September 30, 2013

J. Mark Penny, ASA
International President
American Society of Appraisers
11107 Sunset Hills Road
Reston, Virginia 20190

RE: Real Property Discipline Committee Chairman's Report

Dear Mr. President:

This report covers the activities of the Real Property Discipline Committee since the last report dated September 30, 2013, to the present. The Real Property Discipline Governors' Report will be submitted separately by the Governors.

ASA-RPC Financial Status:
I addressed our financial status in my last report, and as of this writing that status hasn't changed by any significant amount. Our issues are still the same, and we are in need of raising revenues.

Since our October meeting in San Antonio the RPC has moved forward with the RP401 Going Concern course.

We have acquired a loan from the Educational Foundation in the amount of $20,000 to help in the presentation and marketing of this course. We have three offerings presently scheduled and are looking to arrange more offerings across the country.

We realize that is imperative that the RP committee develop income via educational offerings. Our focus in that arena would provide the appropriate balance and would result in a much more healthy discipline. The added bonus of educational offerings would be the potential increase of membership and increased exposure of ASA.

Our goal is to continually look at ways to generate revenue, while providing a member or potential member a benefit.

ASA-RPC Education Initiative:
I earlier mentioned that we are now getting the RP401 Going Concern course off the ground with our first offering beginning March13, 2014. We have also begun a series of webinars, covering varying subject matter.

Gary Snowdon, ASA is the RPC education subcommittee chair and has been working putting together a catalog of courses available for presentation.

It is my anticipation that the RP 401, webinars and other course offerings will be beneficial to the RPC.

Having an arsenal of state approved classes, that are competitive with those being offered by proprietary schools, and other associations, will only help in taking care of the educational needs of our members and potential members.

Governmental Affairs:
RP Government Relations subcommittee has been involved with several issues, with the latest being a bill in New Jersey that would abolish the appraisal board along with other limitations.

John Russell and Peter Barash have worked constantly to stay on top of these situations.

We are still working in collaboration with NAIFA. This working relationship has allowed each association to speak in a louder more unified voice.

2014 International Conference Sub-Committee:
Samuel F. Luceno, M.S., FASA, RPC Conference Committee Chair, has provided the following report.

The RPC Conference Committee Members include: Ernie Demba, FASA; Bill Wilson, FASA; Micheal Lohmeier, FASA; Ron Prat, ASA; Sam Luceno, FASA. The first meeting was conducted at the end of the 2013 Annual Conference in San Antonio, TX. During that meeting a list of alternative presentation topics and possible speakers was developed and specific duties were assigned to each of the various committee members. By the time our first ASA International Conference Committee Meeting was held, the RPC Conference Committee had selected specific and back-up presentation topics and speakers for each of the slots to be filled. We all realized that early preparation was necessary in order to ensure ASA Headquarters Staff to have sufficient time to submit the applications and documents necessary to secure approvals for the AQB and various state Continuing Education Credits. The 2014 Real Property segment of the ASA Annual Conference is as follows:

<u>*MONDAY*</u>
9:35 AM to 12:05 Noon > 2 Hours: Best Practices for the Appraisal Professional
By Ernie Demba, FASA

1:35 to 5:35 PM > 4 Hours: Appraisal Report Review
By Roger Durkin, J.D., M.S., FASA

TUESDAY
8:00 AM to 5:05 PM > 7 Hours: Allocating Components in Going Concern Appraisals
By L. Deane Wilson, M.A., ASA; Rob Schlegel, FASA; Larry L. Perdue, ASA
deane@theblackwellgroup.org

WEDNESDAY
8:00 AM to 11:50 AM > 4 Hours: Ad Valorem/Mass Appraisal Issues Symposium and Conservation Easements component and The Appraiser As Testifying Expert: Preparing and Presenting Expert Valuation Testimony
By Micheal Lohmeier, FASA, MAI; Paul Bidwell, ASA, MAI; Thomas Countryman, Esq.

In conclusion, we as a committee have been continuing to face the challenges and continue to look for ways to provide our members/customers a reason to be a part of ASA.

I am proud of the RP team. I could not ask for a better group of individuals who donate a tremendous amount of time and effort to ensure we are moving in the right direction. I would like say "Thank You" to all the members of the RPC. Being volunteers, their time and efforts are truly appreciated

Respectfully Submitted,

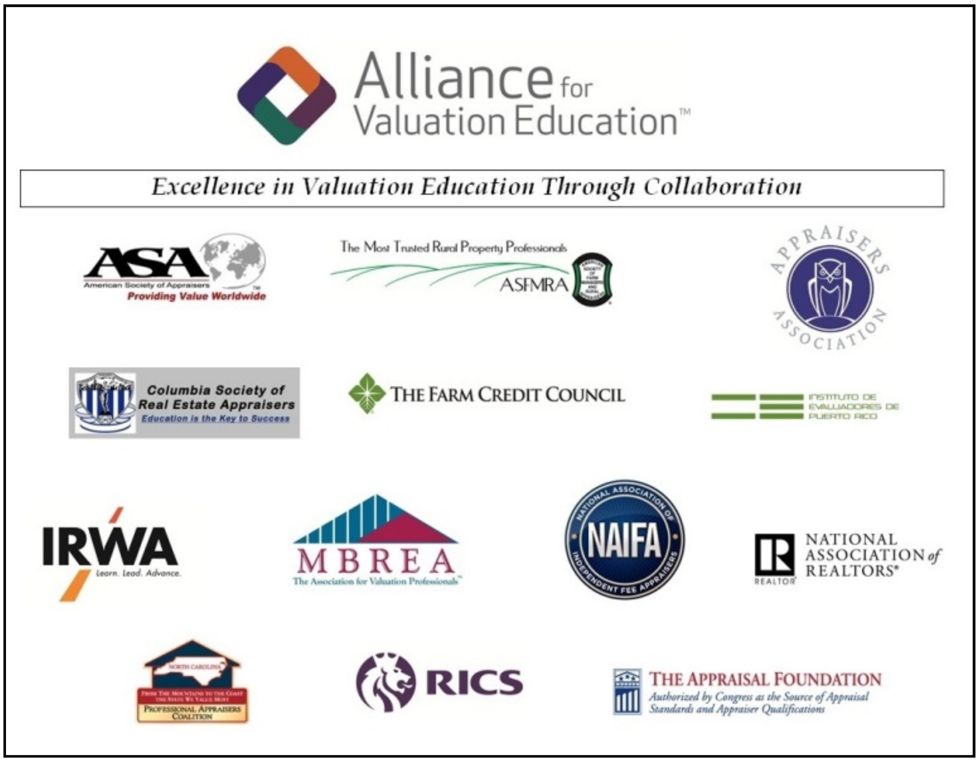
Michael T. Orman, ASA
RPC Chair

PC: RP Committee
RP Liaison (John Russell)

The next step in the Development of Appraisal Education and Cooperative Effort within the Appraisal Profession

By Micheal Evans, FASA, FRICS

Has anyone heard of the Alliance for Valuation Education (Alliance)?



At its May 2012 meeting, The Appraisal Foundation's (Foundation) Board of Trustees (BOT) established the National Education Partnership Task Force (NEP Task Force). Its charge was to: determine the feasibility of a national education partnership and, if feasible, develop a business plan to implement such a partnership. At its August 2012 meeting, the NEP Task Force concluded there was an immediate need for more consistent and timely appraiser education and therefore there was no compelling reason to delay implementation. Additionally, the NEP Task Force concluded a national education partnership:

- would promote the public trust
- was consistent with the goals of the Foundation and its Sponsors
- would benefit the valuation profession
- should be formed as a new corporation, separate from both the Foundation and its Sponsors

The partnership would be a collaborative effort between the Foundation and its Sponsors to develop topical, timely, quality, consistent education for valuation professionals and others interested in valuation education. The partnership's intent would be to not compete with its Sponsors; rather, the partnership would develop education that would supplement Sponsor education and also serve the needs of the large group of appraisers who are not affiliated with a professional organization.

At the May 2013 Foundation BOT meeting, the Foundation and its Sponsors (who opted to be part of the new organization) each chose three individuals to serve on the new organization's Board of Regents. The Board of Regents held its Organizational Meeting in Chicago in August 2013 and the Alliance for Valuation (Alliance) was constituted. The Regents chose a seventh At-Large Regent to serve on the Board. The following individuals currently serve on the Alliance Board of Regents:

- Paul Bierschwale, Chair
- Lee Hackett, Secretary
- Micheal R. Lohmeier, Treasurer
- Charles Blau
- Mark Grace
- Sandra Guilfoil
- Steve Sousa

Alliance Board of Regents
Left to right (back row): Lee Hackett, Micheal R. Lohmeier, Paul Bierschwale, Charles Blau, Steve Sousa
Left to right (front row): Mark Grace, Sandra Guilfoil

The Alliance will advance the interests of appraisers who are not affiliated with partnership organizations. Unaffiliated appraisers will have additional quality educational opportunities, as well as exposure to the country's leading professional valuation organizations. This partnership will also serve the interests of others who have a need or desire to learn more about the valuation process but who are not appraisers.

There are several benefits for Alliance Sponsors, including but not limited to the following:

- the ability to provide new benefits to members and potentially increase membership
- offer timely, quality courses
- increase education opportunities
- outsource course development
- increase opportunities to pursue other projects
- reduce course inventory
- provide courses at a significant cost savings
- submission by the Alliance to the Appraiser Qualification Board's Course Approval Program
- provide additional "branded" courses that will include participating organization logos, a description of the organization and contact information
- enhance organizational stature
- increase exposure to non-affiliated appraisers and
- possibly increase revenues

Courses (Product Line) and Delivery

The Alliance will license its courses to Alliance Sponsors and other valuation education providers. The Alliance will not present the courses. The Alliance will offer the course materials to the Alliance Sponsors at a discount below the wholesale price and to other valuation education providers at wholesale price.

The Alliance's initial focus will be to develop classroom continuing education (CE) for real property appraisers. Initial topics will be primarily those considered by the Appraisal Practices Board. Subject matter experts and instructional designers will be drawn, wherever possible, from Alliance Sponsors.

In the future, consideration may be given to developing real property appraiser qualifying education (QE) (e.g., Basic Appraisal Principles and Basic Appraisal Procedures) remedial real property education, and other valuation discipline education.

The Alliance will have its first course available for sale in summer 2014.

For more information, visit the Alliance website at: www.avenew.org

AUTHOR BIOGRAPHY

Michael Evans, FASA, FRICS has been actively engaged in the real estate appraisal field for 30 years; he is currently President of Evans Appraisal Service, Inc., a real estate appraisal company specializing in agricultural, commercial, industrial, special purpose and residential properties. He is one of a very few to hold designations in both Real Property and Rural Property for the Society. He also holds a California State Certified General license as well.

He served as the international president for the Society in 2010 and currently is the Society's trustee on The Appraisal Foundation's Board of Trustees. If you have any questions regarding this article he can be reached at mike@evansappraisal.com.

