

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

II. CLASSES AT THE UNIVERSITY OF WISCONSIN--MADISON

O. Business 935: Seminar--Urban Land Economics (MBA
and MS)

2. Sample Lecture Notes

- I. As you will recall Ratcliff sees 2 broad areas for computing market value V_p - essentially inference from past market transactions or

Simulation of investor decision systems. Recently he argued in the October 1972 issue of the Appraisal Journal that the "new school" evolutionary modifications of long held appraisal theory rather than radical change.

- A. Within the "new school" one group focuses on the mechanisms of appraisal analysis - such as discounted cash flow and computer applications of various sorts.
 - B. The other faction within the "new school" is concerned with appraisal as behavioral science - to develop inputs without which the formulas and machines lose reality.
 - C. Both of these elements are present in Ratcliff. You will note some of your readings are designed to suggest the application of marketing techniques in other fields to the whole problem of inference and simulation.
 - D. Ratcliff now emphasizes 3 types of value:
 1. V_s - subjective value to the owner or investor
 2. V_c - cost of production
 3. V_p - market value
 - E. V_s is the value of feasibility analysis and has no direct relationship to appraisal as it represents the investment judgment from the viewpoint of a specific individual, the owner, an investor, the expert. (Chapter 8)
 - F. V_c represents the cost estimates such as Beck plus land value but should include the opportunity cost of delay and indirect costs of construction. (Chapter 9)
- II. Appraisal is concerned with prediction of a transaction price. Market value is not intrinsic in the property but rather are determined by the public's reaction to the qualities of the property. These reactions are extrinsic and represent the demand side. The competitive supply of these qualities play a role in setting price. The trick for the appraiser is identification of the qualities to which consumers are responding and maintaining accurate information as to the supply.
 - A. Since appraisal is predicting under conditions of uncertainty, price cannot be measured like temperature on the thermometer or board feet in a stick of lumber. Ratcliff fears that over concern with measurement leads to preoccupation with the static attributes of the property rather than the dynamic forces which establish price.
 - B. Market value is a compromise between what the buyer would have paid if necessary and what the seller would have accepted as a minimum.

- C. Market value has nothing to do with "fairness" of the predicted transaction but only with the actuality. Even in condemnation it is the course and not the appraiser who determine just compensation.
- D. Since it is behavior relative to attributes of a subject property, people make values and determine prices. Thus appraisal is a behavioral science.
- E. Ratcliff makes the point that the best practicing appraisers rely mainly on market behavior, employ qualifying terms such as estimate, central tendency or even range of value.
- F. While pragmatism has been the guiding spirit of practitioners a real gap exists between conventional appraisal textbooks and the tenets of the "new School"
- G. Reference to Chapter 10 in Ratcliff strengthens his view that cash flow models per se do not produce market value directly unless research is provided on probable investor motivations, decision rules, and attitudes toward risk. Thus, there must be careful market segmentation to identify most probable buyer and to isolate his investment decisions, as much as possible, from subjective trade-offs as to locational preference, deviations from the norm, or special managerial intuitions and satisfactions.
 - 1. Babcock revisited and Hodges Cart of returns is an attempt to make IMV a statement about market value while Mini-Mod or AIP represents Vs.
 - 2. The Wendt article emphasizes the failure of appraisal to relate investor behavior to the larger forces of national and regional economics as they affect behavior.
 - 3. In chapter 9 Ratcliff makes reference to (216-222) models as a way of communicating behavior of market segments.
 - 4. In Chapter 10 Ratcliff provides a simple linear regression as a means of converting a weighted matrix to a conclusion. Note that the regression is negative as the worst rated features receive the highest scores. Real estate is just beginning to borrow techniques for multi-variable analysis which are "old hat" in other disciplines for application to real estate. Appraisers are great gatherers of information but have never successfully communicated how they synthesize and correlate.
 - 5. To synthesize and correlate requires that you first edit the information to retain that which is reliable and relevant. The second problem is to structure the information into a common denominator so that interrelationships can be revealed. The market approach relates sales prices to attributes of the property. The income approach converts space-time units to cash-time units.

III Ratcliff would reorganize the appraisal report so that it is inductive rather than deductive, moving from the property interest to the ~~likely~~ probable buyer to the institutional setting in which the buyer and the seller must operate. The outline of an appraisal report ala Ratcliff will suggest the process.