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"Impacts of Regulation on the Appraisal Industry", sponsored by AIREA Research Series, May 16-17, 1987

AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS

Research Forum Participants  
May 16-17, 1987

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Gail L. Beron, MAI  
The Beron Company  
Southfield, MI

David W. Craig, MAI  
David Craig and Company  
Topeka, KS

John D. Dorchester, Jr., MAI  
Real Estate Research Corporation  
Chicago, IL

Robert F. Ferguson  
New Jersey Association of Realtors  
Edison, NJ

Robert L. Foreman, MAI  
Real Estate Analysts of Newport, Inc.  
Newport Beach, CA

\* James A. Graaskamp, Ph.D. \*

University of Wisconsin  
Madison, WI

James T. Harrington  
Rooks, Pitts and Poust  
Chicago, IL

Austin J. Jaffe, Ph.D.  
Pennsylvania State University  
University Park, PA

Robert J. Kabel  
Manatt, Phelps, Rothenberg, Tunney & Evans  
Washington, DC

William Mundy, MAI, Ph.D.  
Mundy, Jarvis & Associates  
Seattle, WA

William L. Pittenger, MAI  
Federal Home Loan Bank of Atlanta  
Atlanta, GA

J. Carl Schultz, MAI  
Schultz, Martin, Carr & Associates  
Atlanta, GA

AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS

Research Forum Agenda  
"Impacts of Regulation on the Appraisal Industry"  
Chicago Marriott Hotel  
May 16-17, 1987

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May 16

9:00 am

Welcome and Opening Remarks (Foreman)  
Introduction of Participants

Session I:

9:00-

10:15 am

Overview and Perspective

Regulatory Issues Before the Current Congress  
(Craig)

Industry Regulation in International Perspective  
(Dorchester)

Environmental Law and Appraisal (Harrington)

Coffee break

Session II:

10:30-

12:00 pm

Regulatory Initiatives for Industry

Can the Appraisal Industry Survive without  
Increased Regulation? (Graaskamp)

Federal Home Loan Bank Board Initiatives  
Affecting Appraisal (Pittenger)

Scope and Content of Self-Regulatory Initiatives  
(Foreman)

Lunch

Session III:

1:30-

3:00 pm

Uniform Professional Standards

Development of a Self-Regulatory Structure  
for the Appraisal Industry (Kabel)

Implications of Uniform National Appraisal  
Standards (Schultz)

Coffee break

Session IV:      Additional Industry Responses  
3:15-            Environmental and Energy Issues Affecting Real  
4:45 pm           Estate Professionals (Ferguson)

                  Measuring Market Perceptions: Impacts of Ongoing  
                  and Single Incidents (Beron)

                  Impacts of Regulations on Market Research,  
                  Analysis and Reporting (Mundy)

                  Concluding Remarks (Dorchester, Schultz)

May 17  
9:00-            Summary of Forum Issues (Jaffe)  
11:00 am           Discussion

## **IMPACTS OF REGULATION ON THE APPRAISAL INDUSTRY**

AIREA Research Series

# **Impacts of Regulation on the Appraisal Industry**

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Research Report No. 2

Proceedings of the May 16-17, 1987 Research Forum  
sponsored by the American Institute of Real Estate  
Appraisers, Chicago, Illinois

W. Lee Minnerly, Editor



American Institute of Real Estate Appraisers  
430 North Michigan Avenue  
Chicago, Illinois 60611-4088

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## FOREWORD

A free and open exchange of ideas often can clarify complex issues and provide useful means for addressing difficult problems. This philosophy serves as well in professional life as it does in other aspects of our society.

This publication in the AIREA Research Series presents the results of such an exchange among the appraisal industry's diverse family of professionals. In May of 1987, 12 persons representing the appraisal industry, government, and the legal and academic communities met in Chicago to discuss "Impacts of Regulation on the Appraisal Industry" at the Appraisal Institute's first Research Forum.

The Research Forum program provides a vehicle for sharing opinions and expertise on issues broadly affecting the real estate appraisal industry. Through publication of proceedings from each event, timely information and significant ideas can be passed to Institute members and their colleagues. This report on issues discussed at the first forum concerns a host of regulatory and environmental subjects, many of which affect daily appraisal activities.

The Appraisal Institute thanks each of the participants for their enthusiastic contributions of time, effort, and ideas toward this most successful dialogue. Robert Foreman, MAI, and member of the Institute's Research/Body of Knowledge Task Force, deserves a special note of thanks for developing the topic and selecting the participants. Peter F. Korpacz, MAI; A. Scruggs Love, Jr., MAI; and Bill Mundy, MAI, assisted in planning the forum. William N. Kinnard, Jr., MAI, and James E. Gibbons, MAI, reviewed the final manuscript.

I am pleased to present these proceedings as a useful record of vital issues before the appraisal profession. They represent a rare and important addition to that part of appraisal literature devoted to topics of industry change and growth.

Richard C. Wolcott, MAI  
1987 President  
American Institute of Real Estate Appraisers

## PREFACE

This report presents to readers an historical "photograph" of the real estate appraisal profession recorded in Chicago on May 16 and 17, 1987. The occasion was the inaugural event of the Appraisal Institute's Research Forum series, which brought together 12 distinguished representatives from the appraisal industry, government, and the legal and academic communities to exchange views and discuss key issues currently before the profession. The topic of the May 1987 forum was "Impacts of Regulation on the Appraisal Industry."

As final preparations for the event were underway, three separate developments took place that underscored its timeliness. First, in April the Governing Council of the Appraisal Institute authorized substantial new funding for the creation of a Real Estate Appraisal Foundation, the basis of a self-regulatory system of industry governance. Also in April, legislation was introduced in the U.S. Senate that would expand the role of the Environmental Protection Agency in monitoring and treating asbestos contamination in federal government and non-school buildings, including privately owned structures. And finally, on May 15, just one day before the forum began, the Federal Home Loan Bank Board published its proposed rule on "Appraisal Policies and Practices of Insured Institutions and Service Corporations" in the Federal Register.

These events, but more particularly the ideas behind them, indicate important directions of change affecting the appraisal profession. Issues surrounding such complex subjects as self-regulation of the appraisal industry, environmental responsibility and liability, and new regulatory efforts of the Federal Home Loan Bank Board continually evolve, presenting broad conceptual and pragmatic challenges to concerned professionals everywhere. Organizers of the May 1987 forum assembled a diverse group of individuals especially familiar with these challenges, to draw them together for substantive, lively, and creative discussion. The result reflects well the purpose of the Research Forum series: to provide Institute members and other industry partners informed ideas about key issues affecting their livelihood.

The forum was organized into topical sessions, each of which had its own theme. Session I provided an overview and perspective of regulatory issues before the Congress, international concerns and efforts, and environmental law and its relationship to real estate appraisal. Session II addressed regulatory initiatives recently developed by the Federal Home Loan Bank Board and the Appraisal Institute. The development and implications of uniform national appraisal standards was the focus of Session III.

Session IV concerned environmental impact and market research issues also affecting the real estate professional. Finally, Session V served as a period for summarizing forum ideas.

Each session began with two or three assigned informal presentations by specified individuals. Thereafter, the forum opened for group discussion. During this period participants offered opinions and suggestions, questions and factual information about issues raised.

In the proceedings that follow, this agenda and format are preserved intact. Each session appears in its actual sequence, with assigned presentations preceding the group discussions. The text is prepared from a verbatim transcript of the event, edited for continuity. All speakers are identified by name. Explanatory notes provide additional context, while preserving the conversational tone of the event. As readers will be quick to discover, the Institute's Research Forum proves to be a highly successful medium for generating ideas and demonstrating how important issues affecting the real estate appraisal interrelate. The resulting image of the profession is one that we hope readers will appreciate from many points of view.

W. Lee Minnerly  
Research Department

## FORUM PARTICIPANTS

### Gail L. Beron

Ms. Beron is principal and owner of The Beron Company in West Bloomfield, Michigan, and a consulting partner and principal of the Real Estate Counseling Group of Connecticut. She holds the MAI designation from the American Institute of Real Estate Appraisers and the SREA designation from the Society of Real Estate Appraisers. Ms. Beron serves on the teaching faculty of both the Appraisal Institute and the Society of Real Estate Appraisers. She is a member of the National Real Estate Valuation Council and of the Commercial Arbitration Panel of the American Arbitration Association.

### David W. Craig

Mr. Craig is principal and owner of David Craig & Company in Topeka, Kansas. He earned the MAI designation from the American Institute of Real Estate Appraisers in 1968, and has served the organization on both local and national levels in many capacities. He is a former chairman of the National Education and National Professional Standards Committees. In 1985 he served as president of the Appraisal Institute. Mr. Craig has been a member of the Appraisal Institute faculty since 1973 and currently chairs the Institute's Government Affairs Division.

John D. Dorchester, Jr.

Mr. Dorchester is executive vice president and director of appraisal services for Real Estate Research Corporation, Chicago. He is co-founder of The Dorchester Companies, Inc. of Tulsa, Oklahoma, and from 1968 through 1985 served as president of its subsidiary, Valuations Systems. Mr. Dorchester earned the MAI designation from the American Institute of Real Estate Appraisers in 1968. He has served the Appraisal Institute in many capacities, including president in 1982. He also holds the CRE designation from the American Society of Real Estate Counselors.

Mr. Robert F. Ferguson

Since 1962 Mr. Ferguson has served as executive vice president of the New Jersey Association of REALTORS®, an organization with over 40,000 members. In this capacity he is the principal industry liaison for legislative and governmental affairs. He holds the CAE designation from the American Society of Association Executives. He is a past director of the NATIONAL ASSOCIATION OF REALTORS® and past president of the New Jersey Society of Association Executives.

Robert L. Foreman

Mr. Foreman is executive vice president of Real Estate Research Corporation in Costa Mesa, California. He is former principal and owner of Real Estate Analysts of Newport, Inc., a real estate appraisal and counseling company. Mr. Foreman earned the MAI designation from the American Institute of Real Estate Appraisers in 1972. He is a former chairman of the Institute's National Admissions Committee, and recently served as chairman of the Research Advisory Task Force. He is author of Communicating the Appraisal: A Guide to Report Writing, and several Appraisal Institute seminars. Currently Mr. Foreman is chairman of the National Education Committee.

\* James A. Graaskamp \*

Dr. Graaskamp is chairman of the Department of Real Estate and Urban Land Economics at the University of Wisconsin. He is also president of Landmark Research, Inc., a real estate consulting company. Dr. Graaskamp holds several professional designations, including the SREA from the Society of Real Estate Appraisers, the CRE from the American Society of Real Estate Counselors, and the CPCU from the College of Property Underwriters. He is the author of The Appraisal of 25 N. Pinckney: A Demonstration Case for Contemporary Appraisal Methods, and numerous other real estate publications.



James T. Harrington

Mr. Harrington is a partner in the firm of Ross and Hardies, Chicago. Since obtaining his law degree from the University of Notre Dame in 1967, he has devoted most of his career to environmental law and litigation. Mr. Harrington has extensive experience in federal, state, and local regulatory development and judicial review, with emphasis on air pollution and state implementation plans, federal guidelines and standards, and hazardous waste and hazardous substance remediation. His practice also concerns environmental law impacts on corporate and real estate transactions.

Austin J. Jaffe

Dr. Jaffe is associate professor of business administration and research director at the Institute for Real Estate Studies, The Pennsylvania State University. He has developed and taught educational material for professional organizations, including the American Institute of Real Estate Appraisers and the Society of Real Estate Appraisers. Dr. Jaffe maintains active research interests in the relationships between legal institutions and the economics of real property valuation. He is the author or coauthor of numerous articles and books. Dr. Jaffe earned the Ph.D. from the University of Illinois in 1972.

Robert J. Kabel

Mr. Kabel is a partner in the firm of Manatt, Phelps, Rothenberg, Tunney and Evans, Washington, D.C., legislative counsel to the Appraisal Institute. He represents a wide variety of clients before the Congress, Executive Departments, and independent agencies in all aspects of the legislative process. Prior to joining Manatt, Phelps, Rothenberg, Tunney and Evans in 1985, Mr. Kabel was Special Assistant to President Reagan for Legislative Affairs. In this capacity he represented the President before the Senate Committees on Banking, Housing and Urban Affairs, Finance, Judiciary, and Labor and Human Resources.

Bill Mundy

Mr. Mundy is president of Mundy and Associates, a Seattle-based firm specializing in real estate market, economic, and valuation research, and is principal and owner of Bill Mundy and Associates, a real estate development company. Mr. Mundy has taught at the University of Washington and is a faculty member of the American Institute of Real Estate Appraisers. He holds the MAI and CRE designations from the American Institute of Real Estate Appraisers and American Society of Real Estate Counselors, respectively. He earned his Ph.D. from the University of Washington in 1977.

William L. Pittenger

Mr. Pittenger is a District Appraiser with the Federal Home Loan Bank of Atlanta in Maitland, Florida. He was formerly in private practice, where he acquired extensive experience in real estate valuation and evaluation. Mr. Pittenger holds the MAI designation from the American Institute of Real Estate Appraisers and the SREA designation from the Society of Real Estate Appraisers. He is an active teacher and lecturer, and has published numerous articles in appraisal, finance, and construction journals.

J. Carl Schultz, Jr.

Mr. Schultz is principal with Schultz, Martin, Carr and Associates, an Atlanta-based real estate appraisal and counseling company. He holds the MAI, CRE, and SREA designations from the American Institute of Real Estate Appraisers, American Society of Real Estate Counselors, and Society of Real Estate Appraisers, respectively. Mr. Schultz has long been active in service to the Appraisal Institute. He is a former chairman of the Institute's National Education and National Professional Standards Committees. Currently, he is first vice president of the Appraisal Institute.

## Part I -- OVERVIEW AND PERSPECTIVE

Foreman: In November 1985, the Governing Council of the American Institute of Real Estate Appraisers adopted a report recommending the formation of a Research Advisory Task Force and a Research Department for the organization.<sup>1</sup> One of the department's functions is to develop meetings between academicians, practitioners in the field, and specialists in related fields to discuss issues that affect appraisal. Our intent is to explore new areas, and in so doing provide material that the Institute can publish and distribute to its members.

Today, we hear from appraisers that one of the most important things affecting them is the issue of regulation: the impact of government on the appraisal process; abuses in the appraisal field; decisions about who values the valuer and who regulates the appraiser; and ways that the articulation of those regulations can best be summarized. A second concern is the impact of major environmental issues on the valuation process. This Research Forum will bring both concerns into focus.