The Appraiser As Testifying or Consulting Expert

Part One – The Importance and Selection of Experts

A credible and convincing determination of value is essential in all appraisal controversies, whether in court, before Appraisal Review Boards ("ARBs"), in informal negotiations and even during behind the scenes strategy and analysis discussions. The successful use of expert appraisers can cost-effectively provide any valuation greater credibility. On the other hand, poorly prepared or insufficiently guided experts can so weaken a valuation that its aftereffects literally haunt the property owner for years to come. This series of articles will focus on the effective selection, training and use of appraisal experts, primarily in a judicial context. However, the principles proposed have application in virtually every situation where expert testimony may be helpful or necessary.

THE IMPORT OF EXPERT TESTIMONY

In valuation controversies particularly, expert testimony generally plays an absolutely critical role. An effective expert can make your client's case; an effective expert on the other side can undermine your evidence and crush your client's case even before it is fully presented. This is because, generally (but with a few notable exceptions), experts are the only witnesses allowed to provide subjective opinion (as opposed to purely factual) testimony on the ultimate issues that decide client's fates. For example, the Federal Rules of Evidence – FED. R. EVID. - expressly state that "testimony ***in the form of an opinion or inference*** *otherwise admissible* is not objectionable because it embraces an ultimate issue to be decided by the trier of fact." *See* FED. R. EVID. 704 (emphasis added). Lay opinions, with only a few exceptions (*see, e.g.* FED. R. EVID. 701), are simply not admissible as evidence in court. Thus, for better or worse, especially where value is concerned, appraisal experts have increasingly become advocates or vehicles for advancing their clients' theories of the case, because they *can* relatively freely express opinions and, in certain cases, virtually "create" new realities through their opinions. *See, e.g.,* TEX. R. EVID. 702; but *cf.* TEX. R. EVID. 703.[1]

Of course, an appraiser's "creativity" is necessarily limited by USPAP's Ethics Rule:

An appraiser must perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests.

An appraiser:

[1] As one might expect (and hope!), in addition to USPAP discussed below, there also are various legal restrictions placed on expert testimony designed to reign in those who would pretend to be experts when they are not. Such restrictions, and their relative effectiveness, will be discussed in a future Part of this series but are beyond the scope of this introduction.

- *must not perform an assignment with bias;*
- *must not advocate the cause or interest of any party or issue;*
- *must not accept an assignment that includes the reporting of predetermined opinions and conclusions…;*
- *must not communicate assignment results with the intent to mislead or to defraud;*
- *must not use or communicate a report that is known by the appraiser to be misleading or fraudulent;*
- *must not knowingly permit an employee or other person to communicate a misleading or fraudulent report…; and*
- *must not perform an assignment in a grossly negligent manner.*

That said, the concept of "value" is necessarily somewhat subjective, even under the best of circumstances, and any time subjectivity is introduced into a courtroom or other presumed "fact finding" exercise, the powers of informed opinions are magnified. In the case of appraisals and judicial determinations of value especially, there is a real need for application of "educated subjectivity," provided it is exercised in a scrupulously professional and ethical manner.

Many owners have a fundamental belief that they don't need to retain appraisal experts. They feel they understand the value of their assets, and perhaps on an emotional or even "common sense" level, they do. However, when confronted with the principles and constraints of USPAP or the need to truly factually justify their opinions of value, most owners are left with just unsupported lay opinions which may not even be legally sufficient to support a favorable verdict. Even where an owner can express an opinion on the value of his or her own property, in most cases, such opinions can be both undermined and overwhelmed by the weight of competent expert testimony of value.

Consequently, there is a recognized need for effective appraisal experts in judicial and other valuation controversies. However, an "effective" expert is not necessarily a "good" expert. Even an average expert who is not successfully cross-examined or otherwise discredited by the other side can become an "effective" expert in trial or negotiations. The goal of this series is to encourage those who would make the leap into the role of testifying or consulting experts in valuation controversies to do so "effectively" with eyes wide open and with full awareness of the various responsibilities and techniques involved. The first hurdle, of course, is to honestly determine whether the aspiring "expert" really has the capacity and qualifications to claim to be an expert at all.

WHAT MAKES AN APPRAISER AN EXPERT?

Legally, the test of "expertise" is fairly broad and somewhat loose. Virtually any accredited appraiser will satisfy the legal test. For example:

> *A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify thereto in the form of an opinion or otherwise if:*

a. the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;

b. the testimony is based upon sufficient facts or data;

c. the testimony is the product of reliable principles and methods; and

d. the witness has reliably applied the principles and methods to the facts of the case.

TEX. R. EVID. 702

The fact is, in some situations, "… the witness's [mere] skill and experience alone may provide a sufficient basis for the expert's opinion." *See*, *e.g., Volkswagen v. Ramirez*, 159 S.W.3d 897 (Tex. 2004). Practically, however, because expertise, like beauty, is most often determined in the eye of the beholder, more goes into the selection of an expert appraiser than just his or her academic prowess. Jury studies repeatedly affirm that if the expert does not *appear* credible, his testimony will be less persuasive. Also, much of the world's knowledge remains functionally useless because it remains ineffectively communicated, and knowledge of value is no exception. Finally, arrogance or condensation on the part of any witness can be the kiss of death to her or his believability. More clearly needs to go into the selection of an expert than mere technical knowledge.

As an attorney, I am frequently charged with the responsibility of selecting experts to support my clients' cases in court ("testifying experts"). I also hire experts to consult with and educate me behind the scenes on the technical aspects of a case, and to assist me in critiquing my (and my opponents') testifying experts' reports and testimony and preparing effective cross examination ("consulting experts"). Because they serve different purposes, I sometimes select testifying and consulting experts based on different criteria. Nevertheless, all "effective" experts should have at least the following fundamental characteristics in common:

1. Unquestioned integrity;
2. Sufficient technical knowledge and professionalism;
3. Above-average communication abilities (written and verbal);
4. Competent appearance;
5. Significant professional honors, including peer-reviewed publications (ideally on topic) and, preferably, some academic affiliation or other instructional experience;
6. Knowledge of limitations and a reluctance to "fake it;"
7. Excellent results (recognizing not every case is winnable, we look for competent and effective showings and will seek references from other attorneys and colleagues);
8. Appropriate sense of humor and humanity; and
9. "Coachability."

These characteristics should not require a great deal of discussion. However, some clarification may be in order. Primarily, the ability to accept coaching is in no way inconsistent with maintaining integrity. Indeed, the two concepts, applied properly, should be mutually supportive, and a case in point should serve as a word to the wise.

Years ago, we were seeking an appraiser for a large power plant. This is not a line of work where we have found a lot of truly capable experts. However, there were a number of appraisers willing to throw their hats in the ring to try to get the work, so we decided to test some fresh waters and brought in a representative of a large industrial appraisal firm for an interview. One iron clad rule we have is "one appraisal; one expert." We are fine with other appraisers contributing to the single testifying appraiser's report and testimony, but the actual witness must be fully prepared to testify on each aspect of her or his "company" appraisal. This is mainly because cross-examination in our jurisdiction is unlimited. For an appraiser who specializes in and testifies only to the cost approach, opposing counsel nevertheless enjoys free reign to question that witness on all he or she did *not* do and does *not* know about, for example, the income approach as it could apply to the property. It is no answer, in our minds, to defer to a colleague in that situation. Knowing our bias, the company still insisted on presenting us with a team of appraisers (along with, of course, a host of duplicative learning curves and potential expenses). They did not get the job. They disregarded our coaching and, in turn, compromised their credibility.

It is no good to pretend to be an expert. Truth is not determined by *anyone's* mere "say so." To be a true expert whose opinions are worthy of admissibility and credibility in a judicial or other valuation controversy, the expert's work must be:

Qualified – *expert must be qualified to state the opinion offered.*

Relevant – *testimony must be sufficiently tied to the facts of the case.*

Reliable – *testimony must be grounded in the accepted technical method.*

See, e.g., Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993).

We will look closely at those requirements in the next Part of this series.

About the Author: Tom Countryman, Senior Counsel at Norton Rose Fulbright (Fulbright & Jaworski LLP) in San Antonio, has over 30 years' experience trying complex commercial cases and specializes in the nationwide recruitment, training and use of experts in property tax, energy, financial services and products liability lawsuits. Tom is a member of the Institute of Professionals in Taxation and was named one of "San Antonio's Best Lawyers" (San Antonio Monthly (2007)) and a "Texas Top Rated Lawyer," LexisNexis *Martindale-Hubbell* (2012-2013).

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HOTELS AND MOTELS: A SHORT EXCURSION INTO THE GNARLY QUESTIONS OF HOW TO VALUE

By Lawrence J. Golicz, Ph.D., ASA, MAI

DEFINING TYPES OF FACILITIES, LOCATIONS, AND NATIONAL TRENDS

There are numerous categories of hotels and motels with or without franchises. They include Luxury Full Service including conventions or resorts, Mid Level Limited and Full Service and Economy Limited. Each category further complicates itself by location which includes Transient Highway and Airport, Interstate Interchange, and Destination Downtowns, Suburban Commercial, Business Parks, Industrial or Medical Centers and Resorts on the water, in the desert and usually including a golf course. From 500 rooms at a casino in Las Vegas to a Mom and Pop with 32 rooms in northern Michigan on a rural highway, the room rate (and quality) of lodging can run from $35 per night to several thousand per night.

As an appraiser, pegging your property category comes quickly with an inspection, an interview with the manager, obtained operating data for three years as well as information on franchises, contracts, and leases. And rating the functionality of the facility is almost second nature in terms of access, corridors, layout, central access to the lobby and services, elevators and the mechanicals, and whether or not the décor is dated and musty.

Back in the office, and tagging competitive facilities in the same market establishes room rates, occupancy, and the quality of competition and in the end an understanding of the market share for the subject. Ranking the subject with its competition also makes it easier to understand the actual performance of the subject over the recent past while looking to the near future “stabilized” or for an “as is” value.

General trends nationally and regionally also provide insight into the local market. This includes the business cycle and cap rates by type of facility. Luxury properties and resorts enjoy a lower rate and the limited service economy properties with higher risk and more volatility exhibit a higher cap rate and higher equity yields. The same may be said for NOI per available room. (In this respect, resorts earn the highest NOI with limited economies earning the least.) Finally, in view of national trends, your analysis of the recent financial history of the subject and its Revenue Per Available Room along with your observation of management skills, staffing and a franchise, if any, you are prepared to judge the local market for your subject with its operating data and with your comparables.

VALUATION TECHNIQUES

The question of Highest and Best Use gets answered in the research process. But often the details of each approach to value may have to be considered first. For example, although sometimes obvious, does land value likely exceed the income value of the property? Or "as is" does the income of the property support an appropriate return to the assets, first to the land, second to the improvements, third to the chattels? And finally, is there any income to allow for good will, or the intangible character of the enterprise? Indeed, does "in transition" apply to the current operation only in support of a holding period because there is no income to the enterprise? Answering these questions typically requires research from all three approaches to value.

The Cost Approach

For hotels and motels many appraisers avoid using the cost approach. With existing properties they claim difficulty with depreciation or a weakness in the economy. And yet if properly done at inspection, the depreciation of the subject for its age and wear and tear as well as any functional depreciation from age or economic obsolescence from a poor market should be understood in the appraisal process for understanding highest and best use as well as other issues.

