



April 2, 2012

Mr. James Hammersley
Deputy Assistant Administrator, Office of Policy & Strategic Planning
U.S. Small Business Administration
409 3rd Street, SW
Washington, DC 20416

Re: SOP 50 10 5(D): SBA Appraisal Institute Course Requirement For Going Concern
Valuations Of Special Use Properties By Real Property Appraisers

Dear Mr. Hammersley:

The American Society of Appraisers (ASA) and the Royal Institution of Chartered Surveyors (RICS Americas)¹ are writing to express strong opposition to an October 2011 revision to SBA's Standard Operating Procedures (SOP) governing the performance, by real estate appraisers, of going concern appraisals of special use properties in connection with SBA guaranteed loans.² We specifically object to the revision which authorizes real estate appraisers to perform business valuations for special use properties if they successfully complete an Appraisal Institute (AI) course entitled "Fundamentals of Separating Real and Personal Property from Intangible Business Assets". ASA and RICS Americas, whose credentialed members are leaders in both real property appraisal and business valuation, strongly object to this requirement based on our conviction that the valuation methods and approaches being taught to real estate appraisers in the AI course are fundamentally flawed.³ If followed, they likely will lead to erroneous conclusions of value thereby casting doubt on the actual value of property collateralizing SBA backed loans. Accordingly, we respectfully urge immediate suspension of this AI course requirement.

Our organizations also are concerned about provisions of the SOP which direct appraisers performing going concern appraisals to not only identify different categories of a firm's assets, but to separately value the property in each such category.⁴ The essential problem with such

¹ ASA and RICS Americas are the nation's leading multi-discipline professional appraisal organizations representing credentialed valuation experts in the major property categories including business valuation, commercial and residential real estate and machinery, equipment and technical specialties.

² SOP 50 10 5(D).

³ Multiple decisions by state courts or state administrative bodies have voiced frustration with the methodology taught in the AI course, based on their conclusion that the values derived from these methodologies vary greatly from the values found when generally-accepted methodologies are followed.

⁴ One SOP provision dealing with "Appraisal and Business Valuation Requirements" for Commercial Real Estate, states: "If the appraisal engagement letter asks the appraiser for a business enterprise or going concern value, the appraiser must allocate separate values to the individual components of the transaction including land, building, equipment and business (including intangible assets). When the collateral is a special purpose property, the appraiser must be experienced in the particular industry." (Subpart B, Chapter 4 II(C)(1)(g), SOP 50 10 5(D)). Another provision dealing with Business Valuation Requirements – Change of Ownership, states that "The lender may use a going concern appraisal to meet [the change of ownership valuation requirements] if the appraisal allocates separate values to the individual components of the transaction including land, building, equipment and intangible assets." (Subpart B, Chapter 4 II(C)(5) (e)(3)).

requirements is that there are very few, if any, appraisers who hold valuation credentials in multiple property categories (e.g. real estate; intangibles; machinery and equipment; business enterprises) and who are competent, therefore, to value more than one category of property. We fully understand that the going value of many businesses, small and large, includes their ownership of property in multiple asset categories. But, the valuation of such firms requires a team of appraisers representing the appropriate disciplines; and we believe the SOP should require that approach.

To be clear, we believe that real estate appraisers who have the requisite education, training and experience can, under carefully prescribed circumstances, reliably perform going concern appraisals of special use properties. Regrettably, the provisions of the SOP which govern going concern valuations by real estate appraisers fall short in establishing adequate qualification requirements for real property appraisers who wish to perform going concern valuations. Additionally, the SOP fails to provide guidance on when it is or is not appropriate for even a properly trained real property appraiser to perform a going concern appraisal without engaging a business appraiser to value the intangible assets of the firm being valued.

Notwithstanding our concerns, we strongly support SBA's important loan guaranty programs and acknowledge that except for the SOP provisions dealing with going concern appraisals by real property appraisers, the agency's operating procedures governing valuations of collateral for SBA loan guarantees appear to be comprehensive and thorough. We share the agency's belief that in the event of borrower default, the safety and soundness of SBA guarantees largely depend on accurate measures of the fair market value of the tangible and intangible assets collateralizing the loans, as determined by appraisers who have the demonstrated competency to value the relevant categories of assets.⁵

ASA and RICS Americas pledge to work with SBA, with the professional appraisal community and with users of SBA-related appraisal services to address those provisions of the SOP which require revision and/or strengthening.