The first three sessions have as their topics regulatory issues before the current Congress, regulation in international perspective, and environmental law. We will go directly to the

<sup>1</sup>In November 1987 the Institute's Governing Council established a Research and Information Services Advisory Committee to replace the Research Advisory Task Force.

three presentations and then open the discussion to general comment. Carl Schultz will be the facilitator.

Schultz: The first topic is "Regulatory Issues Before the Current Congress," presented by David Craig.

Craig: I'm not sure that I can tell you as much as Bob Kabel can about what's going on, but I'll try to give you some background. As you know, Congressman Doug Barnard (D-GA) held hearings about a year and a half ago on abuses in the appraisal industry that had reportedly caused losses in financial institutions insured by FSLIC, FDIC, and others. The hearings lasted two days, but it took about six months to assemble a report.<sup>2</sup>

The report suggested a self-regulatory organization, similar to that of the certified public accountants, which we had mentioned in our testimony as something the appraisal industry ought to look into. We've had continuing contacts with Congressman Barnard since then, getting occasional mixed signals on exactly what he has in mind, but he tells us that he will introduce legislation on the national level having to do with the

<sup>2</sup>In December 1985 the Commerce, Consumer and Monetary Affairs Subcommittee, Congressman Doug Barnard, Jr. (D-GA), chairman, held hearings on the impact of faulty and fraudulent real estate appraisals on real estate financing and investment. Results of the hearings were reported in "Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in the Secondary Market," House Committee on Government Operations, 99th Cong., 2nd sess., H. Rept. 99-891, 1986. David W. Craig, then president of AIREA, testified before the subcommittee.

regulation of appraisers.<sup>3</sup> To some extent he has blessed the work of the Select Committee on Implementation comprised of the eight appraisal organizations that have been attempting to put together a self-regulating organization.<sup>4</sup> The Congressman has encouraged us to go forward with these efforts and get it set up. If we do, then he would probably lean toward enabling legislation that would cause the states to adopt a certification program. There would be some federal oversight committee that would look at the degree to which agencies were using the system, and whether the states had adopted and were enforcing a certification program to protect the federal funds and agencies involved with appraisers.

Where we stand at the moment is that a task force of nine appraisal organizations has developed uniform standards for the

<sup>3</sup>On November 20, 1987 this legislation was introduced. The bill, cited as the "Real Estate Appraisal Reform Act of 1987," would establish a Federal Interagency Appraisal Council authorized to create and regulate appraisal standards and appraiser qualification requirements. The proposed Council would be authorized to approve state appraiser certifying agencies to certify appraisers in federally covered transactions. Concurrently, the Appraisal Institute has proposed model certification legislation and self-regulatory structures for the appraisal profession.

<sup>4</sup>The Select Committee on Implementation is comprised of representatives from the American Institute of Real Estate Appraisers, Society of Real Estate Appraisers, National Association of Independent Fee Appraisers, National Society of Real Estate Appraisers, American Society of Farm Managers and Rural Appraisers, International Right of Way Association, International Association of Assessing Officers, and the American Society of Appraisers.

appraisal industry. Their work has basically been completed.<sup>5</sup> At their last meeting they turned over the uniform standards to the Select Committee, which in turn is to hand them to the self-regulating organization or the Appraisal Foundation when it is in place. The Foundation would have a freestanding Appraisal Standards Board. This Board would establish standards for appraisers as far as education, experience, and qualifications were concerned and would disseminate such information to the states.

There is some difference of opinion within the committee on how this should operate. Hopefully, we'll get that worked out at the next meeting, which is in about three weeks.<sup>6</sup>

Among the eight organizations, the Society of Real Estate Appraisers and the American Institute of Real Estate Appraisers are very close in their articles of incorporation and bylaws. There are two major differences remaining between our two organizations. As I interpret it, the Appraisal Institute is suggesting that the foundation be called the "Real Estate Appraisal Foundation." The Society is suggesting that it be called the "Appraisal Foundation," leaving out the words "real

<sup>5</sup>The Uniform Standards of Professional Appraisal Practice have been adopted by all eight members of the Select Committee on Implementation as of November 1987.

<sup>6</sup>These concerns are addressed in the Articles of Incorporation and Bylaws of the Appraisal Foundation, both developed since the May 1987 Forum. The Articles of Incorporation were filed in the State of Illinois on November 30, 1987.

estate" in deference to the American Society of Appraisers (ASA). ASA would like the foundation to address appraisal questions having to do with all the things its members appraise, which go way beyond real estate.

The other major difference between the Appraisal Institute and the Society regarding the formation of a Foundation is the composition of its membership. The Appraisal Institute suggests that the Foundation consist of the appraisal organizations and outside organizations such as federal regulators, academicians, and other users of appraisal services. The membership question will be resolved one way or the other. I don't think that is a sticking point. The Foundation would be run by trustees who would represent organizations beyond those concerned with real estate appraisal.

The question on which the eight organizations reached an impasse at the last meeting was whether the certification would be done at the national level or by the states. Some of the organizations feel that we should form a national organization that would certify and discipline appraisers. Others of us don't think that will work. We think we should go in the direction that most other professions have gone, and that is to have the states certify. Certification would be voluntary, so it would not keep people from practicing appraising just as the CPA program does not keep uncertified accountants from practicing. However, certification would probably be "picked up" by federal



agencies and others who would require that the appraisers doing their work be certified.

I believe that if that all happens, the only remaining question is whether the oversight federal group would have veto power over activities of the Foundation.

Recently the NATIONAL ASSOCIATION OF REALTORS® approved a resolution that allows them to support this program. Basically, they agree that they would back the plan. That is a big step forward.

I think that covers where we are currently with these issues.

Schultz: The next presenter will be John Dorchester, speaking on "Industry Regulation in International Perspective."

Dorchester: I think it's appropriate to put the discussion of standards in the United States into something of an historical and worldwide context. We tend to focus on the immediate problems and the immediate quest for solutions to those problems, but there is a continuum here that is an important background to our actions. It might help us understand not only where we are, but something about where we are headed. I'll only go back to the mid-1960s for a starting place.

At the height of the federal interstate land sales problems Congress passed the Federal Interstate Land Sales Act.<sup>7</sup> It may seem strange that this act could be a genesis of much of what we're talking about now, but a number of things came out of the abuses of the telephone and mass-mail marketing of tracts of ground to every small investor in the United States. What happened during that time was a move at a federal level to begin regulating certain aspects of the real estate industry and, particularly, a move towards the regulation of accounting.

It was discovered at the height of those problems that there were rampant abuses in accounting for development activities. As books of account were shown to investors, numbers in one set of books did not necessarily match those in another. What all this eventually led to was a move by the Department of Justice against a number of professional groups, including the American Bar Association, the American Institute of Architects, and ultimately the American Institute of Certified Public Accountants (AICPA).

AICPA went through something of an ordeal in taking a look at its internal standards and enforcement. Then in 1973 AICPA reached an accord with the Financial Accounting Standards Board (FASB), which recognized FASB standards--a very nice accord in light of difficult circumstances.

<sup>7</sup>Refers to the Interstate Land Sales Full Disclosure Act, enacted August 1968. The purpose of this legislation and its subsequent amendments is to ensure that buyers, prior to purchasing certain kinds of real estate, are informed of facts that will enable them to make informed purchasing decisions.

But the problems of accountancy and financial reporting were not occurring in the United States only. They were a worldwide problem. In the same year that the Financial Accounting Standards Board was formed in the United States, the Royal Institution of Chartered Surveyors formed a committee in the United Kingdom that was called The Asset Valuations Standards Committee (TAVSC). In its earliest days TAVSC was a committee of three individuals. Those three individuals wrote the bulk of the standards for the Chartered Surveyors that were published through the Royal Institution in the form of what they called Guidance Notes and Background Papers. Guidance Notes meant, "here are the rules;" Background Papers meant, "let's talk about them and put them into a practical context."

The Chartered Surveyors didn't stop there. They took the TAVSC regulations beyond the Royal Institution into the British Companies Act and to the London Stock Exchange, and had those regulations adopted as regulations of the market. They took the regulations of a private professional organization into the public arena and said these should be the "rules of the road" for business in the United Kingdom.

Because they were successful at the start, the Chartered Surveyors said, "That worked so well, why don't we move it over to the Continent?" About two years later, the same standards, almost verbatim, were adopted by the European Economic Community.

They became the standards for all exchanges and the basic underpinnings for valuation practice throughout Europe.

By the latter part of the 1970s the Chartered Surveyors said, "Why don't we really go public and take this around the world?" The American Institute of Real Estate Appraisers began meeting with representatives of this group in 1979; in 1980 there was a formation committee and in 1981 we established what is now called The International Assets Valuation Standards Committee (TIAVSC). It has grown with a rather specific purpose, but behind that purpose are wonderful opportunities for the United States and for the rest of the world.

Going back to the historical context, the American Institute of Real Estate Appraisers and the other appraisal organizations in the United States today, as well as regulators and the public at large, are looking for standards. We're still looking for vehicles. Interestingly, as far as the Appraisal Institute is concerned, we have been involved with a very specific vehicle for about seven years now. At this point the standards from the international committee have been recognized by the International Accounting Standards Committee, by the United Nations, and by most of the major developed countries of the world--with two exceptions: the United States and Canada. So, again, the quest for standards is an active one. It is one that not only has historical context but also includes broad participation by the rest of the world.

Let me talk just a moment about the specifics of those standards and how they operate. The International Assets Valuation Standards Committee developed parallel to the International Accounting Standards Committee. Both bodies are involved with financial reporting. Both the Accounting Committee and the Valuation Standards Committee have worldwide representation; both support the development of standards at the world level and also encourage those standards to be adopted within the laws of each member country.

TIAVSC standards specifically relate to valuation associated with financial reporting. If you were to compare the standards of The International Assets Valuation Standards Committee with those of the American Institute of Real Estate Appraisers you would find no conflict. There are two major areas of difference, however. One is that the international standards are written in British English, and therefore it is necessary to "translate" select words for American usage. For example, In the United Kingdom they use the words "replacement cost" to mean going to the market and buying an equally satisfactory substitute (what we would call a market approach). Yet here when we talk about "replacement cost," we mean the cost approach. This is why many people in the United States believe that the English and others on the Continent use a cost approach in their valuation when, in fact, they use exactly the same techniques that we do here in the United States. So there are some linguistic boundaries that must be overcome.

The second area of difference is that the international standards focus specifically on an area that we have not addressed to date in the United States: that of current value accounting--how to reflect values on the books of account and in the financial reports of any types of business entities on other than a historical cost convention. The current value reporting basis has now been adopted throughout the world except in the United States and Canada. There is a very strong move within the international body of accounting as well as within the body of valuers for the United States and Canada to adopt these standards.<sup>8</sup>

Rather than going on with what I think is a fascinating story, I would simply offer that the international standards have provided the vehicle, a format, and an international forum for debate on issues that, to this point, would indicate the standards we have established in the United States make a lot of sense. I believe they will help us to understand that, in the quest for standards in the United States, in addition to focusing on the questions of regulation and the issues with Congress, we must turn our attention to co-equal dialogue with FASB, the Securities and Exchange Commission, AICPA, and other business financial partners.

<sup>8</sup>This is elaborated in the March 1987 "Report of the Inter-governmental Working Group of Experts on International Standards of Accounting and Reporting," prepared by The Economic and Social Council of the United Nations. In 1988 the Working Group will accelerate efforts to harmonize international standards. Concurrently, TIAVSC will promote implementation of its standards among its approximately 30 member countries.

This will ensure that the standards that are developed are those that we believe we can live with and that are in agreement with what is actually going on in the world. We have an enormous opportunity and we have an enormous obligation.

Schultz: Thank you, John. Next we'll hear from Jim Harrington on "Environmental Law and Appraisal."

Harrington: I do not purport to be an expert on the appraisal side of this issue. I'll start with the supposition that anything that significantly impacts the value of real estate is of great concern to the appraiser. With that, I will talk about the impacts of environmental law on real estate appraisal in Illinois and across the country.

I have found that many appraisers are acutely aware of the environmental problems but many others, even those doing major projects across the country, don't seem to be very sensitive to them. I'll mention two or three instances we've either dealt with or become aware of recently that have significant impact on value. In the first instance a major office complex was being sold, and the buyer failed to show at the closing because his expert said asbestos had to be removed. The seller's experts said it merely had to be "coated." This was about a \$12 million sale and an appraisal was involved. I don't know what happened to the appraiser's opinion in this case.

In another instance I'm aware of a major property that was sold for development. There was an appraisal. I don't know what the impact was when the new owners discovered that under the National Environmental Policy Act and the Endangered Species Act they couldn't drain areas classified as wetlands. They had to keep the cattails.

A third instance involved the purchase of a property in Chicago for a major new industrial plant. After purchasing the property the owners discovered something called a New Source Ban.<sup>9</sup> Illinois doesn't have approved rules for the construction of major industrial sources in areas that have not attained the Urban Air Quality Standards, so you can't put a new industrial plant in metropolitan Chicago or East St. Louis or in numerous other areas across the country. I assume that the vacant parcel would have more value if it were used for an industrial plant rather than a warehouse for paper products.

What is the nature of some of the laws that you are dealing with? The National Environmental Policy Act<sup>10</sup> says that anything involving a major federal permit requires an environmental review.

<sup>9</sup>Under 42 U.S.C. Sec. 7410(a)(2)(I), no new major source of air pollution may be built in an area that does not already achieve established air quality standards or does not have an approved plan to achieve them.

<sup>10</sup>The National Environmental Policy Act of 1969, effective January 1970, defined a national policy for reducing and eliminating damage to the environment (42 U.S.C. Sec. 4321 et seq.).



The Clean Water Act<sup>11</sup> says that anything requiring the filling of wetlands needs a permit from the United States Army Corps of Engineers. A permit from the Corps requires environmental policy review. So anything involving a permit from the federal government probably needs an equal review, and anyone who doesn't like what you're doing can probably challenge you on almost anything.

The acts that you should be most familiar with are in categories dealing with hazardous and toxic substances. One is called the "Super Fund," or Comprehensive Environmental Response and Liability Act as amended by SARA, the Superfund Amendment and Reauthorization Act.<sup>12</sup> This delivers a most significant

<sup>11</sup>Reference is to the Clean Water Act of 1977, which further amended sections of the Federal Water Pollution Control Act signed into law in June 1948. The Clean Water Act of 1977 added provisions affecting permits for the discharge of pollutants and other materials into water supplies. See 33 U.S.C. Sec. 1344; see also the Rivers and Harbors Act, 33 U.S.C. Secs. 403, 407.