In fact, the Cost Approach is important to properly establish excess earnings, if any, to the enterprise or good will. To claim a value for the good will straight from the NOI, as is often done in tax appeals, is misleading. Before any return to the entrepreneur's intangible asset may be applied, there must first be established from the net operating income a return to the land, then a return "on and of" the depreciated improvements, and also a return "on and of" the depreciated furnishings, fixtures, and equipment, and then, *and only then*, may the remaining unclaimed income to the property be capitalized at a rate to indicate the value of the good will. Only the "excess earnings" to a property can be claimed and capitalized to the enterprise or good will. Simply said, it seems contrary to common sense to value good will with a trickle-down theory in the face of the Theory of Rent established in the economics of capitalism by David Ricardo.

The Market Approach

For the Market Approach the principal of substitution also applies. An informed purchaser will pay no more for the subject than the cost of acquiring another existing property with the same utility. Granted, comparisons amongst similar sold properties typically require adjustments. Although some effort may be necessary to adjust for differences, and despite some weaknesses, the range of value indications is useful when checking the income approach. How else can one be sure the income approach falls within the realm of reality? And alternatively, the Gross Income Multiplier, another reasonable measure of comparison, is a buyer's rule of thumb tool that readily compensates for the many variables in similar properties. Without a doubt, despite some difficulties, the Market Approach is an important leg in the triad of valuation. At the least, it establishes a check and balance and reinforces the credibility of a value conclusion.

The Income Approach

Investors and bankers most often rely upon the Income Approach in buying or financing hotels and motels. They rely upon the appraiser's estimate of the anticipated future benefits of income and the capitalized benefits in dollars as a value. This involves direct capitalization of actual or market adjusted income or a projection of income years into the future discounted to a present worth (DCF).

But how does one segregate the income stream for valuing the components of the total asset value? By first taking a percentage of the income stream for FF& E and then for the Enterprise and then leaving the remainder for the real estate is nothing more than a self-fulfilling prophesy for the given that management never fails to maximize the assets, a major assumption in the income approach. In such cases, the real estate may be significantly undervalued with an overvalued underperforming performing enterprise. Properly allocating the income stream requires consideration of depreciated cost. Any buyer would consider obsolete décor and furnishings, and less than competent management or poor franchise agreements of much less value relative to the core potential of the real estate.

For management, typically 3%-4% of the gross income is allocated to the enterprise. With excess earnings available, this is appropriate. But if management fails to maximize the return to the assets, how can there be any good will or excess earnings to attach as an intangible? This can only be determined if the hard assets of the property are receiving their proper share of the net operating income before any residual is applied to the enterprise component. Estimating the hard asset component values, a standard method of allocating fair value for book keeping purposes, can readily and reasonably be determined in the Cost Approach without the use of magic wands and unsupported percentages.

Also a DCF is often presented as a seven to ten year projection based upon typical holding periods. This method, used with caution and supporting projections, is a viable method to value, but it does not necessarily improve upon how to determine the intangible component except as is often done with percentages of gross income subtracted from the NOI and then separately capitalized. Since DCF's require the use of assumptions into the future which may prove speculative, i.e. some DCF models do not or cannot account for business cycles and often project beyond the life of a current trend, then Direct Capitalization of Actual Cash Flow for an "As Is" and/or a discounted value at Stabilization can be offered as less Speculative in a down or recovering economy.

CONCLUSION

The old days of appraising with sale price per room just will not work. The complexity of the lodging industry offers ever different challenges from year to year. With cyclical trends nationally and regionally, combined with a local market, competition, efficient or inefficient management, along with various special features, and then absorbing everything to form a judgment of value for a motel or hotel remains difficult, but rewarding. In the end, this short excursion into the realm of valuing hotels and motels pleads the case for appraising with the three approaches to value, as too much reliance on just one approach can only lead to the torpedoes of worthless assumptions sinking ships.

About the Author

Dr. Lawrence J. Golicz, PhD, MAI, ASA is currently acting as an independent valuation consultant, and appraising for over forty years, Dr. Golicz has specialized in atypical and complicated property appraisals. He has had experience with all types of real estate, has performed mass appraisals of whole communities, appraised tangible property of all kinds, including machinery and equipment, and provided valuations dependent upon special purpose improvements, including sewage treatment plants, licensed land-fills, scrap metal processing, recycling facilities, power plants, refineries for gasoline and recycled oil, a whey plant, and breweries. For extensive complex properties he has participated in the appraisal of the General Motors Technical Center and the Chrysler Technical Center. Also acting as a Special Magistrate for Tax Appeals, Dr. Golicz has provided expert testimony in federal and circuit courts in bankruptcy and foreclosure as well as before the Michigan Tax Tribunal. He can be reached for further contact by email at lgolicz@tampabay.rr.com.

DEVELOPING EFFECTIVE AGE ESTIMATES

OVERVIEW

Effective age estimates can be developed from information obtained from the market and applied with a technique that will substantiate the appraiser's opinion and be more reliable than just guessing.

Introduction

The effective age estimate of any building should be based upon information that is available to the appraiser and can be applied with a simple technique. The appraiser should have a defendable basis to support the opinion. Guessing is never a good appraisal practice, and with simple application of how to determine the effective age of a building, the estimate can be substantiated if a question arises through appraisal review.

The actual age of a structure is sometimes referred to as *historical age or chronological age.* It is the number of years that have elapsed since building construction was complete.

Effective age is simply the difference between economic life and remaining economic life of the structure. The age is evident by the condition and utility of the structure. The level of maintenance employed by owners or occupants responsible for maintenance is based upon pride of ownership and can influence the effective age of a building. If a building is better maintained than other buildings in its market area, the effective age of the building will be less than its actual age.

Lack of proper maintenance can also increase the effective age to more than the historical age or chronological age of the building. In some cases, reasonable maintenance has been done on a structure and the effective age and historical age (or chronological age) may be one in the same.

It is a matter of judgment, the appraiser considers all the factors, both current and those anticipated in the immediate future into consideration. Effective age can fluctuate year by year or remain somewhat stable in the absence of any major renewals or excessive deterioration.

In order to determine a reasonable effective age for a residential property, the appraiser must first understand the economic life of residential structures. The appraiser must keep in mind that there are various market areas throughout the United States that have residential structures that are still in existence and use that have an actual age of up to two hundred-(200) years. That is why it is so important that the appraiser recognizes the economic life cycle for the market area they work in.

Most economic life studies, also known as typical lives, made for residential properties suggest that if no maintenance is done at all, the economic life of a residential structure can be as short as forty five-(45) years. Marshall & Swift has conducted studies on economic lives and has developed the following schedule: Section E of the *Residential Cost Handbook*, which has the following Typical Lives:

	Single-Family Residences		**Low-Rise Multiples, Town Houses, Duplexes**	
Quality	**Frame**	**Masonry**	**Frame**	**Masonry**
Low	45	50	--	--
Fair	50	55	45	50
Average	55	60	50	55
Good	55	60	50	55
Very Good	60	60	55	60
Excellent	60	65	55	60

Although this table can be relied upon as a reference, it is best that the appraiser have the basic understanding of how the table as such is developed. Depending upon the market area, the appraiser may establish a similar chart based upon independent study, and the appraiser may find that the economic life for residential structures in that particular market area may be greater and could extend the table lives to maybe even eighty-five-(85) years. Please note that under USPAP, the appraiser is responsible for any analytical method used.[1]

EFFECTIVE AGE ESTIMATE - RESIDENTIAL

The appraiser can first start with the chronicle age of the subject property and make comparison between the subject and other residential structures within the market area. Say for example, the subject property has a chronological age of twenty five-(25) years and has had better than average maintenance. The appraiser would make a visual comparison of similar type properties that are similar in actual age, and then to those that may be years younger. The subject may in comparison have equal condition to structures that are ten years-(10) younger. The subject could also reflect an older age.

Based upon observation, the appraiser may conclude that the subject is equal to these structures and reflect their similar age. The subject then would have an effective age of fifteen years-(15). Photographs can provide good support for this conclusion. Although no two-(2) properties are alike, the key is the level of comparison.

[1] Competency Rule, USPAP, 2014-2015.

The second technique is through Market Sale Abstraction utilizing the Replacement Cost Approach. Although this technique is simple and provides substantiation for the opinion estimate, it does take some time to develop. However, if the technique is set up in an Excel format, it becomes much quicker.

The following **example** demonstrates how the estimate of Effective Age for a Single Family Residence is derived. Utilizing the Sales Comparables within the appraisal report, a range of effective ages can be developed. Since the Comparables selected have been deemed by the appraiser to be the most comparable to the subject from the market, support for an opinion of effective age can be substantiated.

Chronological Age of Subject – 35 Years

1. **Sale Price** of Comparable #1 – Age Equal to Subject: $167,900

2. Subtract the estimated land value (the site) from the sale price. - 33,600

3. Value attributable to the depreciated improvements $134,300

4. Replacement cost of the home and other improvements from the appraisal:

House	(2,200 sq. ft. x $100.20)	=	$220,440
Garage		=	12,100
Site Improvements		=	3,600
	Total Replacement Cost		$236,140

5. Calculate the Total Depreciation by subtracting the value attributable to the improvements from the replacement cost new. Depreciation abstracted includes all forms of depreciation. (Step 3) from the reproduction cost (Step 4)
   Total Depreciation: $236,140 - $134,300 = **$101,840 (Market Abstracted)**

6. Percentage Depreciation of the improvements: ($101,840 / $236,140) 43.13%

8. Economic Life: 55 Years x 43.13% = 23.72

9. Effective Age Estimate: **SAY** 24 Years

10. **Chronological Age (35) Effective Age of Comparable (24)**

If this process is repeated to the other Comparables, a simple range is developed and the appraiser could reasonably determine an effective age by comparison for the subject property. If the Sale Price of the subject is known, the same method of abstraction could be used on the subject, thus giving the appraiser an indication where the subject property falls within the market.

This technique does not substantiate in any way that the sales price for the Comparable Property or the Subject property as to being accurate or correct. This technique takes known facts (sales price, replacement cost information, land value estimate), and applied to an appraisal technique to abstract an effective age estimate.

The resulting estimate of effective age in this example is not etched in stone or absolute. Just by simple appraiser preference, the estimate could be revised to twenty-(20) years, thereby allowing for further deduction for economic obsolescence. The main thing to remember is that the appraiser has some form of backup and is in conformance with USPAP.

COMMERCIAL / INDUSTRIAL

The same two-(2) methods (**Visual Comparison and Abstracted**) as previously discussed can be applied to commercial and industrial structures. Industrial properties can be more complex when difference sections of the structure have been added on to over the years, but an effective age estimate can be abstracted from known information.

EFFECTIVE AGE - EFFECTIVE GROSS FLOOR AREA USAGE

When the appraiser is confronted with an industrial building that has been developed throughout the years, and various sections are younger than other parts of the facility, an estimate of effective age still can be reasonably made and substantiated.

In this **Example**, the subject property has had many additions made to the original building many years ago. An effective age estimate can be made based upon the effective gross floor area usage. Date of appraisal is in the year **2013**.