I. OBJECTIONS TO CURRENT PROVISIONS OF THE SOP

- **The Appraisal Institute Course Is Seriously Flawed And Its Mandated Use Should Be Suspended:** The business valuation and real property valuation leadership of our organizations are convinced that the AI course, which was developed privately without adequate exposure to and comment from the professional appraisal community, teaches a limited and inappropriate methodology for valuing the tangible and intangible assets of special use business enterprises. The valuation principles taught in the AI course are contrary to market practices and are not generally accepted by those who are widely-acknowledged to be the most experienced and expert appraisers of the market value of special use properties. They fail to meet the generally accepted requirements for valuing either business interests or real property interests. These interests are separate and

⁵ The importance of collateral is reflected in the SOP's general requirements for collateral. They state that although a loan request cannot be declined "solely on the basis of adequate collateral," SBA "requires that the lender collateralize the loan to the maximum extent possible up to the loan amount"; and that "if business assets do not fully secure the loan, the lender must take available personal assets of the principals as collateral."

distinct, neither being the residual of the other. This is not just the conclusion of our organizations. It is the conclusion of many of the nation's most experienced and expert appraisers of special purpose properties, some of whom are themselves senior members of the Appraisal Institute.⁶ It is also the conclusion of numerous state courts and administrative bodies which have found the valuation approaches taught in the AI course to be "unduly speculative,"⁷; contrary to "uniformly accepted methodology"⁸; or "unreasonable and unlawful."⁹

- **Completion Of A Single Course – Even One Which Teaches Proper Methods and Approaches – Cannot Provide Real Estate Appraisers With The Valuation Skills Necessary To Perform Going Concern Appraisals of Special Use Properties; Additional Qualifications Should Be Established:** Successful completion of a single course conducted over a day or two – even one which correctly teaches generally accepted valuation approaches and methods – cannot provide a real estate appraiser with the valuation competency necessary to reliably perform going concern appraisals for special use properties. While we believe that a real property appraiser's successful completion of a single course with an appropriate curriculum can be an important component of acquiring the valuation skills necessary to reliably appraise the tangible and intangible assets of special use properties, such courses, by themselves, are insufficient to ensure mastery of the requisite skills. Additional qualifications should be established, one of which might include continuing education requirements taught by professional appraisal organizations which regularly teach the principles and application of going concern and intangibles valuation; and which award business valuation credentials to those with demonstrated competency.
- **Guidance, In The Form Of "Best Practices," Should Be Developed To Establish When A Real Property Appraiser Is Or Is Not Competent To Conduct A Going Concern Valuation Without Associating With A Business Appraiser To Value The Firm's Intangible Assets. Such Guidance Is Essential To Ensure The Integrity of Going Concern Appraisals Of Special Use Properties In Connection With SBA Loan Guarantees:** Just as all businesses are not the same, it is self-evident that differences between one special use enterprise and another can be substantial. For example, the nature and extent of the tangible versus the intangible assets of one company can differ markedly from that of another. Consequently, a going concern appraisal of one small business enterprise may require a different set of valuation skills than the going concern valuation of another, depending, for example, on the type and mix of assets held and the likely impact of each on the overall value of the enterprise as a going concern.

⁶ See, for example, the February 21, 2012, letter to the president of the Appraisal Institute signed by six senior Institute members, a copy of which was sent to SBA.

⁷ Initial Decision and Order, Tennessee State Board of Equalization, Wolfchase Galleria Ltd. Partnership v. Shelby County, tax years 2001-2003.

⁸ Iowa Supreme Court, June 18, 1997, Merle Hay Mall vs. City of Des Moines Board of Review and Merle Hay Mall v. Polk County Board of Review.

⁹ Hillard City Schools Board of Education v. Franklin City Board of Revision, 128 Ohio St. 3d 565, 2011-Ohio-2258.

In some going concern valuation engagements of special use properties, it would be appropriate to rely exclusively on a properly qualified real property appraiser to perform the valuation. However, in situations where the intangible assets of business are a significant portion of the value of that business, best practices would necessitate the use of both a real property appraiser (to value the tangible real property assets) and a business appraiser (to value the intangibles). While the professional appraisal community understands these differences and how they affect the skill-sets necessary to produce a reliable going concern valuation, there is an urgent need for the development of a more formal and comprehensive set of Best Practices that are generally recognized by the entire profession.

Currently, SBA's SOP fails to describe the facts and circumstances under which it is appropriate for a real property appraiser to perform a going concern valuation without associating a credentialed business appraiser; and those situations in which the real property appraiser is not competent to value a business's intangible assets and should, therefore, engage a business appraiser. The development of Best Practices could be incorporated into the text of the SOP or in a separate document referenced in the SOP.

Our organizations, which include both business valuation and real property members, are committed to assisting the professional appraisal community, including the Appraisal Standards Board of The Appraisal Foundation, in the development of such Best Practices. Importantly, this process would benefit from and be accelerated by the stated interest of SBA. Accordingly, we urge SBA to lend its support to and join with us in this important effort.

II. OUR RECOMMENDATIONS TO SBA

- (1) **SBA Should Suspend Operation Of The Current SOP Requirement Relating To the AI Course:** We strongly urge SBA to immediately suspend the operation of its current SOP provision which permits real estate appraisers to perform going concern appraisals for special use properties upon successful completion of an AI course, whose curriculum we and others find to be improper. Without suspending this requirement until the AI course has been corrected, SBA will put itself in the position of requiring real estate appraisers who conduct special use property appraisals for SBA guaranteed loans or who would like to do so, to take and pass a course that many leading experts in the field and many state courts and administrative bodies believe teaches valuation principles that are seriously erroneous and that are likely to produce incorrect and misleading values.