<sup>12</sup>References are to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. Sec. 9601 et seq.), as amended by the Superfund Amendment and Reauthorization Act of 1986. The former, also known as CERCLA, was enacted in December 1980. It provides for the clean-up of land contaminated by hazardous waste materials. The latter, also known as SARA, (Pub. L. 99-499, Oct. 1986), provides additional funds over five years to clean-up especially dangerous hazardous waste sites identified by the U.S. Environmental Protection Agency (EPA), and to establish new research programs in hazardous materials. SARA also requires good faith investigations of property prior to a purchase, to determine if contamination is present. SARA significantly amended other provisions relating to clean-ups [see 42 U.S.C. Sec. 9601(35)].

impact on real estate nationwide and has parallels in many state laws.

Essentially the act says that anyone who owns real estate at the time a toxic substance is disposed of on that real estate, or anyone who arranged for its disposal, or anybody who transported it and selected the site on which it is deposited, anyone who now owns the real estate is absolutely, jointly, and severally liable for its cleanup, subject to certain limited defenses.

The real problem is that whoever takes title to the real estate also is potentially responsible for the cleanup. So apparently valuable real estate may, in fact, be a liability. It may be a liability to the bank that forecloses on it (or takes a deed in lieu of foreclosure), or to the corporate merger partner, or to the buyer.

Supposedly, SARA was going to help out with this. I think most lawyers will tell you the amendment complicated real estate valuation. Basically the act defines contractual relationships to include land contracts, deeds, or other instruments transferring title or possession, including leases. Liability for the cleanup is present unless the new owner did not know and had no reason to know that any hazardous substance was disposed of in, on, or at the facility.

Presumably, if an industrial facility is involved, you have reason to know that substances may have been disposed of there. Similarly, if it is a warehouse, you have reason to know. If upon walking the property you see chemical stains or smell chemical odors, you have reason to know. This means that title will pass with an absolute joint and several liability for cleanup.

I think this is probably the most significant impact on real estate value today. I know of no industrial property that we have dealt with that doesn't have potential SARA liability. There are ancillary liabilities, too. If you pass an operating industrial plant that must have a permit under the Resource Conservation Recovery Act, ancillary to that permit is something called a "corrective action" requirement for the disposal of existing hazardous waste.<sup>13</sup>

<sup>13</sup>See 42 U.S.C. Sec. (6924)(u).

Quickly moving on to another area, let's look at ECRA, the Environmental Cleanup Responsibility Act.<sup>14</sup> Let me touch on what it means in Illinois. It simply means that before you can transfer title, before you can close a plant, or before you can abandon a plant, you have to get a certificate from the local Environmental Protection Agency (EPA) or its equivalent that the plant is clean of all hazardous substances, not just waste.

Again, I would suggest to you that all the industrial property in this state would go through an ECRA review. You will likely find that paint plants, print shops, metalworking plants and the loft buildings that people appraise all the time are going to be subject to ECRA review. In New Jersey, title often takes years to clear and until you transfer title or possession, the property has no value. I would assume that could significantly lower the appraised value of property; certainly a bank might think so if it was taking a mortgage on the property relying on your appraisal.

<sup>14</sup>The nation's first "Environmental Cleanup Responsibility Act" was passed in New Jersey in 1983. California, Illinois, Minnesota, Pennsylvania and West Virginia have similar laws, and several other states are considering such legislation. Generally, New Jersey law requires an owner or operator of an industrial property that manufactures or uses hazardous substances or wastes to cleanup their facility prior to closure, sale, or transfer of the operation. The owner or operator must submit to the New Jersey office of the U.S. Environmental Protection Agency (EPA) either 1) a cleanup plan with a surety bond to ensure payment of removal costs, or 2) a declaration that there have been no discharges of hazardous substances or wastes at the facility or that any such discharges have been removed in accordance with EPA regulations. In the spring of 1987 a similar bill passed the Illinois Senate and is now pending in the Illinois House.

There are other things that are happening. Illinois is about to adopt a ground water protection bill which is about 100 pages long.<sup>15</sup> We spent several hours trying to go through it with representatives of industry and various state departments yesterday. The bill does several things, some of which are similar to the Federal Safe Drinking Water Act.

For example, it establishes minimum set-back zones (up to 1,000 feet) for every public water supply well in the state. It establishes a minimum set-back zone of 200 feet around every potable water supply in the state. If a neighboring property has a well, the land adjacent to it might be limited. Under the bill as presently on the Illinois Senate floor, anything that would generate 200 pounds of waste a month, any kind of waste, would be prohibited. They didn't bother to decide whether the distance is measured from the property line or from the actual point of origin in the plant.

The bill also addresses the right of localities, or the Illinois Pollution Control Board, or some combination, to establish recharge zone protection areas to protect the real estate that may recharge ground water. It allows the Board and/or these local municipalities to establish requirements for siting, operating, maintenance, removal, and enclosure of anything that might affect ground water. Areas that may be subject to recharge

<sup>15</sup>The Groundwater Bill, Public Act 85-863, was signed into law on September 24, 1987.

zone protection include the Chicago metropolitan area, the East St. Louis metropolitan area, and most metropolitan areas adjoining the Illinois River. This ground water protection bill may change the value of a lot of property the day it is signed.

So with that, I think it's clear that environmental activity is going to have a big impact on your industry and on the appraisal of property. Your industry must look at what's going through the legislature that may impact real estate transactions and development. Legislation will come down awfully fast.

Schultz: Jim, thank you. While you have the floor, perhaps we can delve into that a little deeper. A number of issues have surfaced that affect and potentially increase the liability of the appraiser, where the appraiser or the public might not even recognize that there's a problem. Asbestos is one of them. I know many appraisers today will qualify their reports saying that they are not experts in asbestos and therefore they have not considered any potential asbestos removal. Does that somehow remove the liability?

Harrington: I don't think there's a clear answer on that available. A case I'm familiar with in California seemed to

suggest that the answer is no.<sup>16</sup> Whether it's the appraiser's liability or the REALTOR'S® liability, some states are going to the reasonable expectation rule. In other words, is there a reasonable expectation that this appraisal will reflect certain types of circumstances which a reasonable person should have known about?

Graaskamp: Are there any engineering firms that can give a "comfort letter," just as you might get on title or something of that sort?

Harrington: There are numerous firms involved in this-- engineering firms, law firms, consulting firms--that do it at different levels. Depending on the level you want they can provide some protection. You can get various consulting firms that will go in and tell you, "Yes, there is asbestos," or "No, there isn't." Once they say there is, you can assume that the most stringent standards are applicable, and begin to determine how much it will cost to get it out.

You can go to the larger, more experienced firms. They've got enough assets to back their letter. When they take it out, they take it out in spades at about five times anyone else's cost because they do it right. You can get those letters,

<sup>16</sup>In Eason v. Strassburger, 199 Cal. Rpt. 383 (Csl. App. 1 Dist., 1984), a real estate broker was held liable for failing to make a reasonable inspection to determine the presence or absence of hazardous materials.

particularly on asbestos, and sometimes on lead dust or other pollutants.

Schultz: Jim, let's consider an appraiser faced with a service station. He has to address in his appraisal the potential of asbestos, radon gas, formaldehyde, termites, and the seepage of gasoline under the surface. How can the appraiser possibly address all of those issues or say that, "I'm not going to appraise it unless you have an environmental study made of every one of these major issues?"

Harrington: I think service stations eventually will be evaluated against other service stations rather than other kinds of commercial properties. You may get comparable values that you can utilize from a certain type of property, wherever it is located, that has a similar type of problem.

Graaskamp: But what it really means is that all previous comparable data are no longer valid.

Harrington: Correct. I'll give you an example. A service station is a good one. There is a stack of about 200 pages of federal regulations on underground storage tanks that are pending for comment. They would appear to apply to any tank that's in the ground on the day they go into effect, even if the tank has been enclosed and filled with sand. I know one environmental consultant whose recommendation is, "No, there is no law that



requires you to take the tank out today, but I'd spend the \$10,000 to get it out because if you don't, when these rules come in, you're going to have to sink wells."

Beron: But doesn't that point out the change that is going on even as we speak? I believe I read that gasoline stations had been excluded from the act in New Jersey.

Ferguson: Yes, they are covered under a separate statute.

Harrington: But when LUST--the Leaking Underground Storage Tank (acronym LUST)--rules come in they will affect those service stations.<sup>17</sup> So if you look at ECRA, you might be exempt, but you may be caught under the underground storage tank rules. Or you might be exempt under them, but if you own the property and there was a dry cleaner there and dry cleaning chemicals are leaking off the property, you are going to be caught under the federal or state Super Fund.

Dorchester: Carl, let me add another dimension. We had a valuation assignment not too long ago where there were multiple explosions of electrical transformers under the sidewalk adjacent

<sup>17</sup>In April 1987 the U.S. Environmental Protection Agency published its proposed rules concerning underground storage tanks (USTs) that contain petroleum; these also address the financial responsibilities of tank owners and operators (see Federal Register, Vol. 52, No. 74, pp. 12661-12864, April 17, 1987). Public comment on the proposal closed July 16; final rules are expected in early 1988. Proposed financial responsibility rules for hazardous chemical tanks are in development.

to an office building. The firemen who came in to fight the resulting fire showed up very shortly thereafter with chlorine acne. There were a number of claim cases of kidney damage and other problems from what turned out to be the creation of dioxins from the intense heat applied to the PCBs in the transformers.<sup>18</sup> Normally PCBs are an inert material. They have been used very commonly in electrical transformers in many office buildings and other types of facilities for quite some time. Real estate products throughout the country have PCB-type transformers. What brought this to my mind was the fire we had last night at the hotel where I was staying. An electrical transformer exploded, completely filling the hotel with smoke. There was little destruction as far as fire damage was concerned, but I did my surveys from the sidewalk, asking about the nature of the transformer before we went into the building. In the office building situation referred to earlier, where we were involved with the evaluation, there were problems with people who had casually walked through the property.

Schultz: What should the appraisal industry do to acquaint appraisers in the public sector on how to handle these issues? What should appraisers be doing?

<sup>18</sup>PCBs (polychlorinated biphenyls) are a group of highly toxic, persistent chemicals formerly used in manufacturing electrical transformers and capacitors. Further sale and use of PCBs was prohibited by law in 1977.

Harrington: I think that first and foremost you are going to have to educate your people through your publications and through seminars, about these laws that are out there.<sup>19</sup> Appraisers who are primarily appraising residential and commercial properties need to be aware of what's going on and know to call for help when they run into a problem. Internally your industry is going to have to look at how you bring others in, much as you would do if you look at a building and you have a question about its engineering soundness. Either you would qualify the opinion or bring in structural engineers to derive information for an opinion that makes sense to a financial institution. You are going to have to do that with environmental professionals, too.

You are also going to have to come up with appropriate and responsible disclaimers. I'm not expert enough on the demands placed on your industry to suggest their wording. However, for purposes of discussion we might consider a statement such as, "We take into account environmental impacts up to this point and no further," and rely on that wording as some basis for protection.<sup>20</sup> If there's something that really impacts value, somehow the process is going to have to take that into account. I think that's where

<sup>19</sup>In 1988 the Institute's Research Department will publish quarterly reports on environmental laws and issues affecting appraisal. Other projects will be announced.

<sup>20</sup>This statement does not reflect the viewpoint of the American Institute of Real Estate Appraisers. Institute members should obtain legal counsel for assistance in developing language for limiting conditions that pertain to environmental issues in appraisal reports.

you'll have to look at developing both standards and procedures, with a heavy emphasis on educating your people to become sensitive to these issues.

Graaskamp: That would suggest having a ring binder with a checklist of annotated implications of all the federal legislation that could bear on various property types. Then each state or chapter could compile modifying state or local laws. At the moment there is no awareness, let alone knowledge of what to do about it once you find it, so a checklist of this type is a good beginning.

Harrington: I think that would be a good idea. We use checklists internally when we do environmental audits for corporate transactions, and some consultants have their own. It might be possible to work with such people and come up with one that at least alerts you to problems.

Graaskamp: Also, you almost need a suggested standard clause in your letter of engagement that either allows you to escape the contract if your client won't provide that kind of input or an allowance for the selection of an appropriate consultant. We generally have a \$5,000 or \$10,000 allowance and we notify our clients if we're going to spend it, but the client doesn't choose the expert; we do.

Schultz: That's a good point. Attorneys have been telling the real estate industry for a long time of the need for an engagement letter or a contract. Many of our members, and many appraisers around the country, do not act on engagement contracts. Major assignments probably have an engagement contract but the typical assignment by a long-standing client frequently does not.

Craig: The engagement letters that I've seen almost always are to protect the client and do not help the appraiser at all. The key point is that the appraiser doesn't know he's got a problem and we've got to educate him.

Schultz: Jim, we didn't mean to pick on you but it's a rather sensitive issue. One of the issues I'd like to bring up is that I understand there is a House and Senate bill regarding what some people call the bail-out of the Federal Savings & Loan Insurance Corporation. I'm curious how that may affect the appraisal industry and our standards as we have them today.

Foreman: I heard oral summaries and finally received a copy of the bill on Friday.<sup>21</sup> The wording of both HR 27 and S 790 are very similar with the exception of the amount, one of them

<sup>21</sup>This proposed legislation culminated in the Competitive Equality Banking Act of 1987, signed into law in October 1987. The law establishes mechanisms by which savings institutions themselves can raise \$10.8 billion to recapitalize the deposit insurance fund. Regulatory provisions also are specified. These require certain activities of the Federal Home Loan Bank Board (addressed in FHLBB's proposed successor regulation to R-41c), and the creation of an oversight committee to review the quarterly reports and budgets of the FSLIC.

being \$7.5 billion and the other being \$5 billion. One of the provisions gives the Federal Home Loan Bank Board 45 days to suggest new guidelines on loan classifications, standards for reappraisal, and improvement of R41C and the appraisal review system.

It also sets up an arbitration mechanism within the Federal Home Loan Bank system whereby someone can test the determination of a supervisory agent. An arbitration panel would be established to review this. Their findings could still be rejected by a supervisory agent, but then the individual would have the option to appeal to the Federal Home Loan Bank Board directly.

Jaffe: Let me rephrase Carl's original question. What I understood Carl to ask is not so much, Should we have more information or more education? but rather the tougher question of What are the valuation effects associated with a whole new list of environmental hazards? Not so much You ought to be aware of these things because this is a new world or Look at all this new legislation that now we need to disclaim against but rather What impact do these materials have on property values? And it seems to me that in some sense it's only going part way to bind a bunch of legislation and have a two-day seminar in which people get geared to this new legal environment. The tougher questions are some of the questions that the appraisal industry are asked, such as What impact does being near this hazardous material have on market value of the bundle? If anything needs to be done, it's

not just monitoring the legal environment with respect to this whole new set of legislation. It's examining the evidence in various places about the impact of a wide range of environmental hazards like radon gas, asbestos, lead paint, and other substances.