Area	Year Built	Square Feet	Actual Age	Square Footage Used
1	1969	14,750	44	649,000
2	1975	4,200	38	159,600
3	1985	10,300	28	288,400
4	1999	14,700	14	205,800
		43,950		1,302,800

1,302,800 / 43,950 = 29.64

SAY: 30 Years

CONCLUSION

In the 2014-2015 Edition of USPAP, the edits to the definition of **assignment results** clarify that assignment results include more than the appraiser's value opinion. The appraiser is responsible not only for the opinion of value, but for **other opinions formed** as part of an appraisal. It's best for an appraiser to take the time and effort to support an opinion rather than guess and then have to worry as to how they are going to defend it later. Like it or don't like, the Cost Approach Method is a viable tool. There are downsides to it, but there are equal downsides to other appraisal methods available to appraisers.

Properly applying valuation methods and techniques not only provides supportable evidence for an appraiser's opinion, but demonstrates that the individual has the knowledge and experience to obtain a reasonable answer to an appraisal question. The techniques provided here gives the appraiser another tool to help solve for that answer.

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Biography of Author

Daniel J. Dzierbicki is independent real estate appraiser specializing in industrial real estate. Daniel holds the Senior designation of ASA-RE with the American Society of Appraiser, also the Senior designation of IFAS with the National Associations of Real Estate Appraisers, and the RES designation with the International Association of Assessing Officers. He currently is a licensed Certified General Real Estate Appraiser with the State of Michigan and a Licensed Michigan Real Estate Broker. Daniel has been in the real estate appraisal field for thirty nine years. **Contact: dzierbicki54@att.net**

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VALUATION ISSUES IN FRACTIONAL REAL ESTATE INTERESTS AND PARTITION COST ANALYSIS

This article develops a probability weighting methodology for evaluating and supporting an appropriate valuation discount for undivided tenancy in common real estate interests. Traditional cost-of-partition models do not reflect the most probable outcome, but instead the least likely and least profitable outcome for a co-owner seeking a liquidity event. We also develop a supportive methodology for estimates of partition likelihood and discount rates, both of which are also consistent with the issues raised in the *Ludwick*[1] tax court case.

Overview of Tenancy in Common Valuation

The standard methodology for appraising fractional interests in real estate is cost-of-partition analysis. This is partly because it is favored by several tax court judges and IRS auditors. However, it is also favored, to the exclusion of other potential analyses, by a large percentage of appraisers hired by tax court petitioners. Such clients benefit when their fractional interests are appraised at a relatively low value, and the cost-of-partition analysis considers the worst possible scenario, leading to a value that reflects a substantial discount. In addition to the cost-of-partition analysis, IRS attorneys sometimes favor conservative assumptions similar to those used by the *Ludwick* court, which were mostly chosen arbitrarily because both appraisers failed to provide support for their chosen methods. While mathematical partition cost analysis appeals to the IRS and tax courts, its implicit assumptions prove difficult to support[2]. This article demonstrates how a more nuanced approach can both (a) rebut the conservatively low assumptions used by the *Ludwick* court, and (b) include alternative scenarios, other than a cost-of-partition analysis, that still address of the likelihood of a partition action.

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[1] Ludwick v. Commissioner, T.C. Memo. 2010-104 (May 10, 2010).

[2] The cost-of-partition method, for example, assumes an orderly sale process within a fixed term, reasonable attorney fees, and an absence of property stigma by potential buyers.

Both appraisers in the *Ludwick* case presented comparable sales data relating to fractional interests that supported their selected valuation discounts. The *Ludwick* court, however, criticized the applicability of the comparables presented by both appraisers. In response to these criticisms, I developed a more suitable probability-weighted model that incorporates multiple scenarios similar to the model used by the *Ludwick* court. In short, fractional interests suffer from marketability impairments similar to other extraordinary sale conditions, such as those properties owned by bankruptcy estates and foreclosed properties owned by banks (REO sales). As such, the use of bankruptcy and REO comparable paired-sale data that are similar in property type[3] will likely prove more persuasive than those comparables presented by the appraisers in *Ludwick.*

Analysis of Ludwick Tax Court Case

Overview of Case

The *Ludwick* case is a published tax court case related to the February 2005 valuation of a 50 percent undivided interest in a Hawaiian vacation home ("Subject Property"). The Subject Property was encumbered by a tenancy in common agreement restricting any partition action; however liquidity was essentially unimpaired as each co-owner retained the right to market the property and retain a pro rata share of the proceeds. The two taxpayers (Petitioners) and their appraiser failed to persuade the U.S. Tax Court to rule in their favor on several key issues. Additionally, the Petitioners failed to address issues that the court found critical. The IRS (Respondent) and its appraiser also failed to persuade the court to accept its analysis. In response, the court effectively developed a weighted average model based upon (a) a sale at fair market value (90 percent probability), and (b) the cost of a partition action (10 percent probability), reflecting each undivided interest's unimpaired marketability.

[3] Specific sale discounts may be abstracted by comparing bankruptcy and REO-affected comparables to unaffected sale comparables. Paired–sale discounts are calculated by comparing, for example, bankruptcy-affected sale prices to non-affected sales and abstracting adjustments. Similarly paired-sale discounts may be abstracted from REO-affected sales prices.

Use of Undivided Interest Sale Comparables

The taxpayers' appraiser used a recap of comparable sales data relating to undivided interests in properties, but failed to list the supporting data. Consequently, the appraiser was unable to submit to the court any *specific analysis*[4] comparing the subject undivided interest to any of the comparables. The *Ludwick* court criticized the taxpayer's appraiser for omitting specific details of the comparables, but not necessarily the use of such comparables. However, the court did criticize the IRS appraiser's use of such comparables and related explanations.

Since the *Ludwick* court criticized the applicability of the comparables presented by both appraisers, the use of bankruptcy and REO comparable data that are similar in property type may prove more persuasive as proxy data. This proxy data is typically more available in the local market compared to fractional interest sale data.

In addition to using proxy data, it is important to use more than one example. In the *Weinberg* case[5], the Tax Court favored the selection of multiple comparables over the opposing expert's use of only one comparable for the minority partnership interest valuation at issue.

[4] In the instant case, the court criticized the taxpayer's appraisal report for using summary statistics relating to transaction that were unavailable. The court also criticized the statistical presentation for omitting any statistics relating to variability (such as standard deviation) and "specifics." In *Northern Trust Co*., 87 T.C. 324.5 (1986), the court disregarded an appraiser's analysis when he based the fractional interest discount exclusively on the average discount of a study. The court found that "The valuation of a closely held corporation...must take into account all of the relevant facts and circumstances of the particular corporations under scrutiny." In *Ludwick*, the Tax Court disregarded the appraiser's analysis because it lacked *specific analysis* of the comparables.

[5] *See Estate of Weinberg v. Commissioner.* 79 T.C. Memo 1507 (2000).

Probability of Partition Action

The *Ludwick* court considered only two alternatives: (a) the Subject Property would be sold at market value (net of sale costs) after one year, and (b) the Subject Property would be sold as part of a two-year partition action. This simple model fails to consider the most likely scenario wherein the non-selling owner, who has more negotiation leverage as the most likely buyer, or another buyer, demands and negotiates a discount similar to the discount resulting from the potential partition action. The *Ludwick* court's assumption of a 90 percent probability that a buyer would pay the full pro-rata fair market value is unsupportable and inconsistent with its model. Even if the non-selling co-owner is financially able and willing to buy the offered 50 percent interest, he or she would not need to pay the brokerage costs or wait one year. The non-selling owner, moreover, remains uniquely motivated to buy the offered undivided interest, as he or she would then enjoy a value enhancement of his or her previously owned undivided interest. In contrast, a third party would be unwilling to pay pro rata for the Subject Property, because it would then own an investment with fewer benefits and more impairments than an alternative property.

Regarding the *Ludwick* case, Exhibit 1 is a summary of several relevant factors that impact the likelihood that a potential buyer of the Subject Property, in my opinion, would require a partition action to achieve a liquidity event. I included it herein as an example for an appraiser to support his or her opinions regarding the likelihood of a partition action. The appraisers' opinion of such a likelihood was a critical issue in the instant case. The factors are rated from 1 to 10, which represent the likelihood of a partition action occurring when that particular factor exists. With respect to the *Ludwick* case, several of the relevant factors are rated a 5 or 8. This indicates that there is a moderate probability, for a potential buyer of the 50 percent TIC interest, that a partition action would be required. In the end, the court settled on a 10 percent probability of a partition action, mostly because neither party addressed the issue in its briefings to the court.

EXHIBIT 1

FACTORS AFFECTING LIKELIHOOD OF REQUIREMENT OF PARTITION ACTION FOR LUDWICK CASE FACT SET

Factor	*Relevance for Higher Likelihood of Required Partition Action (Scale 1 to 10, 10=maximum.)*
Residence that co-owners use personally	8 (owner-users are more likely to resist partition action.)
Existing loan financing	1 (no loan, less risk to buyer)
Number of co-owners	8 (2 total, fewer co-owners make partition action more likely)
Concentration of ownership	5 (50% max for co-owner, no majority owner)
Exposure time for Property	5 (1 year marketing time per respondent)
Fee ownership of Property	1 (Property is fee simple, less risk than leasehold, interest subject to ground lease)
Property Age and Condition:	Unknown
Consistency of Distributions	10 (Property is unleased, more opportunity cost to buyer)
TIC Agreement with Partition Action Prohibition	3 (Property is encumbered by a TIC agreement, but each co-owner has a right to market the property)

Cost of Partition Method in Ludwick Case

The *Ludwick* court questioned the parties' appraisers regarding the rationale underlying a lack of marketability discount. It agreed such a discount was warranted, although no mention was made of a discount for lack of control. The *Ludwick* court concluded that a buyer of an undivided interest "could not demand a discount greater than (a) the discount reflecting the cost and likelihood of partition and (b) the discount representing a marketability risk."[6] The *Ludwick* court, however, did not incorporate marketability risk into its financial model. The court also noted that the Petitioners' appraiser admitted that a partition action was unlikely between the co-owners.

Since the *Ludwick* court criticized the applicability of the comparables presented by both appraisers, the use of bankruptcy and REO comparable data that are similar in

[6] Ludwick v. Commissioner, T.C. Memo. 2010-104, 4-12.

property type may prove more persuasive as proxy data. This proxy data is typically more available in the local market, compared to fractional interest sale data.

In its calculations, the *Ludwick* court found that a hypothetical partition action would take two years. The cost of litigation would be one percent of the property value (or $72,500), and the *Costs of Sale* would total six percent. These expected value figures appear reasonable, but I believe the likelihood of a court action exceeding these figures is much greater than the likelihood of the actual costs falling below the estimates. Lacking any supportable analysis from the taxpayer's appraiser, the *Ludwick* court used, in its valuation model, a 10 percent "rate of return" or discount rate, as suggested by the IRS's appraiser.

Discount Rate Analysis for Partition Cost Model

Overview

For most cost-of-partition cost model analysis, a higher discount rate than that used by the *Ludwick* court is supportable by two methods: the build-up method and institutional investor surveys.

