

Understanding your real estate appraisal

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INTRODUCTION

This booklet provides an explanation of the information contained in the Uniform Residential Appraisal Report, commonly known as the URAR. The URAR form is used for the majority of real estate appraisals completed for single family residences. The URAR form was designed by a group of mortgage industry leaders in an effort to standardize the property valuation reporting process. The major sections of the form will be covered in this booklet with an emphasis on those items that can be especially confusing to those not familiar with appraisals. We will cover the actual form itself after a few introductory remarks about the appraisal profession.

TYPICAL USES FOR AN APPRAISAL

A reliable estimate of value is sought by many parties for many different reasons. Perhaps you are getting your property appraised for yourself to determine a selling price or maybe a lender requires it for getting a new loan. Financial institutions insist on an appraisal to determine the amount of money that they will loan an applicant. Other typical uses for appraisals are—

- property tax valuations
- court related disputes
- insurance losses
- determining value for selling a home

QUALIFICATIONS OF APPRAISERS

Until recently, the appraisal industry wasn't uniformly regulated. Starting in 1993, the law now requires the use of a licensed or certified appraiser for any *federally-related transaction*. While licensing is voluntary in Illinois, nearly anyone wanting to do mortgage appraisals will seek to be Licensed or Certified.

WHAT IS MARKET VALUE?

An appraisal is basically an unbiased estimate of value. There are many legal definitions of market value in the industry. Fannie Mae, the huge purchaser of mortgages in the secondary market and one of the creators of the URAR form, has their own definition. Their definition states among other things, "...the most probable price a property should bring in a competitive and open market". The market value derived in the URAR report is in adherence with Fannie Mae's definition which can be found in its entirety on the last page of the appraisal report in the Statement of Limiting Conditions.

UNDERSTANDING THE APPRAISAL REPORT

There may be many pages contained within your appraisal report. A typical appraisal report may consist of the following pages—

- a title page
- page one of the URAR form
- page two of the URAR form
- an additional comments page
- a location map
- a property sketch
- a photo page
- and a statement of limiting conditions

In this booklet we'll limit our discussion to the actual URAR form itself which is two pages in length and should be titled at the top of both pages. A lot of the information in an appraisal is self-explanatory. We'll provide an explanation for some of the information that may be a little more confusing for you. If you still have questions after reading this booklet and studying your appraisal, please don't hesitate to call us. Our phone number is on the back page of the rear cover.

THE SUBJECT PROPERTY

The top part of page one contains information regarding the house being appraised, referred to as the Subject property. This section provides an identification of the property being appraised (legal and tax information) as well as the property rights. You should be familiar with most of this information already if you are the home owner. If the subject property is in the process of being sold, then an actual summary of the pending transaction is also report near the top of page one. The abbreviation *HOA* stands for homeowners association and is only applicable if you live in a condominium or townhouse where there is common ownership with monthly maintenance fees. The purpose of the Neighborhood Analysis section is to identify the area, based on common characteristic or trends, that is subject to the same influences as the subject property. This section is where the appraiser considers the influences of social, economic, governmental, and environmental forces on property values in a neighborhood. The appraiser usually defines the boundaries of the neighborhood and reports characteristic information. If the subject property is negatively influenced by something nearby such as a large factory or railroad tracks, the it would be commented on in this section. Near the lower part of page one is where the property's actual age as well as its effective age is reported. The effective age is the age that the property appears to be according to how well it has been maintained as well as its amount of modernization. A well maintained property that is 30 years old with a modern usable floor plan and room layout may only have an effective age of 15 years. On the other hand, the same property that has been poorly maintained and doesn't offer the same utility of a newer house may have an effective age of 40 years. The room list grid near the bottom of the page itemizes which rooms are on what

levels of the property as well as the actual square feet of living area. The appraiser calculates this figure from his exterior measurements of the subject property. It is important to note that the *Square Feet of Gross Living Area* reported in this section only includes *above-grade* living areas, excluding unheated areas such as porches and balconies. The remaining below-grade areas are reported as a basement. For example, if the subject property is a bi-level where the lower level is partially below grade, then only one-half of the actual living area would be reported here; the other half of the living area would be reported as a basement. Though not included in the total living area calculations, any below-grade areas are given their fair share of value as basement areas. The bottom of the page is where the appraiser has space to provide more detailed commentary on additional features of the property as well as any depreciation. Depreciation is anything that causes a loss in value to the property. This loss in value may come from wear and tear or the presence of old-fashioned fixtures in the house that need to be updated. Exterior factors such as the location of nearby commercial properties or busy roads may also cause depreciation. Sometimes the appraiser will continue his or her discussion of depreciation on an addendum page if there is not enough room at the bottom of page one.