Schultz: The issues that are brought up in some of these environmental matters go beyond the typical appraiser--the research that is going to be necessary, for instance, to measure the effect of radon gas. The typical residential appraiser is not going to be able to delve into the damage issue on his or her own. Some other environmental issues are national, and in order to get the necessary comparable data one may have to go all over the country to find properties that have been affected by particular hazards. The research needs are going to be tremendous.

Jaffe: When there is so limited information available about actual property effects, that information will be very valuable for the appraisal community. Since a whole list of new materials need to be examined, compiling of information, even from distant places, would seem to be essential.

Graaskamp: I think that probably until there is some very major, highly public court settlements which rule in favor of sellers or buyers, business will essentially go on as usual.

Schultz: I'd like to ask Don a question. Do the international standards delve at all into the environmental issues?

Dorchester: They do at least in part and they certainly do in practice. If you were to appraise a manufacturing plant in Indonesia, for example, whatever engineering and environmental studies that would be generally recognized and required in Indonesia would be required as part of the valuation. The standards say that the valuer must satisfy himself or herself as to all of the underlying cause-and-effect relationships in the value equation, and in whatever member-state that evaluation is taking place. All those factors must be taken into consideration.

Graaskamp: In effect, disclaimers are really not the answer to the problem, and that makes the appraisal a fiction.

Dorchester: That's correct. If anything, the emphasis should be on disclosure: here's what we did and here are the effects. But the international standards do say that you must be clear. They discourage assumptions.

Graaskamp: Does that suggest an extension of our reporting formats? Now that you have to report fair market value and then adjust for financing and leasehold advantages, might there be additional lists of discounts that represent environmental exposure? A statement that indicates an engineering study has



been done and that risk is not present might be advantageous. Your reporting statement ultimately is going to be a central tendency of fair market value with a whole series of credits looking much like the closing statements on transactions.

Mundy: I have a remark that gets back to one of the comments that Austin made. We're currently involved in work on a landfill site where significant externalities have been generated. We conducted a nationwide search to determine what has been published on hazardous sites. We found just a few more than 50 articles. One observation that we have been able to make is that there apparently aren't any effects on value as long as the site has not created some kind of an externality, but where externalities have been created, there appear to be value effects. And they vary considerably. This is an area where a tremendous amount of research is currently needed because the material is ambiguous, some research designs have been questionable and consequently, the results are questionable, too.

Beron: Jim, you had mentioned before that perhaps we should have some kind of a checklist. The NATIONAL ASSOCIATION OF REALTORS® has already prepared a partial list of some of the things that we

might want to include as part of the assumptions and limiting conditions portions of our appraisals.<sup>22</sup>

Schultz: And perhaps we should address these issues in the engagement letter.

Beron: Right, because I think we have all found that if we don't have something in the engagement letter at the time that we take the assignment, we really can't defend using assumptions and limiting conditions after the fact.

<sup>22</sup>Reference is to the "REALTORS® Hazardous Substances Reference Manual" (1986) developed by the NAR's Hazardous Substances Task Force. The report contains suggested disclosure and verification forms for sellers and their agents, not real estate appraisers.

## Part II -- REGULATORY INITIATIVES FOR INDUSTRY

Schultz: The next presenter is James A. Graaskamp speaking on "Can the Appraisal Industry Survive without Increased Regulation?"

Graaskamp: The question is, I think, a little ephemeral. I think most industries have found that once they get over the shock of what they perceive as government interference with their industry, government regulations adroitly exploited have been a great advantage to the industry. Either they establish a monopoly for them or they shield them from the consumer, or at least greatly narrow the parameters of the unknown as to where their responsibility in their process lies. So I think initially one does not have to regard regulation as a singularly negative concept.

Now I would like to divide the question of whether the appraisal industry can survive without it into essentially three areas, looking at regulation as protective rather than as pejorative. The first major factor that accounts for the appraisal profession being uncomfortably ill is its customer base. Historically, the appraisal industry has been unable to protect itself from its own customers. If R-4lc has anything to say for itself, it is the fact that it makes the customer, as the fiduciary hiring the appraiser and applying the appraisal in his or her lending and realty process, equally culpable for an inappropriate or

incomplete piece of work. It is now in his or her vested interest that you should be allowed to operate as a professional.

That type of regulation is a very positive element, and to define it as part of the regulatory environment of appraisals certainly is to be encouraged. How do we protect ourselves from our best friends, namely, our customers, who have gone a long way toward destroying the credibility of the appraisal process? The American tradition of reciprocity, of advocacy and the team approach, is very hard to overcome whether you are in a law case or a loan case. The measure of success is, Did we get the loan? The fee system has traditionally enhanced it; more frequently one is hired by the applicant for the loan than by the lender, and then there is the matter of all parties working for community development. This very parochial type of relationship in many cases is virtually an implied conspiracy between the lender who wants to make a loan under any circumstances, and the developer who needs the loan under any circumstances, and the appraiser who wants to be part of the "good ole boy" network that carries this off.

So regulation protects us from our best friends, but I don't think we can survive without it. I think making the customer equally culpable with the appraiser for a poor piece of work, as evident in R-41c, is a very positive regulatory step.

The second area of increased regulation concerns what Mr. Harrington was talking about today. I think the appraisal is a critical social function for equity in our society. Whether we're talking about the protection of our financial institutions, about the relationships between two parties attempting to achieve a fair contract, or about eminent domain and public compensation, the appraisal product should be the pivotal issue rather than the appraisal process. The appraisal process too often is manipulated today against the advocacy positions of the usual vested interests. To the degree that increased regulation could better control the appraisal product so that it performed its critical function of social equity, then regulation advances the interest of professionalism in the appraisal process.

The third and perhaps most significant area in which regulation is a positive factor to the survival of the appraisal industry lies in the historical success of the appraisal process. There is a tremendous financial vested interest in the status quo, which is unfortunate in a society moving as quickly as Mr. Harrington has suggested this morning. We're moving toward a much higher level of social responsibility on the part of enterprise to society and to individual property owners. The social transaction is beginning to take precedence over the business transaction. The appraisal process has not kept up with that, and there are vested interests that do not wish to keep up with that. This renders the education of all of us in this room, let alone the entire professional cadre of appraisers, obsolete.

It obliterates a very significant investment of personal entities and money and time. Obviously, some would much prefer the status quo and a broader array of exemptions, disclaimers, shifts of liability to other professions, and so forth. The threat of new legislation and the related spin-offs of Congressional investigation of the collapse of the Sunrise Savings and Loan Association of Florida show the rate at which we've accelerated consideration of these issues.<sup>23</sup> Without that spur of regulation, there would not be a creative response to bridge the gap between social and business responsibilities.

Regulation is the only way in which we can break the inertia of the financial success of the appraisal process and force the responsible appraiser to come to grips with change in the business environment in which he or she works.

So for all these reasons, the appraisal industry not only cannot survive without regulation, but regulation provides the most accelerated means to move the industry into what essentially is the twenty-first century of professional response. Since we are a pivotal factor in a legitimate transaction and ours is a society in which the social transaction is now bearing equal weight with the business transaction, I don't see any way in

<sup>23</sup>For additional information see "Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in the Secondary Market," House Committee on Government Operations, 99th Cong., 2nd sess., H. Report 99-891, 1986, pp. 16-23.

which the appraisal industry can adapt without regulatory protection.

The final element is simply the cost of regulation itself. I think the appraisal industry has found it has not been able to afford self-regulation. It cannot afford it for several reasons. One obvious reason is the legal cost of due process associated with removing designations from those who have failed their responsibilities. Another is an internal cost in energy to the organization that has to spend so much of its resources disciplining its own members. This becomes very divisive and makes it difficult to go forward with the more positive aspects of this profession.

The punitive aspects of regulation within the profession should be divorced from its fraternal and educational functions so that the great majority can work together. Other industries have managed to insulate themselves from certain disagreeable functions, from inertia, and from their customers who otherwise would kill them with love and fees.

Schultz: Thank you, Dr. Graaskamp. Our next presenter this morning is William Pittenger of the Federal Home Loan Bank of Atlanta, speaking on "FHLBB Initiatives Affecting Appraisal."

Pittenger: Thank you, Carl. I've been asked to talk about the Board's perspective of regulation, including the history of

Federal Home Loan Bank Board regulations: how they evolved, where they're going, and how they fit into the appraisal process.

I'd like to start with the Bank Board's history of appraisal standards. The Federal Home Loan Bank Board has been interested in appraisal standards and has incorporated the appraisal process as an integral part of its standards since at least 1963. The first regulation, 563.17, dealt primarily with the examination process and how the appraisal fit in with it. In 1968 a technical memorandum was issued that defined fair market value, or market value as we refer to it today.<sup>24</sup> That definition remained in effect until the appearance of R-41b in 1982.

In response to questions that have continually evolved about the appraisal process, and about the management of appraisal standards as far as secured lending transactions go, the Board began to issue a series of regulatory interpretive memoranda beginning in 1977 with the first R-41 memorandum. It dealt with appraisal management and procedures. Interestingly, it referred directly to the standards of the Appraisal Institute and the Society of Real Estate Appraisers. Because it did, and because of legal constraints, it was subsequently withdrawn and reissued

<sup>24</sup>In 1963 Insurance regulation 12 CFR 563.17-1 briefly addressed appraisals as a component of the examination process. The R-41 series of interpretive memoranda developed to further instruct insured savings and loan institutions and service corporations further in appraisal policies and practices.



three months later. The R-41 memoranda were from the beginning intended as an evolutionary series. It was never intended that there would be one document that would forever serve the needs of appraisal standards in terms of Bank Board policy. Rather, it was fully recognized that the document would evolve in the context of the complexities in the marketplace and the steady growth of our profession, recognizing that as a profession we are comparatively young.

In March 1982 probably the most widely known memorandum was issued. This was R-41b and up to that point in time it was probably the most complex document. However, it was not until 1983 or 1984 that the rank and file of the appraisal and thrift industries became aware that such a document even existed.<sup>25</sup>

There were basically two events that led to this realization. The first was the emergence of Appraised Equity Capital in 1982, and the tremendous volume of appraisals that came about as a result of that development. The overall quality of appraisals evident at that time was alarming. The deficiencies that were noted were not simple matters of noncompliance with a regulatory

<sup>25</sup>Memorandum R-41b described revised requirements for defining market value, for reflecting deductions and discounts in appraisals of development properties, and for utilizing market/economic feasibility data. Compliance with the memorandum became a matter of increasing concern to both the appraisal and thrift industries after 1983, when appraisal reviews revealed many deficiencies in the reports submitted by institutions in support of Appraised Equity Capital, and large real estate loan losses attracted the attention of the United States Congress.

or an interpretive standard, but they were basic, fundamental problems with appraisals.

The second event concerned loan losses which we are still experiencing today. Beginning in the early 1980s people began to realize that many of the loan losses could be traced to faulty loan underwriting and faulty loan decision-making at all levels, and also from problems created by faulty appraisals. Memorandum R-41c attempted to identify some of these problems as they related to secured lending. It developed over an 18-month or 24-month period, but was actually written over a six-month period in 1986 after consultation with the appraisal industry and with the Board's district appraiser staff.

Quite a number of things were beginning to happen at that point. Historically, we appraisers have had a tendency to limit our product, our information, in the form of assumptions and limiting conditions. The Bank Board was beginning to take the position that, "Hey, guys, we don't need theoretical statements here. We're looking for your best shot at reality." I see this shift as a by-product of a larger shake-out process.

Memorandum R-41c was, as you're very much aware, even more complex than R-41b. Interestingly, it was not regulation at all; it was intended as a comprehensive set of appraisal standards that attempted to address questions unique to a secured credit lending situation. It acknowledged that secured credit lending

transactions require sophisticated information, and that such transactions are considerably more sophisticated than they were ten or 15 years ago. As you are also very much aware, R41c was the subject of a considerable amount of criticism. The Board has traditionally recognized that the appraisal process, like the appraisal profession itself, evolves through time. It's very hard to regulate per se some of the things that we attempt to do in the appraisal process. The Board always viewed its interpretive memoranda as the most desirable means to put forth appraisal standards and information reporting requirements. Unfortunately, quite a number of extraneous pressures were brought to bear including, but certainly not limited to, the federal court judgment concerning R-41b.<sup>26</sup>

<sup>26</sup>The United States District Court for the District of Columbia ruled in January 1987 that Memorandum R-41b was adopted without adequate notice and thus had "no binding effect" on regulated thrift institutions (Haralson v. FHLBB et al., Civil Action No. 86-1218, U.S. Dist. Ct. D.C. Cir.). The impact of the ruling on Memorandum R-41c, which replaced Memorandum R-41b in September 1986, was not clear.

Memorandum R-4lc now will be replaced with a regulation.<sup>27</sup>

Let me share with you the way this regulation evolved. First, as a result of the criticism that R-4lc received, there has been a perception that we as appraisers are incapable of making up our minds and agreeing on anything. We would all have to admit that we've seen evidence of this to some degree. Also, R-4lc could not possibly have been introduced at a worse time than last fall. It was directly linked to asset classification and the forbearance issue. Part of my adjustment in coming to work for the system is the realization that appraisal standards are secondary to political considerations.

This is one of the realities that we as appraisers must deal with here. The district appraisers staff of the Federal Home Loan Bank system met almost a month ago in San Antonio and for the very first time came to almost unanimous agreement on what ought to be included in the regulation. However, many of the suggestions from staff have not been incorporated. The regulation that you see today has been written by attorneys and

<sup>27</sup>The proposed regulation, 12 CFR Parts 563 and 571, appeared in the Federal Register on May 15, 1987. Public comment was to be solicited until September 1; however, in August the proposal was temporarily set aside by provisions in the Competitive Equality Banking Act of 1987. This new law states in part that "An appraisal standard shall be established which is consistent with the appraisal standard established by the Federal banking agencies." Since the federal banking agencies (the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board) do not have comprehensive appraisal standards, the proposed regulation could not be used. Subsequently, a successor regulation, 12 CFR Part 571b, was released by the FHLBB on October 20, 1987.

policy people. And frankly, I see that as a very serious problem for all of us.

Let me move on to a contemporary view of "appraisal services," for lack of a better name. To my knowledge and that of many of my colleagues, the Board has never advanced any sort of opinion or philosophy relative to the general nature of appraisal services. However, it is my view that within the Federal Home Loan Bank System an appraisal is an information tool and there is nothing intrinsically valuable about one. Its only value derives from its ability to answer questions about a particular decision that needs to be made. It's not an end in itself, but rather is useful only to the extent that it answers questions.