Discount Rate via Build-Up Method

Using the build-up method, I started with a base discount rate of 9 percent, which reflects the cash flow discount rate for residential, institutional property investment.[7] The second layer relates to the incremental risk of an extended partition action (exceeding two years), which I estimated at 2.5 percent. The third layer reflects the entrepreneurial reward required to administer the adversarial litigation and is estimated at 2.5 percent. The fourth layer relates to property specific risks; this premium also reflects the Subject Property's lack of institutional appeal, relative to Class A and B properties referenced in the investor surveys. As the Subject Property is very large and

[7] Applicable real estate investment surveys include Price Waterhouse Coopers (pwc.com) and realtyrate.com.

pays no distributions, I added an additional one percent for this layer. The indicated discount rate is calculated as follows

Base Real Estate Discount Rate – Institutional Property	9.0%
Add: Risk of Partition Action Term Premium[8]	2.5%
Add: Entrepreneurial/Admin. Premium[9]	2.5%
Add: Subject Property Specific Premium[10]	1.0%
Total Discount Rate Via Build-Up Method	15.0%

TO BE CONTINUED

About the Author

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[8] This premium reflects the incremental risk associated with the high probability of a partition action requiring more than two years as opposed to less than two years.

[9] This premium reflects the incremental risk and administrative effort required to manage a lawsuit as a litigant.

[10] This premium reflects the incremental risk associated with the Subject Property, such as secondary location, atypical improvements appealing to a limited buyer pool, or local real estate market sluggishness.

CONFIRMING AND VERIFYING MARKET DATA WHILE MARKETING YOUR APPRAISAL SERVICES

By Kelly Berriman

So I got this order for an REO duplex: 2 bedrooms, 1 bath each unit, 2028 sq. ft., built in the 1900's with a 2 car garage. And this is a neighborhood where a garage is considered a luxury amenity. The subject is located in an REO driven market. So I pull up MLS just to do an initial search for data. Sales range from $0 (2 of them) to $39K with average price of $8K. Most of the sales are 2 beds, 1 bath each unit with 1900-2100 sq. ft. built in the 1900's so I assume the majority of my adjustments are going to be for condition. How do I determine condition of the comparable sales in neighborhood and how they relate to my subject with the limited data on MLS? I could look at the photos but that is not much of an option for this market. I could guess, but something in the back of my head tells me that is not why AMC sent me this order. I could call the Agent and ask and in turn verify the sale.

Gone are the days of the MLS book and microfiche and waiting in line at the Register of Deeds. Today accumulating market data is way less labor intensive. It is at your fingertip which means it is just as easy for the client to search for comparables as it is for us. In fact it is so easy even an AVM can do it.

Despite all the technology, all the plethora of data, our clients still need someone to analyze it, which is one of the reasons computers have not completely taken over. As most appraisers place the majority of weight on the Sales Comparison Approach when appraising a residential property, the selection and verification of comparable sale properties is critical. How can you determine adjustments for sales concessions, financing type or condition of sale if you never researched these conditions?

I get together every so often with people in other aspects of the real estate world and we swap stories. During these venting sessions some people are amazed at how many different governing authorities we appraisers have to abide by. And all of them want us to verify our sales data. USPAP requires it. FHA requires it. Fannie Mae's *Selling Guide* requires appraisers to "report property data accurately and consistently". See Fannie Mae B4-1.3-07: Sales Comparison Approach Section of the Appraisal Report (04/15/2014) and FAQ 19 as examples.

The City of Milwaukee lists homes currently owned by the City and available for purchase on their website. These homes are offered for sale at a lower than market value with stipulations for the buyer. FSBO's are sometimes listed for less than other competing homes as the seller is not paying a 2.4-3% commission to a listing agent. Alternatively some FSBOs are listed for higher than market value as the seller did not employ a Realtor for an accurate CMA. Time on market, method of marketing, sales date, type & term of financing, relationship of seller to buyer, etc: these all have an impact on sales price. Value is more than simply the number of bedrooms and bathrooms a property has. There is a direct relationship between price and motivation of buyer and/or seller. Unfortunately, motivation is not always readily available on the MLS system.

There are multiple ways of verifying your sales data in addition to MLS. However, when I research the suggested list of attorney, title, financial institutions, etc., I can't help but think that these resources will declare confidentiality so what's the point. That routes me back to the Register of Deeds, which thankfully is now online for many areas. Unfortunately, the public data is not always up to date. And this source does not provide me with any data other than sales price and conveyance date.

Back to my REO duplex. I call or email agents of comparables to fill in the gaps. Per an NAR article dated July 2, 2013 entitled "NAR Issue Brief: Appraisal Management Company Q&A": "Real estate agents are encouraged to provide appraisers information such as recent comparables that are similar to the property being appraised, plat surveys, inspection results, and details about the neighborhood, such as schools and shopping options." This article additionally includes information for how Agents can assist in deterring inaccurate appraisals.

Occasionally an agent will cite confidentiality of their client. I tell them I understand and respect their concerns and then point to Line 272 (Distribution of Information) section of the WB-11 Offer to Purchase form which allows for Agent to provide information regarding the transaction to an appraiser.

Believe it or not there are times when I am appraising more than one property at a time and this personal contact, while informative, makes it a little more difficult to meet the AMC's twenty-four hour turn time demands (wink). And wouldn't it be great when I am looking at older sales if I didn't have to contact the agent each time and rack his or her brain. I thought so too. That is why I began accumulating this data in the form of a spreadsheet. Each week I gather the sales in the areas I appraise and email a short survey to both the listing & sales agent. So far I am getting about a 30% return. I then remove sales which agents did not return the survey. This can be somewhat labor intensive but over time I hope to be able to zoom in on market trends for individual neighborhoods rather than simply a community overview.

According to an analysis by the Wisconsin Realtor Association, there has been an 11.3% decline in sales in March 2014 compared to March 2014 *information taken from wra.org. A decline in sales naturally means a decline in market data. Without relevant market data appraisers can sometimes find it difficult to explain what is happening in the market in a way which is acceptable to the bank guidelines. But do the decline in sales equate to a decline in value? Not necessarily. I have had to explain to my clients recently that Wisconsin experienced some of the most frigid temperatures these past 3 months. Cold weather means limited showings and fewer homes on the market. This low supply has naturally translated into bidding wars and offers coming in at or above purchase price. For one sample area I have found an average of 1.83 offers for each home sold in the month of March. I can then compare this average to the pre-freezing months and explain to my clients how the low supply has impacted demand. Once I explain the current state of the market I find many of my clients understand the lack of sales past 90 days on the grid.

In essence I am creating a market study while marketing my services to hundreds of Real Estate agents. Not only am I able to justify my lack of current market data but I am also able to explain supply and demand, which as we all know are the most basic forces behind value. I also know if a particular property was purchased for the school system, what condition the property was in and seller motivation among other things. I now have an overview of buyer motivation and am able to graph the motivation for that market. And surprise, location, location, location still tops the chart.

About the Author

I began my career in the Real Estate industry in the 1990's as a Loan Originator with Goldstar Financial. I received my Real Estate Salespersons license in 2002. I received my Appraiser's license in 2003 and Certified Real Estate Appraiser's license in 2005. Contact information: P.O. Box 1185 * Waukesha, Wisconsin 53187, 262-442-2323, bberriman2000@yahoo.com.

Valuing Real Property Going Concerns

By Paul R. Hyde, EA, MCBA, ASA, ASA, MAI

The Problem

Most everyone agrees that valuing real property falls under the purview of real estate appraisers and requires a real estate appraisal license in the jurisdiction in which the property is located. Many people agree that valuing a business entity (often referred to as a going concern) requires special skill and expertise possessed by qualified business appraisers. The problem occurs when the need arises to value a business enterprise that is difficult to distinguish from real property. The majority of licensed real estate appraisers do not have the education, training, and experience to value a business and business appraisers do not have the license, education, training, and experience to value the real estate component.

The purpose of this article is to outline and clarify the problem, as I see it, and to propose solutions as to how various real property going concerns should be valued … and by whom. Some real property going concerns can relatively easily and competently be appraised by real estate appraisers; others require both a real estate and a business appraiser. I will explain and clarify which real property going concerns fall into each category which should assist appraisers, and those that order appraisals, to determine who should be retained to appraiser various real property going concern types.

My Background & Qualifications

Why should you read and pay attention to this article? I am a business and real estate appraiser. I specialize in appraising business and real estate combinations and have written and taught many appraisal classes over the years. I am an Enrolled Agent (Enrolled to Practice Before the IRS), a Master Certified Business Appraiser, an Accredited Senior Appraiser in both Business Valuation and in Real Property – All Types, and an MAI real estate appraiser. I am also a Senior Appraiser with the American Society of Agricultural Appraisers – a machinery, livestock, and equipment appraiser. My work experience includes being a commercial loan officer, the Chief Financial Officer for a 46-unit restaurant chain, real estate development and construction, commercial real estate and business brokerage, and for the last fifteen plus year's full-time real estate and business appraisals.

Terminology

Another part of the problem associated with valuing real property going concerns is the wide dispersion of different terminology and the lack of agreement among those trying to describe the entities in question. Many real estate appraisers refer to what I call a real property going concern as simply a "going concern." The problem with this definition is that many businesses without a real estate component (except perhaps for office or industrial leased space) are referred to by many as a going concern. In business valuation, businesses are typically valued under one of two basic premises: a going concern scenario or a liquidation scenario.

L. Deane Wilson, MA, ASA and Robin G. Wilson, MAI in their text, *Going Concern Valuation for Real Estate Appraisers, Lenders, Assessors, and Eminent Domain*[i], do an excellent job explaining many of the problems associated with these types of valuation, but their definition of "Going Concern" could include business entities without real property.

David C. Lennhoff, MAI, SRA, Maureen Astroieni, MAI, and James D. Vernor, MAI, Ph.D. in their class materials for *Fundamentals of Separating Real Property, Personal Property, and Intangible Business Assets*[ii], refer to the concept in question as the "Market Value of the Total Assets of the Business." This term is not widely used and is not used by business appraisers.

Ben Wilcox, CBA, MAI in his article *Complexities in the Use of Real Estate Appraisals*[iii] uses the term "Interdependent Properties" meaning "one in which the revenue and the income of real estate and the business that occupies it are intertwined and difficult to separate." This definition is a good one, however, I believe that the term Real Property Going Concern is more clear and concise.

Defining the Appraisal Subject

Clearly, a significant part of the problem when valuing real property going concerns is to clearly define what is being appraised so that no misunderstanding can be reached regarding what the value conclusion presented in the appraisal includes.

Most often, real estate appraisers are asked to conclude to the market value of a specific real property defined by a legal description. This typically means the value at which the property would likely sell with a specified marketing period and exposure time using a "standard" definition of market value. This value conclusion represents the total value of the property, i.e. not the equity in it and it does not include the value of business type assets such as cash, accounts receivable, inventory, etc. that may or may not be present as of the effective date of the appraisal.

Business appraisers are often asked to conclude to the fair market value of the equity in a business enterprise (i.e. net of long-term debt) rather than the value that the assemblage of assets would sell for using a definition of fair market value such as that set forth by IRS Revenue Ruling 59-60 or the very similar definition set forth in the International Glossary of Business Valuation Terms, adopted by all of the major business appraisal organizations.

The key points outlined in these definitions are both the buyer and seller must be willing without any compulsion to buy and sell, they must each have a good understanding of all relevant facts regarding both the company and the market for it, they must be able to make such a trade, and the value is expressed in terms of cash equivalents.