COST APPROACH

Page two of the URAR includes the three approaches to value. The first of these is the cost approach which occupies the upper portion of the page. The idea behind the cost approach is to determine what it would cost to reproduce or replace the subject property at today's building prices. The appraiser makes this estimate based upon current square-foot building costs for the above and below grade areas of the property. Next,

building costs are added for any additional amenities such as porches, fireplaces, garages, etc. The appraiser then subtracts an amount for depreciation after considering the effective age of the property. In effect, the appraiser is saying, "OK, I know what it would cost to build this house today if it were new, but the subject property isn't new." The amounts deducted for physical and functional depreciation take this logic into account. External depreciation would only be deducted if the subject property was negatively influenced by something nearby in the neighborhood such as a factory or railroad tracks. Finally, the appraiser adds the value of the property's site back in. The estimate of physical and functional depreciation get increasingly difficult to estimate as a house gets older. Therefore, this approach to value seldom gets a lot of weight in the final value decision unless the subject property is a very new house. The cost approach is particularly useful in the insurance industry where they need to know what it would cost to replace a house should it become destroyed. With insurance valuations, there is no need to estimate depreciation at all.

SALES COMPARISON ANALYSIS

The sales comparison approach requires that the appraiser collect sales data on comparable nearby properties that have sold recently. Then, he makes adjustments to allow for individual differences between the subject property and these *Comparables*. This second approach to value is usually the most influential in the final value determination. There are a number of categories of comparison in the sales comparison grid. If something is superior in a comparable property as compared to the subject, then it is given a negative adjustment. Vice versa for an inferior feature. At first glance these adjustments may appear to be backwards. But take a look at how they work. Let's

say for example that Comparable #1 sold for \$100,000 but had a two-car garage versus the subject property which only had a one car garage. This superior feature would demand a negative adjustment, lets say of -\$2,000 made to the comparable's sales price. This would yield a market value for the subject property of \$98,000. This superior feature of the comparable demanded a negative adjustment to its sales price thus resulting in a lower value for the subject property. These adjustments are extracted from the marketplace using various procedures, supplemented by the appraiser's knowledge of the local area. What is finally arrived at is an adjusted sales price for each of the three Comparables. The appraiser will then reconcile, or weigh, these adjusted sales prices giving most weight to the property or properties that are most similar.

INCOME APPROACH

The third approach to value is the income approach which is only used when there is a sufficient rental market for the subject property and when an adequate amount of market data is available. Basically, this approach takes a look at the gross income that has been derived from comparable sold properties as a result of rental activity. The sales price of a Comparable property is divided by its monthly gross rent to derive a multiplier. The multipliers from a number of different comparables are reconciled to derived one gross multiplier. This multiplier is then applied to the gross rent of the subject property to determine its value. This approach is rarely used for single family houses unless the property is mostly located in a rental market and data is plentiful. It is more common however for properties used primarily for rental— typically duplexes and larger.

RECONCILIATION

At the bottom of the form is where the appraiser reconciles the three approaches to value. He considers the reliability of all three indications of value and places the most emphasis on the approach that is the most reliable. This determines a final *market value* for the property as of a specific date. The appraiser should state the reasoning behind the reconciliation in the space provided or perhaps on a separate addendum page.

ADDENDA

Depending on the client's requirements, there could be a number of different pages following the URAR. These would typically include a map page showing the location of the subject property and comparables. And a property sketch showing the general room layout and exterior dimensions of the subject property used for calculating gross living area. There will also be photo pages showing the subject photos and photos of the comparable sales. The *Supplemental Addendum*' and *Statement of Limiting Conditions* are pages required by various agencies. They contain miscellaneous information that is quite self-explanatory.

THANK YOU

We at Appraisal Services hope you found this tiny booklet to be informative. Please don't hesitate to contact us if you have any appraisal questions whatsoever. We can be reached at (630)897-3339 or on the web at www.appraisalservices.com.

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