In terms of professional standards, it's recognized that appraisers can ethically produce a wide variety of reports in response to a host of decisions that must be made in any real estate endeavor. We tend to look at professional standards as a level of acceptable behavior for providing information that needs to be contained in any appraisal report. We do not tend to view an appraisal as a generic product, if you will, or something that will serve the needs of all potential users. As far as R-41b, R-41c, or any subsequent regulation is concerned, it is not the Bank Board's view that one standard should be imposed on every appraisal.

As far as the new regulation is concerned we had seriously hoped that the general thrust of R4lc would be retained. After quite a few months of field testing it's very apparent now that there is a need for fine tuning. However, we do believe that the general thrust of R-4lc needs to be incorporated into regulation form.

As far as the future of appraisal standards at the Bank Board are concerned, I think the handwriting is on the wall. We are going to see them in regulation form over the years, probably clarified by interpretative and technical memoranda as need arises. The Board believes that some form of overall regulation and industry oversight is necessary. It is generally supportive of the efforts being made so far toward self-regulation.

Schultz: Thank you, Bill. I'm sure we'll continue on that in the discussion period because R-4lc probably has had more effect on appraisers and appraisals than any document in recent history. The next presenter this morning is Bob Foreman, speaking on the "Scope and Content of Self-Regulatory Initiatives."

Foreman: Thank you, Carl. First, I think a person has to view the historical context and take a look at why we are where we are today. In the late 1920s the Appraisal Division of NAR's predecessor, the National Association of Real Estate Boards, first issued a code of ethics for real estate appraisers. This was before the founding of the Appraisal Institute. The code was very broad in nature. It had been taken partly from statements

by other professional groups, including architects. And in part it was developed in response to a public perception that something was going wrong with valuers in this country. People were experiencing severe real estate losses and the real estate community was concerned.

The problem got worse during the Depression, of course, and the pressure for more structure resulted in the founding of the Appraisal Institute. But remember, too, the code of ethics contained very broad, generalized statements. The whole thing fit on about half a page and that is how it remained until the late 1950s. A major addition of material in the 1960s eventually made it about a 15-page document.

Then a number of court decisions came down that affected the role of the appraiser and the due process requirements of a professional organization acting to change anyone's livelihood. The Goldfarb decision addressed the role of a professional in society; specific exemptions for federal antitrust law came out in Goldfarb and later in a whole series of minor decisions at state court levels.<sup>28</sup> These decisions made it very clear that as long as one was following due process, and it was in the public interest, professional organizations could self-regulate.

<sup>28</sup>In the Goldfarb decision (see 421 US at 787-88 N.17), the United States Supreme Court commented on the distinction between a profession and a business in regard to the application of antitrust laws.

Now at the same time we were looking at this, we were also experiencing administrative problems. Back in the late 1970s and early 1980s appraisers were confusing ethics and standards. We went to considerable length to split them apart, stating that ethics essentially dealt with issues of bias, contingent fees, and conflict of interest, whereas standards concerned the content of a proper appraisal report. Unfortunately, what has happened in a lot of the current work is that ethics issues have been left aside. It's as if in the very process of splitting ethics and standards we have left one part floating or adrift.

Coming out of this, though, was another complication: ethics cases incorporating standards issues. Attorneys would say, "Would you please show me the specific standards that have been violated? Where are they articulated? Where are they set forth? Are they in your courses?" Well, our courses all have a disclaimer. They do not represent an official position of the American Institute of Real Estate Appraisers. "Then they must be in your textbook," said the attorneys. But there, too, we have the same disclaimer.

We were trying to hold disciplinary proceedings against persons for violating standards, but nobody would take the time to articulate them. When we eventually tried to do so, we discovered one can't be too specific. There are many exceptions to each case. We suddenly realized that we were biting off an



enormous task. The Institute's Appraisal Standards Board was created out of this need to articulate standards issues.<sup>29</sup>

Another problem was that we expected this board to produce reams of standards quickly. We had a volunteer army working on this, but discovered a considerable amount of time and energy were required to complete just one or two products. And then there was the matter of due process. We had gone to great lengths to comply, but we were still relying on a volunteer army. People who earn their living by completing appraisal assignments suddenly were thrust into roles of investigating facts and using due process procedures. However, they had no background in this, and so everything was falling far behind. Along with the tremendous hoopla about appraisals in the press, about savings and loan issues, and even about our regulations and standards, the backlog was embarrassing all of us. The challenges were obviously much bigger than one organization could handle.

This is how the Institute came to develop its position on self-regulatory structures for the real estate profession. And herein lies the importance of the Real Estate Appraisal Foundation, which will select and fund an Appraisal Standards Board and an Appraiser Qualification Board. The structure also includes state certification of qualified appraisers and state

<sup>29</sup>The Institute's Appraisal Standards Board was created in November 1981. It is responsible for developing and submitting to the National Bylaws Committee guidelines and procedural rules relating to professional competency.

enforcement provisions.<sup>30</sup> This particular approach has a great deal of merit but there are people who question how effectively some states will perform. But we're moving ahead.

Graaskamp: Let me ask you a critical question. The accountants could not operate if they had accounting standards for each state. The financial information business knows no artificial political boundaries. I don't understand why the system has to be encumbered by being duplicated state-by-state.

Foreman: The standards would not be duplicated state-by-state. The enforcement of those standards...

Graaskamp: Even the enforcement isn't done on a state-by-state basis by the accountants because when you become that parochial, the "good ole boy" forces overwhelm the intent of the original legislation. Ultimately the system is trapped into protecting the members of its fraternity, making it unable to protect the public for which it is intended. You need to neutralize parochialism by having a larger national base. It's not going to

<sup>30</sup>Essential features of the regulatory program include an independent Appraisal Standards Board, an independent Appraisal Qualification Board, appropriate legislation for the state certification of qualified real estate appraisers, state enforcement provisions with penalties for violations of standards and other rules, and the adoption by federal and state regulatory agencies of appropriate requirements relating to both the qualifications of appraisers and appraisal standards. The Appraisal Foundation, established November 30, 1987 as an Illinois Not For Profit Corporation, creates and supports the Appraisal Standards Board and the Appraiser Qualification Board.

work at the state level. If I were on the other side, or I were an appraiser attempting to frustrate the need for this kind of process, I would deliberately promote a state system because I felt I could capture 50 states easier than I could capture one national agency in which there would be some judicial process.

Beron: At a recent meeting didn't Congressman Barnard say that he was going to put the regulatory structure on a federal rather than state-wide basis?<sup>31</sup>

Craig: That's not what the speech says. It's very interesting to read his speech. We're getting different signals from the Congressman on this issue. I don't really know what he has in mind. I personally would disagree somewhat, Jim, because I don't see it happening effectively at the national level. It's too big and cumbersome.

Graaskamp: Perhaps a regional approach is best. There would be no reason why you couldn't set it up on the same basis as the regions for the Home Loan Bank or the Federal Reserve, but you must disarm the parochialism within a single state. The "good ole boy" network is too tight.

<sup>31</sup>Congressman Barnard's remarks were made at a seminar sponsored by The University of Wisconsin Real Estate Alumni, Baltimore-Washington Chapter. His presentation, "Impact of Appraisal Reform on Lenders, Developers, and the Appraisal Business," was delivered on April 23, 1987 in Baltimore, Maryland.

Kabel: I think there is some interplay between federal and state roles in accounting, and the Institute's proposal was modeled after that of the accounting profession. In fact, accountants are licensed by the state. There is some parochialism but there's an interplay between the federal agency and the states.

Graaskamp: But can't that very quickly become monopolistic?

Kabel: There are certain states where there is no reciprocity and there are other states where there is. I met with Congressman Barnard last week and he is very determined to keep it at the state level. I know he's given mixed signals. It may be the last signal we gave was mixed as well.

There are a variety of reasons why he's determined to keep it at the state level, and one is the issue of grandfathering. What about Mr. X who has appraised in northwest Wyoming for 40 years and cannot be certified? How do you handle that person? Congressman Barnard wants to leave that determination with the states. Give them a model bill, and let them determine for themselves if there's any grandfathering to be done. Some have toyed with the idea of grandfathering all existing appraisers but I think they're off of that now because it basically destroys the whole program.

Graaskamp: Well, I sense the basic objective of Mr. Barnard is to go in with the support of all eight or nine organizations that

are on the Select Committee, and that he is willing to compromise to maintain that kind of support.

Ferguson: I've been a lobbyist for the REALTORS® since the early 1960s. This is an area where a state can regulate much better than the federal government. I think you would have nothing but problems on the federal level. Groups have to learn the mistakes that were made in creating real estate commissions and medical boards. For instance, we now have three or four public representatives on our real estate commission and I can tell you justice is improved considerably by not having the foxes watch the chicken coop.

Kabel: I fully agree with Bob Ferguson. Correct me if I'm wrong, but all professions are basically regulated by the states. It would be a nightmare to regulate the appraisal profession from some super agency. I think it's very impractical. Also, the response at the state level to the model bill that the Institute proposes (or some other type of legislation) is very encouraging.

Dorchester: I'd like to ask Jim Graaskamp a question about a word he used earlier. You said you felt that we should have a "national" system. You didn't say a "federal" system. Is there a difference?

Graaskamp: I am not a great advocator of the federal government doing much of anything. In fact, my father told me that we're

lucky we don't get all the government we pay for. What I do see is a very distinct parochialism at local and state levels. Perhaps regional districts could provide a regulatory environment helpful in diffusing the traditional reciprocity that exists at the state level.

Jaffe: I find myself agreeing with Jim Graaskamp wholeheartedly. As Bob mentions, it has been done at the state level, but that's an indictment because self-regulation has not been effective in terms of driving out incompetence.

Schultz: Bob Ferguson spoke about letting outsiders into the regulatory or disciplinary process. Is that feasible on the state level?

Jaffe: Well, I find myself knowing far less about the details than many people in this room, but as an historian who became involved with these kinds of issues a few years ago, I think the evidence suggests that certification boards are made up of foxes looking after the chickens.

Schultz: What if we could set this system up so that it wasn't that way?

Jaffe: This is a new world. Largely, we're talking about a significantly different system than has been the case in the past.

Foreman: I think we do have a precedent though. One of the reasons that we changed our internal ethics was because there were some groups absolutely sitting on their hands and other groups actively conducting vendettas. The degree of inconsistency was absolutely unreal. I have some reservations, but I would almost prefer a regional approach to get someone other than our competitors looking at the process.

Harrington: In Illinois, the Department of Education and Registration regulates other professions with boards that set standards. But there's a state department that investigates and enforces standards. I think you will find in states there are ways of regulating other than having a set of foxes passing on the qualifications of fellow foxes. I think you have to look seriously at a problem of law: to what extent do you enforce disciplinary standards as opposed to competency standards? In law you will never find a disbarment proceeding that relates to competency. You can be the world's worst trial lawyer and not be disbarred. If you look at physicians, you're seldom going to find anybody being dropped from registration because he's an incompetent doctor. But if you expect state enforcement to deal with the fact that an appraiser's act doesn't live up to a standard of competency the industry thinks should be out there, it's not going to work. Don't expect state enforcement people to deal strongly with competency issues. I don't think it's done in any other profession.

Dorchester: I was responding a few moments ago to Austin's comments, and to Jim's, which was the reason for my asking about a "national" versus "federal" system. It strikes me that the thrust of both of your comments implicitly states that we're putting an awful lot of pressure on whatever this certification model is going to be. I worry that there may be too much pressure put on it already. We can't agree completely in the crafting or the creation of the certification itself. Yet it strikes me that we have some powerful tools that we didn't have some time ago.

We have common agreement among virtually all of the responsible appraisal organizations in the United States concerning appraisal standards. We also have a common industry phenomenon wherein people in the marketplace hiring appraisal services say, "We want you to do this to an R-41 standard." So there is a greater understanding of standards than might be obtained from an Appraisal Institute textbook or course or seminar.

Graaskamp: But it's coming from pressure on the consumer. We're getting more regulations through our marketplace than we are through our...

Dorchester: I want to respond further because that's really where I'm going. At the back of your books for this Forum there is a brochure called "Facts About FASB, Financial Accounting Standards Board." Some rather intricate paragraphs lead it off,



but what it really states is that the Financial Accounting Standards Board serves as a surrogate for the Securities and Exchange Commission.

What strikes me is that I see appraisal regulation coming under the Financial Accounting Standards Board. There is absolutely no reason why a substantial portion of what we're talking about in regulations shouldn't be centered there today. We are already seeing regulation through the Federal Home Loan Bank Board. We are also going to see regulation through the banking system at large. Eventually, we're going to start bumping up against such questions as: "Now wait a minute, whose standard is this?" "Is this the national Appraisal Standards Board?" "Is it the Appraisal Institute's Standards Board?" "Is this something that NAR has done separately?"

There are some enormous structural problems to overcome. And one of the things that must be done is to acknowledge those people who can in the public interest practice and follow standards. We must start someplace. But if we sit on the federal or national level and try to define all variables beforehand, I think we would be far into the next economic disaster before we would have the parameters of brilliance to say, "Well, here's the way this program should operate." Imperfect though it may be, we have a lot of things going for us, and at the same time we have the ability to off-load structural concerns at the local level, where they can best be addressed.

Graaskamp: Does this suggest that there is no such thing as a generic MAI anymore? Is the MAI going to be subdivided into certain levels of specialty or expertise?

Dorchester: Jim, I think that is a very incorrect interpretation of the Appraisal Institute's designation. Whether you're a member or a candidate, before you can take on an assignment you must be qualified. We may have members who have pitched themselves too broadly, or we may have a market that interprets too broadly, but that is something that needs to be looked at separately. I would not want the designation to be subdivided into "MAI Residential" or any other classification like that. Specialization does not have to be reflected in a designation, but within certification processes you have a means of speaking to such distinctions in the public's and professional's mind.

Graaskamp: Should the Appraisal Standards Board, then, be regrouped into several subcategories, in which you would have, say, a "residential group" that was primarily concerned with issues for mortgage insurance, lending, and so forth? If both consumers and practitioners were on the same panel you could move more quickly to a compatible set of standards for each area.

Schultz: Most of the regulations that have been proposed look at that through use of the advisory councils that are going to assist different aspects of the appraisal industry.

Jaffe: Placing the Qualification Board on the national level seems to make less sense than placing it on the state level. But placing the Appraisal Standards Board on the national level is very sensible. The real opportunity happens at the Appraisal Standards Board level.

Beron: I think there's an aspect of this that we're really overlooking. In the Congressional subcommittee report Barnard found over 250,000 people involved in the appraisal profession.<sup>32</sup> Perhaps this would be a way to bring some of those people under the educational standards that we have benefited from all these years.