The concept of Premise of Value is defined by the International Glossary of Business Valuation Terms as: "an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; e.g., going concern, liquidation."[iv]

When valuing a Real Property Going Concern it is critical to define just what is included and the standard of value used. This will usually depend on the purpose and use of the appraisal. If the appraisal is being done for a lender, particularly a lender associated with the Small Business Administration, the value sought is typically the value of "the assets that would typically transfer in a sale" rather than the equity in the entity. If the value is needed for a divorce, for estate and gift work, or for some dispute, it is often the fair market value of the equity in the entity. The value conclusion reached must be clearly defined so that it is impossible to misunderstand.

Going Concern Property Types

I divide going concern property types into two categories: Simple Real Property Going Concerns and Complex Real Property Going Concerns. Of course, there is a grey line separating these two categories as some real property going concern types could fall into either category depending on the facts and circumstances.

Simple real property going concerns can be relatively easily appraised by real estate appraisers using typical real estate appraisal approaches and methods. Complex real property going concerns require both a real estate appraiser and a business appraiser.

Simple Real Property Going Concerns

Simple real property going concerns are those that can usually be appraised using an improved property sales comparison approach with minimal differences between the Subject and the sales comparable data available. In other words, those assignments that do not require an identification of the amount, if any, of intangible asset value present. Instead, all that is required is the total value of the real property going concern.

Simple real property going concerns include, but are not limited to, the following property types:

- Assisted Living Facilities
- Auto Dealership
- Auto Repair or Tire Center
- Bowling Center
- Coin Operated Self-Serve Car wash
- Fast Food Restaurants
- Full Service Car Wash
- Full-Service Restaurants
- Gas Station – Convenience Store
- Golf Courses
- Hotels
- Mini Storage Facilities
- Mobile Home Parks
- Motels
- Movie Theaters
- Nursing Homes
- Recreational Vehicle Parks

Real estate appraisers have sufficient data and expertise to determine the value of the real property, and often the combined real property and intangible business value, of simple real property going concerns. Real estate appraisers can often find sales of these types of properties that include the business operations as well as sales of vacant real property. They also often attempt an income approach using a capitalization rate extracted from the market to identify the combined real property and intangible asset value of the real property going concern.

It should specifically be noted that real estate appraisers are not qualified or competent to determine the amount of intangible assets, if any, for any of these simple real property going concerns. Should the assignment require identification of the intangible asset value, a competent business appraiser should also be included in the assignment and the real estate appraiser should determine the market value of the real property only. The methodology and data available to real estate appraisers is insufficient to determine the business value portion of any real property going concern. The real property and intangible asset components of a real property going concern have very different risks and the appropriate methodology needed to determine each of these requires different expertise. If this is needed, the following section outlines how it should be done.

Complex Real Property Going Concerns

Complex real property going concerns are those that cannot usually be appraised using an improved property sales comparison approach since there are typically major differences between the Subject and the sales comparable data available. In these assignments, a real estate appraiser is needed to identify and conclude as to the value of the real property and the market value of a lease payment that would be paid to an independent third party if the real property were leased instead of owned by the entity. A business appraiser is needed to value the going concern after including the market lease expense in the Company income statements and in the income forecast developed for valuing the going concern portion of the real property going concern. The combined value of the real property as determined by the real estate appraiser and the going concern as determined by the business appraiser constitutes the fair market value (or market value) of the real property going concern.

Complex real property going concerns include, but are not limited to, the following property types:

- Amusement Parks
- Assisted Living Facilities (typically larger facilities)
- Convention Centers
- Hotels with Restaurants
- Nursing Facilities (typically larger facilities)
- Restaurant business entities that also own the real property
- Truck Stops
- And many other properties with integrated real property and businesses

The key to differentiate between the simple and the complex real property going concern is are there readily available improved and operating sales comparable data that is similar enough to the Subject to require little in the way of adjustments for differences. If so, the entity can be considered a simple real property going concern and can be valued by a competent and experienced real estate appraiser. If not, the entity will require both a business and a real estate appraiser.

Unfortunately, size alone of the entity does not determine if it is simple or complex. It is the nature of the entity and the availability of sales data for similar property sales and listings that define the difference. A major factor that directly affects the differentiation between a simple and a complex real property going concern is a comparison of the historical and expected financial performance of the entity as compared to the industry. The more different the Subject from the industry, the more likely it is to be a complex real property going concern.

It should be noted that there are significant differences between the methodology used to value real property and business entities. The risks associated with an income stream associated with the real property portion is typically much less than the income stream associated with the intangible business assets. Also, the income stream capitalized by real estate appraisers is much different than those used by business appraisers. Real estate appraisers typically capitalize net operating income – a pretax, before debt service, with no depreciation expense taken, income stream. Business appraisers typically capitalize net cash flow – an after-tax, adjusted for depreciation and capital expenditures, adjusted for changes in working capital, and it may, or may not, be adjusted for debt service.

Allocation of Value – Real Property Going Concerns

The fair market value of an operating company portion of a real property going concern should be determined after inclusion of a market lease expense for the real property owned by the Entity "as if" it were leased from an independent third party using standard business appraisal methodology. As part of this process, business appraisers are sometimes asked to allocate the value between tangible and intangible assets. It is important to note that the value of either the equity in the business or the value of the "assets that typically transfer in a sale" can be determined depending on the purpose and use of the appraisal. The market value of the real property is added to the value of the operating company in order to arrive at the value of the Real Property Going Concern. If the equity in the entity is the subject of the appraisal, any debt associated with the real property would be subtracted when the value of the real property is added.

This allocation of the value in a real property going concern is not always as simple as it appears. Depending on market conditions, industry conditions, the property type, and other factors, occasionally the real property's value may exceed that of the value as a real property going concern or the value as a real property going concern may be less than the replacement cost new for the real property. In circumstances such as these, the appraiser's job becomes more complex and the real estate appraiser and the business appraiser will have to work together to determine how much functional or external obsolescence should be allocated to the real property and how much intangible asset value may remain. For example, in an operating nursing home, the cost and time associated with licensing a facility likely has some intangible value even if total entity value is less than the replacement value of the real property.

It is often difficult to determine a market lease rate for the real property portion of a real property going concern. When valuing a complex real property going concern, I recommend that the real estate appraiser use both the cost approach (which includes the sales comparison approach for the land) with an improved sales comparison approach for similar properties that "have gone dark" as a sanity check. Ideally, the real estate appraiser will find similar real property that is leased to similar real property going concern entities, however, this is highly unlikely or if found, they are generally not leased at "market" rates. Instead, once the value of the real property portion has been determined, the market lease rate must be determined by applying an appropriate lease rate factor to the value of the real property.

In order to determine the appropriate lease rate factor for the real property portion in a real property going concern, I have contacted a number of people actively involved build to suit leases and sale-leaseback of properties. Over a number of years, I have contacted various investors and lenders that are involved in sale-leasebacks of special purpose properties such as assisted living facilities and hotels. In this process, I determined that these rates are very similar to discount rates applicable to the same types of properties. There are a number of sources for discount rates. I prefer to use the quarterly Investor Survey published by RealtyRates.com as it is readily available, has been published for many years, and Robert Watts, the publisher of the survey, has agreed with me that the discount rates in his survey is a good proxy for sale-leaseback rates.

I apply the selected discount rate to the concluded market value of the land and improvements (determined by cost approach and confirmed by a sales comparison approach, whenever possible) to get the annual lease rate. This lease rate is assumed to be on a triple net basis, i.e. the tenant will also pay the property taxes, insurance, and all repairs and maintenance for the property. This market lease rate is then used by the business appraiser as an expense in order to determine the fair market value of the business portion of the real property going concern.

The combined value of the business portion (including the value of any personal property and intangible value) and the real property portion yields the value of the real property going concern.

Conclusion & Recommendation

Real estate appraisers should be careful in taking assignments to value real property going concerns. It is often not possible to find sufficient sales data to allow the appraiser to reach a supportable conclusion of value. Should this occur, the real estate appraiser should have a relationship with a competent business appraiser to allow them to complete the assignment in a manner that is USPAP compliant and that results in a credible conclusion of value that is well supported.

Real estate appraisers should be further cautioned that attending at a "course or two" will not provide them with the knowledge and experience requisite to value the business portion of a real property going concern, and that should they attempt to do so, they may very well step over the line into incompetence without realizing it. They should further consider the fact that their professional liability insurance policy very likely will not cover them when valuing businesses and real property going concerns certainly include a business. I am required to carry two professional liability policies – one for real property and another for business valuation. It is interesting to note that the annual premium for the same amount of business valuation coverage is four times that of the real property annual premium. This indicates to me that the insurance companies view business valuation as much more risky than real property valuation.

In my years of appraising real property, personal property, and businesses, it is clear to me that business valuation is much more complex and subject to disputes and arguments than are real and personal property valuations. Valuing real property going concerns is very interesting and challenging work – be sure to be qualified for the work you take on or get someone to assist you that is qualified.

About the Author

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Prior to forming his own company, Paul worked as a commercial loan officer evaluating businesses and granting business loans. Paul later held the position of Chief Financial Officer and one-third owner of a twenty-seven unit restaurant company with a USDA meat processing plant for seven years. He has taught classes for a variety of organizations in business valuation, investments, tax planning, and small business management. Paul also served as an instructor for The Institute of Business Appraisers, Inc. for many years. He works full time in the business and real estate appraisal field. His contact is telephone at 208.722.7272 and email at prh@hydevaluations.com.

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Practical practice management: When can you change the name of the Client on an Appraisal Report?

Many appraisers have received a request to "re-certify" an appraisal to another client. This is especially true in the in the real property arena where there is significant rate competition among mortgage providers. When is it appropriate for an appraiser to change the name of the client on an appraisal report? This article will answer that question and provide a few examples of how you can comply with these types of requests and still comply with USPAP. Recently, on two separate occasions appraisers have contacted me to discuss the issue. The first was in reference to the instructions in a regional VA handbook that stated:

> *If a Veteran decides to change mortgage lenders after the appraisal has been completed, the appraiser should be able to accommodate this change without violating USPAP (Uniform Standards of Professional Appraisal Practice) as follows:*
>
> *1) Use the same VA case number*
> *2) Create a new internal file number*
> *3) Change the lender name and address on the appraisal report*
> *4) Upload the report into WebLGY*

In the second instance, it was a new lender taking over an FHA file and requesting that the appraiser "re-certify" the appraisal to them. The appraiser had completed a FHA compliant appraisal about 30-days prior to this request for a different lender. The new lender explained to the appraiser that based on the FHA mandate that an appraisal shall stay with the home for a period of 4 to 6 months, the FHA had told the lender they must use the "original appraisal". Indeed, the potential new client presented the excerpt below from HUD.gov, which indicates the instances when a lender may obtain a new appraisal:

> ***New Borrower Using an Existing Appraisal.*** *If the transfer is made for a new borrower to use an existing appraisal, the new lender is to collect an appraisal fee from the new borrower. The appraisal fee is sent to the original lender who, in turn, is to refund the fee to the original borrower. (Handbook 4155)*
>
> *For cases assigned on or after January 1, 2010: A 2nd appraisal may be ordered by the 2nd lender when:*
>
> 1. *The 1st appraisal contains material deficiencies determined by the DE underwriter for the 2nd lender.*
> 2. *The appraiser performing the 1st appraisal is on the 2nd lender's exclusionary list.*
>
> *3. Failure of the 1st lender to provide a copy of the appraisal to the 2nd lender in a timely manner would cause a delay in closing, posing potential harm to the borrower. Potential hare include events outside of the control of the borrower such as loss of interest rate lock, purchase contract deadline, foreclosure proceedings and late fees. (Handbook 4155.2: 4.4i-j*

The FHA statement above is a little dubious; however, one can see the logic that the new lender was using to try to convince the appraiser to “re-certify” the appraisal. An appraiser reading either one of these edicts from a federal agency might well believe that they can simply change the name of the client on an appraisal report – they cannot! The long and short of it, is that there is no such thing as “re-certification”. It is a professional sounding term based on the “appraiser’s certification” required in every report. The term is often misused in an attempt to get an appraiser to change the name of the client on a report that has already been issued. This is a violation of USPAP. Barring a jurisdictional exception (not covered here) an appraiser can NEVER, NEVER, EVER, EVER change the name of a client on a report that has been previously issued.