We believe suspension of the current SOP provision is required in the public interest not only because of the consensus among valuation professionals¹⁰ that the current AI course is wrong; but also because the course was never properly vetted. It was not vetted by the professional appraisal community and to the best of our knowledge and belief it was not vetted by SBA or by any independent valuation professionals retained by SBA to conduct a thorough review of the course. In other words, SBA endorsed this course and mandated

¹⁰ Professional appraisal societies, leading practitioners, valuation executives at some financial institutions and at least one Big 4 accounting firm regard the AI course with deep concern.

that it be taken by every real estate appraiser who seeks major SBA-related engagements, based only on the recommendations of the authors of the course and no others. While there may be some eventual disagreement among valuation professionals over what is right and what is wrong about the AI course, there can be no disagreement over the fact that it was not properly vetted to begin with and that highly respected AI members have themselves concluded that “the Appraisal Institute is performing a serious disservice to itself, its members, the general public and to appraisal education by offering this course in its present form.” This conclusion and the growing consensus which supports it should not be ignored by SBA.

It is important to emphasize that suspension of the offending SOP provision while the AI’s course curriculum is revised and other aspects of the SOP are strengthened, will not leave SBA vulnerable to the performance of ongoing concern appraisals by unqualified real estate appraisers. Subpart B of the SOP contains valuation requirements that protect the safety and soundness of SBA loan guarantees. Specifically, it requires that a going concern appraisal be conducted by “an appraiser experienced in the particular industry...” Although there is a need for clarification, this language suggests that a real estate appraiser who has little or no experience valuing the tangible and intangible components of a particular type of special use property is prohibited by the SOP from appraising it for SBA purposes. Also significant is that the SOP’s “Valuation Requirements” make frequent reference to the Uniform Standards of Professional Appraisal Practice (USPAP). The SOP requires that appraisals “must be prepared in compliance with USPAP...” and mandates that appraisers identify the scope of work appropriately based on USPAP. Importantly, every appraiser whose appraisal is compliant with USPAP must meet USPAP’s Competency Clause. This means that in signing a USPAP compliant appraisal, the appraiser certifies and affirms that he or she possesses the knowledge and experience necessary to value a particular type of property, tangible or intangible, and is capable of completing the assignment properly, including compliance with relevant federal laws and regulations. A violation of the Competency Clause by a state certified or licensed real estate appraiser in connection with an SBA assignment would subject that individual to sanctions by his or her state’s appraiser licensing authority. In conjunction with a suspension of the AI course requirement, SBA could affirm that the Competency Clause of USPAP is specifically applicable to going concern appraisals performed by real estate appraisers.

(2) **SBA Should Encourage And Work With The Professional Appraisal Community To Develop Additional Qualification Requirements For Real Estate Appraisers To Ensure Their Competency To Value The Intangible Assets Of Special Use Business:**

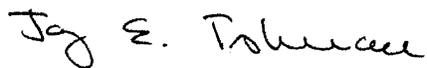
Our organizations urge SBA to encourage and work with the community of professional business appraisers and real estate appraisers, to establish educational, experiential and other qualification requirements – beyond the single and flawed AI course requirement which currently exists – for real estate appraisers who wish to value the intangible assets of special use firms. While we believe that properly vetted courses for real estate appraisers can and should be an important component of more comprehensive qualification requirements, the range of skills necessary to value intangible property cannot be acquired simply by completing a single course. In this regard, we believe that

a more robust set of requirements for real estate appraisers should include continuing education from professional appraisal societies which teach, test and award designations to qualified individuals in business appraisal practice. This would ensure that real estate appraisers who seek to value intangible assets of special purpose businesses would be exposed, on a regular basis, to the knowledge and experience of credentialed business valuation experts who regularly teach the relevant valuation principles.

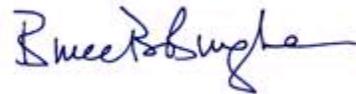
- (3) **SBA Should Encourage and Work With The Professional Appraisal Community To Develop A Set Of “Best Practices” Governing When A Real Estate Appraiser Is Or Is Not Competent To Value The Intangible Assets Of A Going Concern Without Associating A Business Appraiser To Do That Portion of The Engagement:** We believe that the integrity of going concern appraisals in connection with SBA guaranteed loans depends on the development of Best Practices which define when the intangible assets of special use firms can reliably be valued by a properly trained real estate appraiser as opposed to when the expertise of a business appraiser is required. Such protocols need to be established by the professional appraisal community, including its standards setting authority, The Appraisal Foundation, in cooperation with SBA and other stakeholders.

ASA and RICS Americas would greatly appreciate an opportunity to work with you and your colleagues at SBA and with other stakeholders to discuss the concerns expressed in this letter and explore possible solutions. Representatives of our organizations will be contacting you to arrange a meeting at your convenience. In the meantime, if you have any questions or would like to discuss our views in greater detail, please contact Peter Barash, ASA’s Government Relations Consultant (peter@barashassociates.com; 202-466-2221) or John Russell, ASA’s Director of Government Relations (jrussell@appraisers.org; 703-733-2103); or Neil Shah, Managing Director of RICS Americas (nshah@rics.org; 646-786-8352).

Respectfully Submitted,



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Cc: Zelaya, Kandace