Jaffe: I think you're absolutely right. I think FASB affects accounting in general, not just members of the AICPA and other accounting associations.

Pittenger: A couple of comments. I agree generally with Dr. Graaskamp in his view. The state government in Florida produced the recent tax on services, the unitary tax, and our less-than-perfect real estate license law.

<sup>32</sup>The Subcommittee estimates there are between 150,000 and 250,000 appraisers nationwide, of which one-third are members of "highly regarded" professional trade organizations. See "Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in the Secondary Market," House Committee on Government Operations, 99th Cong., 2nd sess., H. Report 99-891, 1986, p. 8.

A second comment concerns the text of Congressman Barnard's presentation in Baltimore. I want to share with you his written comment about the issue of federal oversight, which is: "The Appraisal Council would be authorized, under proper due process safeguards, to amend the Foundation's appraisal standards and to strengthen enforcement of certification/licensing requirements, but only if the Foundation and the states fail to exercise these responsibilities adequately. Appraisal standards would be amended by regulation under The Administrative Procedure Act, after public notice and a hearing. Certification requirements could be enforced by the Council through the use of civil enforcement actions such as cease-and-desist orders. Again, the Council would act only if the Foundation's appraisal standards were seriously inadequate; or only if the State Boards licensed incompetent appraisers or refused to discipline appraisers who engaged in unethical behavior."<sup>33</sup> Again, I don't know if other signals are contrary, but that is the text of his presentation.

Craig: I think that's in line with what he's said all along. He said that "We want this to happen over a fairly short period of time, and if the states don't pick up the ball and cause it to happen soon, we'll do it with a federal regulation of some kind." What he's saying in the excerpt you read is that a federal oversight committee would act if the states didn't act. The

<sup>33</sup>Quoted from "Impact of Appraisal Reform on Lenders, Developers, and the Appraisal Business," Rep. Doug Barnard, Jr., April 23, 1987, Baltimore, Maryland.

difficulty I see is that the oversight agency would be able to veto standards. I'm not sure that I agree with that.

Schultz: I think another great concern is what a federal agency may do in the way of formulating new appraisal practice and theory. I came into the appraisal business during the urban renewal and redevelopment era, and in an effort to get certain things accomplished, agencies redefined values and told us, "You appraise a certain way and if you appraise that way, projects will be economically feasible." It almost appeared that there was no real reason for preparing an appraisal because you ignored local market factors.

Graaskamp: And you have that problem with FASB. FASB is always looking over at the Federal Trade Commission because the first time around they didn't move fast enough. At one point the FTC issued its own regulations and usurped FASB's authority. So the federal government does have a way of influencing such boards. There's no doubt about it.

Beron: I was going to mention before that regulations sometimes create odd things for us. We have the interesting situation now of "present market value," a phrase introduced by the Bank Board that really has nothing to do with appraisal terminology.

Foreman: That's all right. We're going to have a clarification. It will be "present market value as of a future date."

Schultz: Bill Pittenger, you thought you escaped this.

Recognizing that district appraisers have some problems with the wording in the new regulations of the Federal Home Loan Bank Board, can you explain it to us?

Pittenger: No, sir, I can't. In all seriousness, that's a major question that we are asking, too. What does it mean? It appears to be a hybrid between accounting and appraisal terminology.

Graaskamp: I thought what they were trying to get at was the difference in accounting between what is called "exit value," which assumes you convert to cash mid-way through the enterprise cycle, and "enterprise value," which assumes you carry forward to the end of the normal cycle. Is that the correct distinction?

Dorchester: Yes. And there's another problem that derives from international evaluation and accounting standards. The concept is called "deprival value," where in accounting terms a present value may be measured as the cost of deprival of the asset, which is neither its current market value under highest and best use concept, nor a controlled liquidation value of a mid- or shorter-term disposal of the asset. Under the deprival cost concept, value would be based on the cost of acquiring an equally satisfactory substitute property in the marketplace for use in a particular enterprise. In the case of an ongoing enterprise buying fixed assets to be used in a facility, the last thing that

one would want to measure is liquidation value, which presumes a sale.

Graaskamp: Does deprival cost go as far as a regular consequential loss?

Dorchester: It can, but under the standards consequential loss is something that would be looked at by the directors of the enterprise. The valuation of the asset itself would measure time in reacquiring an equally satisfactory substitute. The concept is market-based but you have to look at it in real world terms: "If I must have a rather unique facility to service this particular need, then I have to look for an equally unique facility to operate in."

Schultz: For those of you who have not seen the regulation, I'll take the liberty of reading Sections 10 and 11. Section 10 states, "Appraisals shall report the present market value to a single purchaser and provide sufficient information to determine value upon completion for all properties for which a portion of the overall real property rights or physical asset would typically be sold to its ultimate users over some future time period. Valuations involving such properties must reflect all appropriate adjustments and discounts as well as the anticipated cash flows to be derived from the disposition of the asset over time. Appropriate adjustments, in discounts are considered to be those that reflect all expenses associated with the disposition

of the realty as well as the cost of capital and entrepreneurial profit." Section 11 reads, "Appraisals shall report the present market value and provide sufficient information to determine value upon completion for properties, other than those described in paragraph (c)(10) of this [Section]563.17-1a, that are under construction, conversion, or are proposed and where anticipated market conditions indicate that stabilized occupancy is not likely as of the date of completion..."<sup>34</sup>

The key question that has been raised by most people is: present market value of what? Does the definition assume completion today or are we looking at present market value, discounting the completion at some future date, back to present worth? Without further explanation, most practitioners who read this will be very concerned when they're asked to make an appraisal of a proposed project.

Foreman: This represents to me something of a compromise between competing factions. If you write it sufficiently vague, you can run in either direction.

Schultz: That's the point of the major objection to some issues in R41c, and I'm sure the new regulation will address such

<sup>34</sup>Federal Home Loan Bank Board, "Appraisal Policies and Practices of Insured Institutions and Service Corporations," 12 CFR 563.17-1a(c)(10) and (11). In Federal Register, Vol. 52, No. 94, p. 18392, May 15, 1987.



differences of interpretation. They are affecting the appraisal industry.

Graaskamp: I guess I'll go back to the accounting text and see what it has to say about exit value, enterprise value, etcetera, because accountants have tried to get at this for a long time.

### Part III -- UNIFORM PROFESSIONAL STANDARDS

Dorchester: It occurred to me during the noon hour that with all the comments this morning on topics regarding impacts of regulation on the appraisal industry that it might not be a bad idea to seek some additional outside counsel.

First, there's Mr. Cooper's Law, which says if you do not understand a particular word in a piece of technical writing, ignore it. The piece will make perfect sense without it. I think we talked about that some this morning. Then there's the Law of Observation which says nothing looks as good close-up as it does from far away. Employing Nikki's Nobel Principle, only someone who understands something absolutely can explain it so that no one else can understand it. I think the FHLBB has done a fine job in applying that principle. Murphy's Paradox, of course, is one that we all face. Doing something the hard way is always the easiest way and maybe that's one of the truisms we're learning here. The Futility Factor states that no experiment is ever a complete failure--it can always serve as a negative example. Maybe we've had a few of those.

On the environmental issue, there's Murphy's Constant, which states that matter will be damaged in direct proportion to its value. Clearly, the question is, "What is the value?" not, "What is the damage?" Commoner's Second Law of the Ecology says nothing ever goes away. And, finally, the reason that I make

these comments: Collins' Conference Principle, which states the speaker with the most monotonous voice speaks after the big meal. So having done that and having insulated our speakers for the remainder of the afternoon, I'd like to call on Bob Kabel for his remarks on the "Development of a Self-Regulatory Structure for the Appraisal Industry."

Kabel: Thank you, Don. By way of introduction, my firm, Manatt, Phelps, Rothenberg & Evans, is legislative counsel to the Appraisal Institute. Our role initially has been to work with the Institute in developing its self-regulatory proposal from the perspective of, "Is this something that's feasible in Washington and plausible throughout the states?" Following that is our role to assist the Institute in implementing the proposal.

We've discussed federal legislation throughout the morning. I think it's clear that something will happen in the Congress whether it's this year, next year, or two or three years from now. Eventually there is going to be some federal legislation directly affecting appraisers. Now the question for the profession is: can it come together to shape that legislation? Congressman Barnard's report cites the banking industry, which fought disclosure of information in lending and was handed a regulatory scheme for truth in lending that it has had to live with ever since. His point to us is to work with Congress, which the Institute and virtually all of the other appraisal organizations are doing, to shape the legislation in a constructive way.

Of course, Representative Barnard is not the only one in the Congress who is interested in the appraisal industry. Yet he has been very skillful in capturing this issue, and I think we're fortunate to have someone with his background. As many of you know he is a former commercial banker from Georgia, and he has a fine appreciation for the problems of appraisers as well as lenders. He is a very credible person on the House Banking Committee, but interestingly enough the now famous set of hearings and report was done through his role as chairman of one of the House governmental operations subcommittees.

We have also spent some time with the Senate Banking Committee. I've met personally with the chiefs of staff for both Senators Proxmire and Garn; when we first started, Garn was chairman and Proxmire was the ranking minority member. Since November the roles have been reversed but we have had very good support from them for the proposal that the Institute is planning to put forth. We've also had strong support from the Conference of State Bank Supervisors.<sup>35</sup> They have not signed-off on a specific proposal because we did not present it to them that way, but we have a good sense that they will be supportive of a self-regulatory approach.

<sup>35</sup>Members of the Conference of State Bank Supervisors (CSBS) include 54 state and U.S. territorial officials responsible for supervision of state-chartered banking institutions; approximately 4,000 institutions are associate members.

I think there's a very good chance of passing something meaningful in Congress if some major trade associations don't become directly involved. And by that, I mean the NATIONAL ASSOCIATION OF REALTORS® and the National Association of Home Builders. I think the REALTORS® have really come a long way in their view of appraisal industry regulation, culminating in the resolution adopted this past week in Washington at their spring legislative meeting. The resolution approved certification at the state level and the establishment of uniform standards, but opposed any federal legislation to require the appraisal profession to actually use these tools.<sup>36</sup>

On the other hand, there was an addendum, if you will, stating that the REALTORS® task force studying these issues should meet again in June to address the topic of federal regulatory oversight. One alternative might be to place the oversight with the Federal Financial Institutions Examination Council (FFIEC).<sup>37</sup>

<sup>36</sup>Reference is to the March 9, 1987 Report of the NATIONAL ASSOCIATION OF REALTORS® Appraisal/Appraiser Regulation Task Force. The first state to adopt certification of real estate appraisers was Louisiana (July 1987). The Louisiana REALTORS® Association supported the certification law.

<sup>37</sup>The five-member Federal Financial Institutions Examination Council was established in March 1979. Its purpose is to promote uniformity in the supervision of financial institutions, and to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, National Credit Union Administration, and Office of the Comptroller of the Currency.

I don't think it's the most satisfactory alternative because you could well have too much variation on a good theme. This concludes my comments.

Dorchester: We'll probably pick up on a number of questions in a minute, but I think it's appropriate, Carl, to turn to your remarks on the "Implications of Uniform National Appraisal Standards."

Schultz: It might be helpful to know the history of how these standards came about. Approximately five years ago the Appraisal Institute completely revised what was known as Regulation 10, which was one document encompassing both the Code of Ethics and the Standards of Professional Practice.

When the Institute placed its Code of Ethics and Standards of Professional Practice into two separate documents, it essentially addressed the difference between competency and integrity issues. The Standards produced by the eight appraisal organizations and the International Right-of-Way Association primarily address competency provisions. As a result of the Institute's actions a new interest developed over standards among the various appraisal organizations and at the Federal Home Loan Bank Board. Much of this interest centered on the new requirement in the Institute's standards regarding cash equivalency. Not long after this a meeting was held between representatives of various appraisal

organizations. One result of that meeting was the creation of the Task Force on Uniform Standards.<sup>38</sup>

The new Uniform Standards have not been adopted by all of the organizations that are involved in drafting them. Each organization has taken a slightly different view. Some have adopted the standards as they are written, but the Appraisal Institute has not. I'll address in a few minutes why I think we can't adopt the present version.

To briefly summarize the ten standards, the first two are almost identical to the Institute's standards except that they only address valuation analysis. Standard 3 has to do with review appraisals, and this, too, is very closely associated with requirements in the Institute's standards. Standards 4 and 5 address the development and communication of a real estate analysis. Standard 6 addresses mass appraisals for ad valorem taxes. Standards 7 and 8 address the development and communication of personal property appraisals. Standards 9 and 10 concern the development and communication of a business appraisal. So, as you can see, the Uniform Standards have gone beyond those of the American Institute of Real Estate Appraisers and other appraisal organizations that address only real estate issues.

<sup>38</sup>The initial meeting took place in February 1986. In November 1987 the Governing Council of the Appraisal Institute formally adopted the Uniform Standards of Professional Appraisal Practice, with supplemental language, effective January 1, 1989.

However, the standards do not cover ethics or integrity problems. Many issues in our Regulation 10 are not addressed, such as fraudulent activities, opinions that reasonable men and women would not accept, bias, confidentiality issues, hypothetical appraisals, misleading advertising, and referral fees. These are issues that are extremely important to the appraisal community and in the regulation of appraisers. If we're going to have some national system of regulating appraisers, we must address these other issues.

Another major difference between the Institute's standards and the new Uniform Standards concerns the definition of an appraisal. In the Institute's standards, an appraisal is any real estate service. It is an analysis, opinion, or conclusion relating to the nature, quality, value, or utility of a specified interest in, or aspect of, real estate. The definition of appraisal in the Uniform Standards is an "act or process of estimating value."<sup>39</sup>

Also, we have to determine who is going to enforce standards. As of now, except perhaps where courts would pass on fraudulent activities, the professional organizations are the most likely enforcing entity. We recognize that professional organizations have been unable to do that up to this point in time. It is both

<sup>39</sup>The Uniform Standards limit the definition of appraisal to estimating value and do not include appraisal services other than those the Appraisal Institute defines as "appraisal assignments."



difficult and expensive for an organization to revoke a professional designation. You also have the problem of parochialism addressed earlier.

Another alternative is to look to some federal agency to serve as the enforcement arm while the industry addresses problems that can be expected from that type of arrangement. The last enforcement mechanism--and the one that we would hope to avoid--is the courts. To me that's a very expensive alternative. As we all know, real estate appraisal is not an exact science and there will always be differences of opinion. The market is imperfect.