In general, the reason one cannot change the name of the client on a report that has been previously completed is because there is the potential for the improper consideration of all of the elements of the assignment. That is to say, at the outset of any appraisal assignment, an appraiser must consider all of the assignment elements leading to an appropriate scope of work. The scope of work the appraiser decides upon must solve the clients appraisal problem in a meaningful way, given the context of the intended use. I know that is a mouthful; another way to think about it is: The use of an assignment result is very individualistic and may vary quite a bit between one client and another. Each client may have specific needs and/or priorities that are important to them given their intended use for the appraiser’s assignment results; therefore, the plan for solving the client’s appraisal problem can only be carried out and developed/executed prior to the report being issued. USPAP states that the development of a proper scope of work requires communication with the client. Changing the name of a client on a report after the report has already been completed basically amounts to evidence that the goals and needs of the “new client” could not have been properly considered in accordance with USPAP because the new client was not identified prior to the issuance of the report. Additionally, changing the name of a client on an existing report and then releasing that report to a new client could potentially be a violation of the confidentiality portion of USPAP.

The following example covers some but certainly not all of the instances that may come up. Let’s assume an appraiser, Allison Jones, has just completed a project for “Bank A”. She has appraised 127 Maple Street, a single-family residential property. The purpose of the appraisal was to develop an opinion of current market value. The function of the assignment results was for the use in underwriting a mortgage involving a federally regulated financial institution. The definition of value was the standard one used by FNMA/FHFA and cited in the Code of Federal Regulations. The report was requested to be delivered in the format of a 1004 (URAR) appraisal form. The appraiser’s property visit took place on April 10th and on April 14th, she had completed her analysis and reconciled a value of $100,000. The 14th was the report date and the day she communicated the report to the client. Then, on April 21st, eleven days after the effective date of the appraisal for Bank A, one of these things happens:

- The loan officer from Bank A (the client that the appraisal was just completed for) calls and states that he has relocated to Bank B and that all of the loan files are transferring with him to Bank B and he needs you to change the name of the client to Bank B, so he may complete the mortgage; or

- Bank A calls you and states that they are not able to provide financing to Joe Buyer, and they are requesting that you "re-certify" the appraisal report to Bank B. They will immediately fax you a letter of release and a letter of authorization to change the name to Bank B; or

- A loan officer (or anyone else) calls you and says because the appraisal was done for the VA/FHA/Federal Housing Finance Agency, etcetera, etcetera, and that their regulations require the original appraisal to be used even if a new lender is taking over the file; therefore, please change the name of the client to Bank B; or

- An appraisal management company calls you and states, that due to an error in their ordering process the wrong banks name was provided to you, now please change the name of the lending institution from Bank A to Bank B and send over a revised copy of the appraisal; or any one of countless other possibilities.

The simple answer to each one of these scenarios is simply: No! However, you may be surprised at how easy it is to accommodate a new client's request, while still complying with the Uniform Standards. First, it is important to keep in mind that there is no prohibition whatsoever with an appraiser using data from accumulated work files. Indeed, in my experience, most appraisers list their own files as one of the data sources used for a valuation. When an appraiser gets a new request to value a property that he/she has already performed an analysis on, it should be treated in the same manner as any new assignment. However, in these instances, it just so happens that some or all of the data, analysis, and other work involved to develop the appropriate opinion of value may have already been completed.

Below, I continue the above example of how a new request for a previously appraised property may be handled. Keep in mind, that previous assignment results are confidential, also in this example; there are no other unusual conditions or confidentiality restrictions on the appraiser from the previous assignment that would affect future assignments. For the remainder of the example, we are going to assume that the new request has just come from Bank B, a rival firm to the client for the previous appraisal. The same scenario described in the first bullet point above:

- Bank B calls and a representative tells the appraiser that Joe Buyer, the purchaser of 127 Maple Street would like to have the appraisal changed over to Bank B's name because Bank B will give her a much more competitive rate on the mortgage. Joe Buyer is no longer interested in getting a mortgage from Bank A.

Step 1:

As required by Uniform Standards, the appraiser must disclose to Bank B (the prospective client) that she provided services for the subject property in the prior three years. I know this seems obvious because the potential new client is specifically citing the appraisal report that was previously done; nonetheless, the appraiser should tell Bank B that she appraised the subject property on April 10th. Additionally, she should disclose any other service she has provided for the subject over a 3-year time period. In this case, Bank B obviously knows that the previous appraisal was performed for Bank A; however, to my thinking, there are few relevant reasons to disclose the client for the previous appraisal assignments. USPAP requires that an appraiser disclose “any service” performed for the subject property over the prior 3-years. It does not require the disclosure of the identity of previous clients. That information is usually not germane to the decision process of a potential new client when considering to employ the appraiser or engage a different individual to perform the service. Furthermore, the appraiser has to be mindful of protecting the “Appraiser-client” relationship of previous clients. So, unless there is some other motivation that seems to make disclosure of the identity of a previous client important, I would advise against stating the identity of previous clients. For our example, Bank B realizes that the appraiser has provided the previous service and would like to continue to engage her to solve their appraisal problem.

Step 2:

Having resolved the notification issue, the appraiser is a step closer to a new assignment. However, some further communication with the new client (Bank B) is necessary. The appraiser determines that the function of the assignment is to develop a current market value opinion of the subject property for its use as collateral in a federally regulated lending transaction (basically the same criteria as the previous assignment for Bank A). The same definition of market value is to be used. The use of the assignment results is the same. The appraisal is to be reported on the same 1004 form and etcetera. This sounds easy so far and appears to be a standard assignment as far as our appraiser is concerned. What she is doing now through communication with the potential new client is going through the elements of the assignment. This is necessary in order to develop an appropriate scope of work. Those elements are:

- Client and intended users
- Use and function of the assignment results
- Definition of value
- Time of the appraisal (effective date)

- Property Characteristics
- Assignment Conditions

After all of this communication with the client, the appraiser learns that Bank B's use of the appraisal is virtually identical to that of Bank A and that the scope of work for solving either valuation problem is virtually the same. At this point, the appraiser realizes that much of the data and analysis from her files, particularly data from the work folder for the previous appraisal on the same property will be very useful in solving this new client's appraisal problem. After all, she did just appraise the property 11-days ago. The appraiser realizes that there must be a very clear understanding of the assignment element "time of the appraisal – effective value date". She asks Bank B if an opinion of value that is 11-days old (the effective date of the previous appraisal) would be sufficient for their use. Bank B tells the appraiser they would like the current market value to be based on an effective date of today if possible or tomorrow at the latest; whichever is the quickest time the appraiser can get out to the subject property; however, in order to save time, Bank B is willing to let the appraiser rely on her previous inspection of the interior and just "drive-by" the property for the new appraisal. "That will save some time. I think I can get out to see it today, so the effective date will be April 21st," said the appraiser. At this point, the appraiser confirms that she accepts the assignment and will proceed with the valuation under the conditions specified.

Step 3:

With the new assignment firmly in hand, the appraiser now begins a new workfile, places the order inside it and makes a mental plan to go out and look at the property later that day. The appraiser takes out the work file for the previous valuation performed for Bank A and reviews the data and analysis in it. The data and analysis in that workfile is valid up to April 10th. Now, the appraiser sets about analyzing the market data for the past 11-days, covering the time elapsed from the April 10th to today, the effective date of her new assignment. The appraiser checks all the relevant data sources, news outlets, databases and so on. Despite the analysis, she does not discover any new data that would substantially affect the previous analysis. There are no relevant new sales that are superior to the comparable sales used in the previous analysis, and there is no significant change in market conditions since the valuation, 11-days ago. "Hmmm," the appraiser thinks… "there is really nothing new for me to add to the data and analysis from the previous report! Well, that is still subject to my inspection later this afternoon, of course."

The appraiser makes a note inside the current work folder that the data and analysis, including the interior physical inspection are based on the work done and contained in the prior workfile for Bank A. The appraiser knows that according to USPAP, all the data for the new appraisal does not have to be copied and placed in the new work file; however, if any data that was relied upon is not specifically contained in the work file, there must be a note pointing to where the data may be obtained. At this point in the process, the appraiser knows that there are no changes in the market since her last investigation and the comparable properties that were previously used for the April 10th valuation are still the best available.

Step 4:

Later that afternoon, the appraiser visits the subject property. She photographs the subject from the street and also takes a photograph of the street scene. The house and street look just the same as they did on her visit 11-days ago. The appraiser then continues to visit each of the comparable sales once again and snaps a new picture of each. By 3:30, she is back in her office, ready to type the new report and send it along. She takes a copy of an old report done on the property and removes all the irrelevant data – data that would not apply to the current valuation. She reviews the report and fills in the new data as appropriate. Recall that the Client, Bank B, stated they wanted a current market value as of the 21st; however, they were willing to rely on the interior inspection from April 10th. So, the appraiser places the new photographs of the exterior of the subject and the new photographs of the comparable sales in the report. She places the interior photos from the prior property visit on the appropriate pages and is careful to note in the caption of each photo that they were taken during the visit on April 10th. Additionally, she types a passage in the appraisal explaining that the exterior photographs are from the effective date of value on April 21st and that the interior photographs, as well as the interior condition and interior descriptions are from the previous inspection on April 10th. The appraiser makes the extraordinary assumption that the interior condition on April 21st is substantially the same as it was at her April 10th visit, and that nothing on the interior has changed to the extent that it would significantly affect the assignment results. The appraiser must take great care in iterating that the use of the extraordinary assumption may affect the assignment results. Finally, after reviewing the data and comparable sales as well as the current condition of the subject, there is nothing that has substantially changed since her last valuation. This should naturally lead the appraiser to a value conclusion of $100,000, the same as the conclusion on April 10th.

Step 5

With the finalization of step 4, the appraiser has developed the opinion of market value as of April 21st. The appraiser makes sure all of the appropriate disclosures are in the certification, disclosures about previous services and since she also adds an additional certification explaining that the April 21st visit was an exterior visit, again reiterating her extraordinary assumption.

