccurate value may be assigned to a property.
- *Age of Property.* In most of America, minorities live in older sections of town. Therefore, the devaluation of older homes based strictly on age has a disproportionate impact on minority communities. Age alone should not be considered during an evaluation, as it is not a reliable appraisal factor.
- *Selection of Comparable Properties.* The most common method of determining a subject property’s value is to select three similar properties that were sold recently and to use their sales prices as a starting point for the value of the subject property. When comparable properties are selected that are not truly comparable, the value of the subject property can be affected. For example, selecting comparables from an African-American community because the subject property is in an African-American neighborhood while disregarding properties in a closer white neighborhood is inappropriate.

E. WHAT TO DO IF AN APPRAISAL SEEMS INACCURATE?

If you believe your appraisal is inaccurate, the first step is to contact your lender in writing, describing the problem and providing any evidence you have. You can ask for the report to be

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independently reviewed or to have another appraisal conducted, but note the lender is not required to do either. Remember that an appraisal that results in a price lower than the agreed upon purchase price should help you renegotiate. You do not want to pay more for a property than it is worth.

You can also contact the following:

- The Massachusetts Board of Registration of Real Estate Appraisers: <http://www.mass.gov/ocabr/licensee/dpl-boards/ra/>
- The Consumer Financial Protection Bureau: www.consumerfinance.gov/complaint