I view the appraisal standards as an excellent enforcement tool. I am deeply concerned, though, that rather substantial differences of interpretation exist. I believe that the explanations of each standard should be detailed, so that persons doing appraisal services know precisely what is expected of them.

Dorchester: Carl, would you expand on your comment about ethics? Are you suggesting that ethics issues not be handled by the professional associations?

Schultz: Well, many of the problems that the industry is faced with--the problems of savings and loans and banks' overvaluation and undervaluation--are more integrity problems than they are standards problems. An appraiser with good communications skills can make a report look like it's a reasonable conclusion of value.

Yet errors in data gathering and analysis can result in an incorrect conclusion. So I really think the regulators are looking at the integrity provisions and not just the analysis and reporting requirements. We need both ethics and standards systems.

Craig: Do you see the Appraisal Standards Board in this self-regulatory organization writing about ethical violations as well as the standards?

Schultz: That's the way I see it functioning.

Foreman: I think you have to because standards and ethical violations can evolve from similar sets of circumstances. Sometimes it isn't until you get into an investigation that it becomes clear that bias is involved.

Craig: Is this the way the accountants do it? Are they answering integrity questions through FASB?

Dorchester: My understanding is that integrity issues are tied directly into their standards. But to the extent that AICPA wants to overlay additional requirements or additional interpretations for its members, it can and does so through its own standards body.

I'd like to ask another question. Must we address integrity issues from the beginning, or is this something that can evolve as we develop the standards?

Schultz: Well, I guess it can be done on an evolutionary basis, but once Congressman Barnard and perhaps some other government officials recognize that the standards address appraisal analysis in reporting and not the integrity issues, I think they are going to be shocked.

Beron: The main question is, are we all going to pull together? Do you see the absence of integrity provisions in the Uniform Standards as a major stumbling block?

Schultz: Absolutely not. I don't want anybody to believe that I even suggest that. I have looked at these standards primarily because I know that the Appraisal Institute is coming up for a vote very soon as to whether or not to adopt them. There is absolutely no way that I can see the Institute simply adopting Standards 1 through 10 and doing away with Regulation 10, because it contains our integrity provisions. I don't see how the other appraisal organizations can do that either. I personally like the idea of treating competency problems through education first and disciplining second, and treating integrity problems with immediate discipline when there is a violation. I think that's something other professional organizations have not considered up to this point in time.

Mundy: I'd like to move to something that was raised this morning concerning integrity and ethics. Should we try to move this responsibility outside of the appraisal organizations and into the public sector, or to some other organization that is specifically set up to handle ethics questions?

Schultz: We have to avoid the "fox and hen" problem. I definitely see a need for improving the integrity of the disciplinary system through some form of oversight or outside influence.

Craig: There isn't any question in my mind that if you've got good investigative people with an agency at the state level, they can deal with the pressures. It's their job to investigate things. But I don't know where we would put it at the state level. Licensing and certification laws that have been introduced in states so far generally fall under the real estate commissions.

Ferguson: I think you want to move cautiously on who's going to regulate appraisers because the track record is poor when a broad, protective agency is involved. At least in New Jersey the track record is poor.

Schultz: There are two other areas of interest regarding the current standards. If we have some form of regulation and these standards are adopted, a signature will be required of the person

who is responsible for preparing the appraisal. That could eliminate some company signatures. Another issue is whether or not the standards and the regulations should pertain to only real estate appraisers, or include all appraisers.

Graaskamp: I think it almost has to include all appraisers. When you appraise a hotel, you're concerned with tangible and intangible personalty, as well as real estate. We've never done a good job of separating the component assets of an enterprise.

Schultz: I don't think there's any disagreement with that. The question is would the same body that certifies real estate appraisers also certify personal property appraisers? When you get involved with business valuation or real property rights, then surely those areas should be covered by the standards.

Graaskamp: I don't know how you separate them. You've got a lot of people out there representing themselves in all types of business.

Dorchester: And selling insurance on the side.

Craig: Well, I have to address this area because I'm the chairman of the subcommittee [of the Select Committee] writing qualifications for certification. I agree that appraisers of personal property probably should be regulated, but I'm not sure

that we ought to undertake that task. It's a big problem in writing qualifications.

Mundy: I think the appraisal profession is similar to any profession where you have specialization. Within our industry are many specializations. Real property appraisal happens to be one.

Ferguson: You're going to have a difficult time at best with what you're proposing. This is not going to be a "walk in the sun," people, believe me. If you get into all the areas you have just been discussing, I'm not sure there is an agency that you can find or create that's going to be able to do justice to certification and enforcement issues.

Dorchester: Carl, I'd like to go back to the ethics issue again. What kinds of things do you think we need most to complete the standards package?

Schultz: Primarily the items that I addressed earlier. Although the word "misleading" is stated in the standards, they really don't address misleading analysis and reporting, fraud, unreasonable opinions, bias, confidentiality issues, maintaining reports, preparing a memorandum or a report prior to testimony, hypothetical situations, misleading advertising, and referral fees. None of these issues are addressed in the Uniform Standards to date.

Dorchester: Couldn't we state the items you just raised in the standards? Couldn't those things be articulated in guidance notes, background papers, or some other form, so that we don't have difficulty understanding the distinction between the two?

Schultz: I don't have any problem with calling them standards. I would have a problem if some regulatory agency enforced a violation of a standard that I considered to be a minor offense in the same manner that it enforced a major violation, such as bias. If there were a way of qualifying the degree of violation, I would have no problem whatsoever.

Dorchester: Let's go back to my original question: after all of this is implemented, is there not an opportunity for the Appraisal Institute, or for another organization, to have higher standards or a more stringent code of ethical conduct than exists in the marketplace? Could that distinction be drawn or should it be drawn?

Schultz: Yes, I believe there is room for an organization to have higher standards than the typical market would have to face, but I don't see this happening soon. Professional organizations might do things differently so long as all of the certified appraisers within them abide by the standards developed by the Appraisal Standards Board.

Beron: Carl, does it follow that all the groups would act as one organization rather than retain their individual status?

Schultz: I think there would be some major shake-ups in the professional organizations. Whether the system is regulated by the states or the federal government doesn't make any difference. I see that we are going to need two different certifications: one for residential property appraisal and one (with perhaps two levels) for commercial property appraisal. But let's assume that the certification system is in place and the state's role is to regulate the industry. Let's also assume we have a Residential CPV--Certified Public Valuer--and we have a Commercial CPV. I just can't imagine that the requirements to become a Commercial CPV are going to approach those for becoming an MAI.

I also see that major financial institutions are still going to need appraisers with greater experience. And the only way one can meet this need is to obtain a more specialized version of the CPV, or something similar to the MAI designation. Perhaps under this system more requirements will be attached to the MAI designation, to elevate it even higher than it is now.

Jaffe: In the absence of increased requirements there is strong motivation for "grandfathering" and for diluting efforts made toward establishing the higher-level designation. I think that you need to emphasize even more strongly that the MAI designation would eventually become a very specialized designation.



Craig: I can't see us getting out of the review and counseling areas in matters of competency. There will always be review and counseling if we're trying to raise the level of the organization. However, it would be preferable to turn disciplinary matters over to some agency who has immunity and subpoena power. That area is really where all the money goes.

Dorchester: Bob Kabel, when you started your presentation you mentioned that feasibility of the product and its successful implementation were important objectives. What does the impact of this expansion of ethics--or failure to include it--have on the plan as you see it right now? Secondly, what are the pitfalls or problems that you haven't mentioned?

Kabel: The ethics question might be resolved with the establishment of the Appraisal Foundation. The Appraisal Standards Board could be charged with addressing ethics issues. That's a major step forward. Congressman Barnard has discussed a federally chartered foundation. He's delighted with the Foundation developed by the Appraisal Institute but I'm not sure he's clear on how the two might complement one another. We've suggested to him that federal agencies recognize the FASB standards, but that FASB is not a federally chartered entity.

Harrington: I think you want to be very careful about letting Washington set ethical standards for individual members of the profession. My own experience with federal regulatory systems

suggests they are totally unresponsive to reality outside of a narrow, project-oriented approach. In other words, the federal government is not too bad at building things or running on-going programs, but when full-scale regulation is its focus, it becomes dominated by career bureaucrats who look upon bureaucracy as an end in itself. Of course, the major pitfall of any standard established in any area is that it will be used as a basis for a complaint and a measure of negligence and liability. If someone wants to sue an appraiser, he or she looks for a standard and attaches it to the complaint. So you want to avoid writing "good intention" statements into them.

Kabel: I'd like to return to the issue of certification. It's important to remember that the intent is not to certify every appraiser. That would be virtually impossible. To draw a parallel with the accounting profession, there are CPAs, other kinds of accountants, and bookkeepers. They all perform certain functions, but some functions can only be done by a Certified Public Accountant. So how do you get this all working? One suggestion is that by a certain date the federal financial agencies would require all persons, whether they are certified or not, to use the standards as developed. Following that, certain types of appraisal work would have to be performed by a certified appraiser. That's the incentive to get the states to act. But what if the Appraisal Standards Board issues ethical standards? Who then enforces them?

Jaffe: The more actively involved state or federal governments are, the more likely it is that certification will be required on virtually all the agency levels because the costs are then borne somewhere else. As a result certification takes on a kind of licensing role. I believe you're correct in intent, but my suspicion is that the Federal Home Loan Bank, for example, would require a certification for virtually every piece they do. Every other agency might, too.

Craig: That's the unspoken part of this. Probably most appraisers would have to be certified. But the problem is that we need a voluntary program in order to work effectively with the states. With licensing you have to grandfather all those who are practicing now. We don't want to do that.

Jaffe: I very much appreciate the voluntary aspect of the program. I'm worried that it will be voluntary for only a few people, but mandatory for virtually everyone else.

Schultz: You're ultimately correct that at some point in the future the system will become mandatory. But we're probably talking 15 or 20 years before grandfathering occurs.

Jaffe: I think that's very wise but I also think it's critical to talk about an advanced designation that allows people some voluntary choice for specialized demonstrations to the market.

Graaskamp: You can choose to wither on the vine by not becoming certified or you can choose to move up.

Schultz: Or in some circumstances, a professional organization will provide advanced requirements for those who need them. I think there's a marketplace for a relatively small group of appraisers who are qualified to do major properties.

Dorchester: I'd like to ask Bill Pittenger a question. Let's go a couple of years down the road. Let's assume we have a national body that is assisting states, that we have some effective standards, and that we're generally pleased with the system's operation. Do you have a guess about the Bank Board's view as to whether the R-41 regulations are still necessary?

Pittenger: Yes I do. I think there will always be a place for Bank Board standards. I can see them going in a different direction, however, and that is in the direction of appraisal content issues rather than ethical considerations. I think the Bank Board will always have guidelines regarding information required for secured credit lending.

Dorchester: Then won't this create multiple layers of requirements that appear similar but have slightly different applications? Could this become a situation worse than what we started with?

Schultz: I think the Standards Board will say that if you are preparing an appraisal for a financial institution that is going to lend money, then it should be on a cash or cash-equivalent basis. That would eliminate the need for an institutional requirement.

Pittenger: Yes, I could certainly see that happening. I think something else is going to happen, too. And that is a shake-out among the financial industry regulators. There is already evidence of that occurring among the rank and file. I have done scores of seminars around the country in the last year, and frequently I hear, "Well, this old 'level playing field' argument served us well for awhile, but now we're starting to take a hard look at the rulebook."

Finally, Carl indicated it was doubtful that regulators realized the integrity components were missing in the current proposal and I think he's right. I don't think anybody spotted this.

Schultz: I have no doubt that the new Appraisal Standards Board will address the integrity issues. Meanwhile, the professional organizations will continue to be responsible for disciplinary actions within their segments of the industry.

#### Part IV -- ADDITIONAL INDUSTRY RESPONSES

Dorchester: Topics this afternoon fall under the general heading of "Additional Industry Responses." We have three presentations and then opportunity for advice, consent, rebuttal, and other remarks. I will first call on Bob Ferguson to discuss "Environmental and Energy Issues Affecting Real Estate Professionals."

Ferguson: To begin with, let me give a little personal background. I'm not a real estate licensee. I'm an attorney. I am also Executive Vice President of the New Jersey Association of REALTORS®. I have been the Association's chief lobbyist since the early 1960s. I thought environmental concerns would really be pressing on this industry but after listening to you talk about certification, I think environmental issues are probably the least of your problems.

Environmental issues crept up on the real estate industry. If I had to pick a day when I knew they had arrived, it probably would be Earth Day in 1970, a day that most people in this room probably don't remember well.<sup>40</sup> But as a lobbyist, I saw that people who had been mortal enemies were holding hands, calling for the creation of a Department of Environmental Protection. In my opinion, it really changed the way that those

<sup>40</sup>Earth Day took place on April 22, 1970. Its purpose was to increase national awareness of environmental issues and the importance of environmental education.

of us who represent the real estate industry in New Jersey look at the problems. New Jersey now has that Department of Environmental Protection. At the federal level the Environmental Protection Agency (EPA) was established in 1970. And as of yesterday our New Jersey legislative roster lists about 400 bills that impact, in one way or another, on the environment and on real estate professionals, including those in appraisal.

I am also a member of the National Association's Legislative Committee. I'm the vice-chairman of its Subcommittee on Energy, Environment and Development.<sup>41</sup> However, like most good Americans, NAR has completely forgotten energy issues. We haven't discussed an energy-related issue in committee since gasoline came down to about \$1.10 a gallon. That's not to say that it won't be back on the agenda, but we're just not talking about energy issues today. At our most recent meeting the two major concerns were environmental radon gas and asbestos.

According to the EPA radon gas will be a problem in 32 states. New Jersey and the Redding Prong received some notoriety in 1985, and in that same year Senator Frank Lautenberg (D-NJ) held public hearings. There it became very obvious that nobody really had a handle on radon gas and its long-term implications for the United States. In January 1986, I went to Sweden with Senator

<sup>41</sup>The purpose of the Environment, Energy and Development Subcommittee is to monitor federal legislation and regulations regarding energy, public land management, land use, agriculture, and the environment as they affect the real estate industry.

Lautenberg as part of a fact-finding committee to learn about radon.<sup>42</sup>

Recently we heard resolutions from various states asking the National Association to require EPA to establish minimal standards for exposure to radon. But what is that level? In New Jersey we use one standard; Colorado is considering another. Fortunately, we haven't had a disruption in the marketplace concerning radon--yet.<sup>43</sup> In New Jersey the reason we haven't had any problems is because we still have a seller's market. We've got four people for every house. But in a buyer's market I think we're going to have a different story. And after one or more banks are "burned for gas," as we say, then we'll likely have mandatory radon testing. The NATIONAL ASSOCIATION OF REALTORS® is very concerned about that. I spoke to members of the Appraisal Institute in New Jersey and they are concerned also.