In the example above, the appraiser's value opinion is based on her research and analysis the same as any other appraisal that she has performed. It just so happens that part of the research and analysis was done prior to the new assignment. This is a perfectly valid and in conformance with USPAP. The scope of work that the appraiser employed for Bank B, solves that client's appraisal problem in a manner that provides an credible assignment result and is meaningful to the client, given the context of the intended use. In thinking about the two items discussed at the top of this article concerning the regional VA handbook and the new lenders instructions to an appraiser that the original FHA appraisal had to stay with a property for 4 to 6 months, even if the lender changed. One can see how a person might find these requests plausible. The advice in the regional VA handbook about creating a new "internal file" number is very similar to our overall scenario above, although, it does not iterate all of the other steps involved. Similarly, the FHA could reasonably keep an appraisal with a specific property for several months regardless of changes in the "lender-client" because the scope of work and use of the assignment results would be the same for each new assignment. Keeping in mind the that there is no such thing as a "re-certification"; an appraiser that was asked to create a new report for a different lender-client on an FHA file that the appraiser had already issued an appraisal for a few weeks before would require virtually no change. In a case like this, the appraiser is responsible to treat the assignment as a new assignment and consider all the elements of the assignment. However, they would almost always be virtually identical from client to client. If the effective date of value was not changed, there would be no new inspection; there would be no new data to analyze. The only thing that would change is the report date and the name of the specific client.

I think that government agencies such as the VA and FHA try hard to fulfill their missions. I also think they do their best to fully comply with USPAP. I do not think that any of those agencies would purposefully ask an appraiser to violate USPAP. That does not mean that from time to time there is not a misunderstanding. Of course, many of us are also familiar with less scrupulous clients that may attempt to get an appraiser to "take a short-cut".

USPAP is not here to make life difficult for appraisers. It is here to help appraisers by being a consistent source of reference and common standards, while at the same time protecting the public trust. Remember there is no such thing as a "re-certification". If someone asks you to do this, it is likely a request for a new appraisal assignment. The end result of either of the examples provided above is that the appraiser will end up with two work folders, one for each valuation. The data, analysis and scope of work performed for each assignment will have solved the client's appraisal problem in a credible manner given the context of the intended use. There will be adequate support for the appraiser's actions and the confidentiality of any prior client or assignment result will not have been breached. Appraiser's that are interested in further reading on this topic can look at Advisory Opinion #26 and #27 bound with the current USPAP publication.

About the Author

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The Appraiser as an Expert Witness (Part One)

In this series of articles, we will look at the basics of expert witness work. Judges can be called by various names, so we will use the term *trier of fact*, which describes the person hearing the case for any tribunal and encompasses titles such as hearings officer, magistrate, judge, administrative law judge, and other titles. These articles will be a mix of the author's personal experiences and general information about expert witness work.

The Fact Witness

Generally an expert witness is hired and paid for the work. However, sometimes an appraiser may be called to testify (about a previous appraisal he or she performed) without compensation, and it is important to understand that in such cases the appraiser will be a fact witness and not an expert witness. The appraiser may be served with a subpoena duces tecum, which directs the appraiser to bring the appraisal and other pertinent information to the hearing. Some appraisers attempt to re-familiarize themselves with the appraisal when they are summoned, but it should be understood that there is no requirement in such cases, and it may open the appraiser up to more questions which might have been avoided.

In other words, as a fact witness the appraiser is generally only required to confirm that the appraisal was performed on a certain date and the value was a certain amount. Therefore, the appraiser may be adding to the "free" work by studying the appraisal before testifying, because whatever questions the appraiser knows from memory may be "fair game" on the witness stand.

Guarding Against Bias

Normally when an appraiser is hired as an expert witness for an appraisal, there is a value dispute and the client would benefit from either a higher or lower value, depending on the situation. Of course, the appraiser is supposed to be impartial and unbiased as an expert witness for the court, but the fact that the appraiser knows what will benefit the client may affect the appraiser's judgment. Human nature is such that it is easy for the appraiser to find that he or she has inadvertently slipped into the role of an advocate for the client without consciously realizing it. One reason is that the lawyer for the client is definitely an advocate, and when the appraiser works with the lawyer, the lines can get blurred.

One way to guard against this is to consider if the methodology and opinion of value might be different if the appraisal was for another use. For instance, the appraiser may be hired for a tax appeal, with a shopping mall as the client. If the appraisal was for a bank loan for the mall, would the value (or range of value) be different than for a tax appeal? If the answer is yes, then bias has crept in, and the appraiser needs to reconsider the value conclusion.

The Expert as a Consultant

The appraiser may be hired to just do an appraisal and critique the opposing side's appraisal, or the appraiser may also act as a consultant to the attorney and help with things like discovery questions, direct examination questions, and technical issues. In my own practice, I am often asked to read the appraisals on both sides of the case, and write a review of them. Since my cases involve complex industrial valuations, and business valuations, even experienced property tax and real estate lawyers need help in understanding the appraisals and finding the faults and errors in them.

However, before I begin expert consulting work, or perform an appraisal for a trial, I tell my prospective client that I must do enough research to determine if I agree with their opinion of value. I do not want to charge the client more than is necessary, because if I cannot confirm their value, I will be of no use to them. Since USPAP requires that I fulfill certain steps and keep certain records even in a preliminary valuation, I set my fee at a minimum for that determination. In some situations, I do not have to do preliminary work, because I can tell from the outset that I agree or disagree with the valuation, based on my experience in the particular industry under appeal.

There have been times when I have agreed to be an expert witness for a client, but have had to decline once I read the appraisals (which were not completed at the time I was engaged) and toured the subject property. In such cases, the initial information was either misleading (not necessarily intentional) or insufficient to determine the value at the outset. Such situations are unpleasant, but the alternative would be to become an advocate rather than an unbiased expert witness. In any event, it is important for the appraiser to never guarantee his or her disposition on a case before all the facts are in, the appraisals are completed, and the necessary research has been conducted. Otherwise, the reputation of the appraiser can be tarnished, as well as the reputation of the appraisal profession.

In other situations, I have been called to do an expert review because the client does not know if the valuation is fair or not. For instance, in a property tax assessment dispute, the assessor may have an appeal pending, and wants a second opinion (besides the opinion of assessor's own appraiser) to get advice on whether to settle or go to a hearing on the matter. I will read both sides and give the assessor my opinion. Another situation similar to this one might be a buyout of a company for which two or more appraisals have been performed, and I am asked to review them and give my opinion of them. The parties involved may use that analysis as another input in negotiating the value of the subject property.

In assisting the attorney at law prepare for the trial, I often help with the discovery questions, (also called interrogatories), to get relevant information that may shed light on the disputed valuation issue. The requested information often includes financial records from the company, product pricing and production history and forecasts, past appraisals and impairment studies, their appraiser's notes and back-up information, etc. As the trial progresses and both sides testify, I may help the lawyer understand the technical issues that have been covered and the flaws in the logic or methodology of the each appraiser's testimony. I can maintain my independence and still help with these analyses, if I do not begin to take sides and become an advocate for the client.

In most cases I have reviewed and submitted written reports to the court for both sides of the issue, but I also make notes on the testimony of the appraisers for the duration of the trial. For this reason, I often am the last witness to testify. By going last, I can sum up the previous testimony of all the appraisers and integrate that into the testimony I give about my reviews. Often mistakes and misunderstandings have occurred, and I will endeavor to explain and clarify them.

In the next article, we will look at ideas for preparing for a hearing.

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What is the Appraisal Practices Board of The Appraisal Foundation and why would I want to become a SME (Subject Matter Expert) for it?

By Micheal Evans, FASA, FRICS

Well, if helping to educate your fellow appraiser is not enough, there is also the fact that you will be credited in the final accepted voluntary guidance adopted by the APB, which will become a matter of public record. Additionally, your work could serve as the basis and source material for a new educational course sponsored by The Alliance for Valuation Education (AVE), a new non-profit organization dedicated to providing greater availability of consistent, quality valuation education, created through the collaborative efforts of 13 valuation organizations. The amount and level of recognition provided by serving as a Subject Matter Expert is hard to measure.

So what is the APB?

The Appraisal Practices Board (APB) is the newest of The Appraisal Foundation's three boards. The APB offers voluntary guidance to appraisers, regulators, and users of appraisal services on recognized valuation methods and techniques, emerging issues, and other topics that may arise for all valuation disciplines. The APB seeks to identify and provide examples of commonly accepted methods and techniques with evaluative commentary where appropriate. The APB accomplishes this by utilizing panels of volunteer Subject Matter Experts (SMEs), which are comprised of individuals with expertise in the specific topic being considered. The SME panels research and cite all pertinent sources of existing information on the given topic, which may include multiple recognized methods or techniques (and may also include some which are not recognized). The SME panel will work in conjunction with an assigned liaison(s) from the APB to draft the guidance. After review by the APB, the board will subsequently vet the issue through a public exposure process. The APB may, at their discretion, ask other Appraisal Foundation Boards or panels (i.e. the ASB, AQB, TAFAC, etc.) to also provide comments. Based upon the feedback from the exposure process, the APB may return the document to the panel for more work or ultimately adopt guidance that addresses the specific topic.

Scope of Work for an SME panel: An SME panel chosen to address a topic will accomplish its goal by, at a minimum, gathering, citing, and researching all existing literature and publications pertaining to recognized valuation methods and techniques as they apply to the topic, particularly:

- Identify primary and secondary sources of sales data and conditions of use and reliability.
- Identify what General Data is needed by appraisers to produce credible assignment results.
- Identify what Specific Data is needed by appraisers to produce credible assignment results.

- Identify the amount and type of data collected for an appraisal based on the valuation approaches used to develop a credible opinion of value given on the defined scope of work.
- Identify methods of reconciliation within the approaches to value used and examples of application. This may include collection and verification of data other than sales information (e.g. income information, cost data, leasehold, leased fee).
- Identify the proper verification process of transactional and property data utilized by appraisers.

The SME panel may also address other aspects related to the scope of work stated above, but only if they are relevant and critical to the process. Additions to the scope of work will have to be approved by the APB.

Some of their published work is noted below:
APB Valuation Advisory #1: Identification of Contributory Assets and Calculation of Economic Rents (Tool Kit)
APB Valuation Advisory #2: Adjusting Comparable Sales for Seller Concessions
APB Valuation Advisory #3: Residential Appraising in a Declining Market
APB Valuation Advisory #4: Identifying Comparable Properties - Revised
APB Valuation Advisory #5: Identifying Comparable Properties in Automated Valuation Models for Mass Appraisal

They are currently working on: Collection and Verification of Sales Data.

SME panelists are not monetarily compensated for their time; rather, they serve on a voluntary basis. They are not considered to be employees of The Appraisal Foundation, but dedicated professionals who work on a pro bono basis. Attribution of their work is provided in the final accepted voluntary guidance adopted by the APB that becomes a matter of public record, which is pretty impressive in my book. Any APB-approved expenses will be reimbursed in accordance with TAF travel policy requirements. Any person, including appraisers, lenders, underwriters, attorneys, government employees, or other interested parties, may apply for consideration to an SME panel by completing an application. You should provide a resume or curriculum vitae, a brief history of experience with the specific subject, and a statement of interest in serving on a particular SME panel. For each topic, the APB sends out a solicitation for SMEs via an e-mail list, posts on the website of The Appraisal Foundation, as well as the Foundation's Facebook and Twitter accounts.

How do I apply?
Contact Staci Steward, Practices Administrator at The Appraisal Foundation (staci@appraisalfoundation.org), to be added to the e-mail list for future SME solicitations.