

How appraisals work



South Livermore California

How lender house appraisals work in a home purchase situation can determine how much a house can sell for. Here is how they work. Buyer Mr. A and seller Mr. B write a purchase contract on Mr. B's house for a purchase price of \$500,000. Mr. A has a 10% down payment (\$50,000) and is pre approved for a \$450,000 loan on the house.

As part of Mr. A's loan approval process his lender will do an appraisal on the house. Appraisals are mostly done by the market value, or comparison approach. What the bank is looking for is to make sure that Mr. B's house is truly worth \$500,000. The comparison approach to appraisals works this way. The appraiser finds 3 recent home sales in the same area as Mr. B's house. Appraisers use the most recent closed sales; preferably within the last 60 days. After all, what a house sold for last year has little to do with what the house is worth today. The more recent the sale date; the more indicative it is of current value. Appraisers also take

great pains to compare similar houses; that is, they compare houses of the same age, square footage, lot size, # of bedrooms, baths, etc. Appraisers compare apples to apples and use only recent similar house sales as proof of current market value on the subject house. Now, for arguments sake, let's say that the three recent comparable sales for Mr. B's house show that they have an average value of \$450,000. Then the appraiser comes up with a final value of \$450,000 on Mr. B's house.



Now we have a tough situation We have a buyer and seller that agreed on a purchase price of \$500,000 and a current lender appraisal of \$450,000. What happens?? Well, first, the lender will not loan on the agreed upon \$500,000 price.

Lenders make their loans on appraised value only.

So in Mr. A's case the lender will approve a 90% loan on a price of \$450,000. So buyer and seller are roughly \$50,000 apart from having a successful sale. Buyer and seller have to renegotiate in order to have a successful sale; in many situations where a house does not appraise, the house sale falls apart.

This kind of real life situation happens all too often in our local real estate market for 2009-2010. One of the reasons why is because all of those bank foreclosures, short sales, and distressed property sales are used by the appraisers in order to get a true picture of current market value. Current market value is defined as what buyers have paid most recently ...And buyers purchasing bank owned REO houses at low prices determine what current market value is on a large number of homes here in California for 2009 to 2010. Foreclosure sales figures are used in appraisals to determine current market value on house sales.

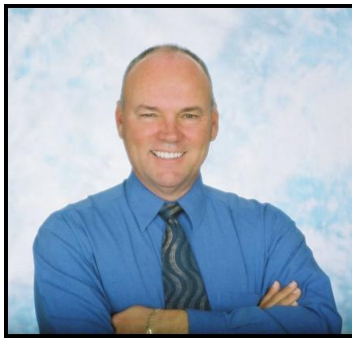
So in effect, the bank appraisal helps insure, to the bank, that the contractual purchase price is indicative of current market value. *Banks won't make loans on houses that they think are overpriced.* Banks will only make loans on houses that appraise for current market value. Many sellers, who are hoping to get a certain amount of money from the sale of their home become disappointed; their house usually won't sell for what the seller wants their proceeds to be.

This is how bank appraisals work. Banks, in fact, before they finalize a buyers loan approval will make sure that the sales price of the house is based on it's current market value.



Here are a couple of links to further explain how appraisals work.

<http://money.howstuffworks.com/personal-finance/real-estate/home-appraisals1.htm>



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