The other item that was on our national agenda was Senate Bill 981, which would require asbestos testing in office buildings.

<sup>42</sup>The radon task force, led by U.S. Senator Frank R. Lautenberg (D-NJ), visited Stockholm, Sweden between January 7-10, 1986. The group reviewed epidemiological studies demonstrating a link between lung cancer and residential radon contamination, and government policies designed to address that nation's radon problem. A copy of its report is on file in the Research Department.

<sup>43</sup>Currently several states are conducting tests to determine if radon levels in single-family homes exceed the federal standard of 4 picocuries of radioactive radon per liter of air. A picocurie is a standard measure of radioactivity.



The forecast is that this bill will probably not pass in the current session of Congress, but eventually there will be legislation mandating asbestos inspections.<sup>44</sup> I don't know how many of you are aware that the NATIONAL ASSOCIATION OF REALTORS® is removing asbestos from its building right up the street [in Chicago] and the cost to correct, depending on how you break it out, is about \$200,000 per floor. Asbestos is a major problem and one that appraisers must squarely face.

There are other environmental hazards, too. Lead paint you're all aware of. Urea-formaldehyde foam insulation (UFFI) is another. Underground storage tanks and water quality represent other important issues. We heard about what's happening in Illinois; we can expect that kind of movement right across the country.

Toxic dump sites--in New Jersey we probably have more of them than any other state in the nation--are creating some unusual problems for appraisers. Under what circumstances do you disclose? I'm not sure. It's something that you're going to have to come to grips with in the not-too-distant future. We have a major lawsuit against a REALTOR® for selling a home adjacent to a dump site. Everybody who was involved in that

<sup>44</sup>Senate Bill 981 refers to the proposed Federal Building Asbestos Hazard Abatement Act, which would expand the role of the U.S. Environmental Protection Agency in monitoring for asbestos in federal and nonschool buildings, including privately owned structures (see The Appraiser, Vol. 43, No. 6, June 1987).

sale, from the appraiser to the local municipal health official, has been named as a defendant. Ignorance of the facts won't work. Our real estate commission tells its members, "You know where the churches are, you know where the schools are, you know where the shopping centers are, and you damn well better know where the toxic dump sites are."

You heard about Super Liens this morning. Massachusetts and New Jersey are Super Lien states, and programs like theirs will also spread across the nation. And the final issue is the Environmental Cleanup Responsibility Act (ECRA), which real estate professionals, including appraisers, cannot escape.

Dorchester: Thank you very much, Bob. Next I call on Gail Beron. Her topic is "Measuring Market Perception: Impacts of Ongoing and Single Incidents."

Beron: Generally speaking, everybody makes decisions based on their perception of what's going to be in their best interest. People acting in their own best interest complements our definition of market value. But once in a while something suddenly comes along that could not have been foreseen.

I'm going to talk about two different types of phenomena: single events and ongoing situations. A single event is usually a newsworthy incident, something like the Mount St. Helens volcano or Three Mile Island or a flood or hurricane or even a train

derailment that spills harmful chemicals in a populated area. On the other hand, there is the ongoing situation, which is something that we are more familiar with in the appraisal field. These would include the introduction of a highway or a power line, as well as local air pollution, water pollution, and soil contamination. Personal reactions to ongoing situations vary considerably. For example, we are fairly comfortable with a highway project because we know what to expect in the construction area. But we are not at all comfortable about water contamination.

Looking at these situations from the point of view of the appraiser, it's important to consider the implications of measuring changes in property value that accompany them. Up to this point, we have had really two ways to do that. We've used multiple regression analysis and we have used paired sales techniques.

But now that additional risk factors are coming into play, we have new variables to measure. And some of these we have not measured before. For example, when you're studying air pollution it is important to know which way the wind blows. Is one quadrant less affected than another? With water contamination one might need to study the local aquifer. Its configuration is basic to locational analysis. Are we in a contaminated or a potentially contaminated area? Is the flow coming this way?

Such things are hard to know, yet quite possibly this kind of information is crucial to an appraisal.

Right now I'm working with a client who experienced a single incident of gas emission and has an ongoing situation of well contamination. We are under instruction to look at only the single incident, but who knows what's coming down the pike? People are worried about the impacts from the continuing situation, yet these are not currently being addressed.

After the accident at Three Mile Island a study by Pennsylvania State University showed that real estate sales dropped off dramatically for a 4-to-10 week period and then returned to their normal level. It was almost as if an inverted "hiccup" occurred in the sales pattern. We are currently studying what happened in real estate markets near Three Mile Island after March 1979. We'll see if there are any lasting effects by looking at sales prices, at how fast things turned over in the market, and at changes in demand for sales. Our challenge, and the challenge to the appraisal industry as a whole, involves defining the elements of property value change that are presently intangible, illusory, and sometimes literally shift with the wind.

Dorchester: Thank you, Gail. Next we will have Bill Mundy speak on the "Impacts of Regulations on Market Research, Analysis and Reporting."

Mundy: I think there are some good reasons why market research is not regulated. One reason is that market research is "soft" research. It's a type of undertaking where both researcher and client understand that answers are inexact and the material is presented in a context of confidence limits, statistical significance, and degrees of error. Another reason could be the environment in which market research has evolved. Market research developed in the academic community and has been associated with good, solid business curricula. It has a long tradition.

Some areas in real estate appraisal relate to the market research profession, and I think appraisers can learn from market researchers. For example, Ethical Rule 3.1 states that it is unethical to knowingly prepare a report that contains a biased opinion.<sup>45</sup> We talked today about bias but I wonder how many practicing appraisers really understand the various forms of bias. Let's say we do a mail survey where we send out from 100 to 300 questionnaires and receive a 30% to 40% response rate. We tabulate the returns and indicate that the results are an accurate reflection of the market. Is there bias there? Yes, there is. But how many people in the appraisal profession know that?

<sup>45</sup>American Institute of Real Estate Appraisers, Regulation 10, Code of Professional Ethics, as amended May 5, 1986.

Market research utilizes the scientific method and as such it is important to understand some of the implications of that methodology. There are three different measures that can be used to differentiate scientific and unscientific research. One is the degree of objectivity. Are both the analyst and the analysis objective? The second is the accuracy of the measurement techniques. Extending this to appraisal, when people gather comparable sales data, for example, do they concern themselves with the degree to which they cover the primary market area? I submit that many appraisers probably take the path of least resistance and select comparables that they can obtain quickly and inexpensively. A lot of data are not picked up at all, and so we violate an important tenet of the scientific method. The third measure concerns commitment to the research problem. Is the study continual? Is the analyst gathering market information throughout the assignment and even afterward, in case change takes place that should be brought to the client's attention?

Also, the market research profession has dealt with ethics in a number of ways. We have learned a lot by doing research for others about ethics, and this knowledge has helped to establish a type of ethical code within the profession.<sup>46</sup> In 1984 researchers from Texas Tech University conducted 450 interviews with people in the market research profession. One-third of the respondents identified professional integrity as the most

<sup>46</sup>See Hunt, Shelby D., et al., "Ethical Problems of Market Research," Journal of Marketing Research, IV August, 1984.

significant problem of the market research industry. Among the various issues concerned with integrity were withholding of information, falsifying research results, misusing statistics, ignoring pertinent data, and misinterpreting results with the objective of supporting a predetermined point of view.

This last issue is really important for us to remember; it speaks directly to the appraiser-client relationship. The market analyst, like a real estate appraiser, is an intermediary, a broker for a client. We have a great responsibility in that area.

Dorchester: I am delighted there is another day of the forum ahead because I think everyone is scratching notes and questions quickly. David Craig.

Craig: There's no internal discipline within the market research profession?

Mundy: No. Another interesting thing is that market researchers don't carry errors and omissions insurance. The vast majority of them haven't even heard of it, based on a little survey I did myself among some of my colleagues.

Craig: Then does the market itself discipline such people?

Mundy: It disciplines, but not in a punitive way. Serious market researchers receive a substantial amount of training. People are supervised closely. One of the ways that market research professionals have avoided regulation is through the degree of supervision that accompanies market research.

Dorchester: Bill, as you started your discussion I heard reasons why the fields of real estate analysis and market research shouldn't be regulated. Then I started hearing things that made me think there were good reasons why they could be regulated, at least to some degree. You mentioned such things as minimum standards for a report, the issue of bias, certain types of disclosures about the adequacy of research, differences between data sources, and the importance of data verification.

I just spent several days in New York talking with Wall Street firms that are very concerned about what they call "cookie cutter" hotel/motel studies. These are the kind of studies that suggest if two hotels are feasible, then two hundred must be feasible also. I heard discussions about Orlando, Florida involving motels rising off of market research that ignored the existence of projects under construction, of lending activity that was capable of being tracked, and of other competitive factors because they just weren't part of the standard. In other words, each project was going to stand on its own merit. I don't understand why the field of market research couldn't be regulated.



Mundy: I'm not saying that the market research profession can't be regulated or couldn't be regulated. The scientific method evolved in the hard sciences--engineering, physics, chemistry--where it is possible to measure things very precisely and replicate experiments. This methodology eventually expanded into the social sciences where there is a significantly greater degree of error, where behavior is not precise or predictable, and where many variables influence opinions. Because of that variability, it's important to use statistical tests to find out if data are acceptable within certain limits. This is what we term "soft" research. But clients understand this, and I think that is really the important thing. They've been well-educated and they know that they should not expect precise answers.

Dorchester: Would you agree or disagree, then, that the field of market research is now at a point where there are commonly accepted principles? Are factors sufficiently common that the marketplace relies on that advice, causing investors to invest or not invest based on the underlying economics and probabilities? Or do we need to be taking a closer look at how market research is being performed?

Graaskamp: Market research differs from appraisal for another reason. Until R-41c identified market research as part of the appraisal function, there was really no compelling support for it and many lenders didn't require that it be done. In fact, some clients don't want to hear about market research because the

discovery of an absent or weak market could kill a "good" project. Beside that, with the scientific method you always present conclusions as alternative scenarios. I learned from the banks in New York that in financial consulting, conclusions are always presented as alternative courses of action. The final choice is that of the client, which takes the consultant off the hook. Instead of providing a fixed number, appraisers should indicate a central tendency or range of alternative outcomes that apply to a specific set of circumstances. In this way they can begin to absolve themselves of at least some degree of error.

Beron: With all the emphasis that is placed on education, I wonder if the incorporation of the feasibility study under the new regulation exposes us to some additional liability. We really aren't trained in the methods you described.

Mundy: It certainly does and that's the reason I began with Ethical Rule 3.1--knowingly preparing a biased opinion. I think a lot of people doing market studies as a result of R-41c are unknowingly producing biased products. We've got to provide them with better education.

Jaffe: One of the hot topics at universities that teach real estate is so-called market research. There have always been people who have argued that being very good at crunching numbers doesn't tell you anything about valuation, and yet very few studies have addressed this claim. We have new books and

seminars and all sorts of statistical methods, but essentially we don't know the fundamental questions. We don't know, for example, the relationship between a location and an investment decision and how it affects the bottom line. We don't know the kind of things that market research should tell us, despite the fact that people have always argued that it would be great to know this or that. People that do what I do and think about things in similar ways, even in different ways, say, "We don't know anything about market research." Knowing how to perform a statistical analysis or identify bias inherent in survey techniques are important skills, but they are secondary to what we really need to know.

Let me broaden my comments and then other people can respond. In some sense all three of these issues raise questions about methodology. It's not simply a question about market research being good or bad. People who work in market research always tell us it's better than what everyone believes anyway. Everyone knows stories about developers who don't care about market research and don't think it's useful. Yet others argue that market research should receive more credit. It seems to me that these are methodological issues about the appropriateness of science, let alone social science, to valuation questions. These are tough, tough methodological issues that I think need to be addressed by the appraisal industry very carefully, not so much in terms of an educational agenda, but in terms of defining and addressing narrow issues.

For example, we talk about the demise of the Appraisal Institute's quantitative methods course.<sup>47</sup> It's a serious issue not because people aren't taking what they need in someone's view, but because methodology is merely slid into the curriculum; it's the fundamental question about how you do valuations. My sense is that one should be much more careful about methodology and less worried about how to teach techniques. It bothers me that the debate is centered on whether we should use one technique or another, or whether we should worry very much about radon testing, rather than what it means in the first place.

Graaskamp: Just to underscore what Austin is talking about, think about cost. Behavioral research is extremely expensive and time consuming. Nobody gives the appraisal enough significance in the decision process to justify spending that kind of money. There's no economic reason to do research.

Jaffe: What you're really saying is that we probably get what we need.

Graaskamp: We get what we pay for and our accounting system is lousy. As a result other people are paying for what we didn't do.

<sup>47</sup>Course 11, Quantitative Methods, was offered in 1984, 1985, and 1986. It was dropped from the Institute's curriculum in 1987 as a result of declining enrollments.

Jaffe: That's not inconsistent with what I am trying to say. If someone bears the cost associated with mistakes, you probably are going to produce the optimal amount of market research.

Dorchester: I'd like to add that I was in New York the last few days with a number of pension fund advisors and asset managers who are starting to define those critical market factors that are meaningful to decisions that must be made.

Let me see if I can tie some of the earlier discussions together with a question or two. I heard Bob Ferguson talking about problems for REALTORS® and the complexity of new issues. A very strong implication exists that it just takes one transaction to prove that you're out of business. If the appraiser, historically identified as the one who provides a mirror on the market, is able to take his or her personal bias out of research, he or she is reflecting only the view of the marketplace. Yet in studying single events or ongoing situations, market comparables may be lacking. Suddenly the appraiser moves past being a mirror on the market and becomes the measurement point himself or herself.

Graaskamp: But doesn't a knowledgeable buyer or seller presume an inefficient marketplace rather than an efficient one?

Beron: Hopefully, the appraiser won't have many horrible incidents to assess. I think, though, that we will have to

develop techniques to look at processes of change and their relationship to property values. I don't know how we are going to do that quite yet.

Mundy: I certainly agree with Gail that we need to develop methodologies by which we can do a better job of measuring the effect of these incidents. It's an area where we're groping in the dark.

Foreman: I think the federal government has found that this thing can cut both ways. I'm working on a case now where a developer bought a parcel of land, discovered it had been contaminated, and is now suing the government for \$400 million. The government is willing to pay the cost of removing the contamination but they are not willing to pay for down time or compensate for the resulting lowered sales price.

Dorchester: I think this is a good time to move into our last item on the agenda for this afternoon. Carl Schultz will offer his concluding remarks.

Schultz: I knew there were some sensitive issues that we were going to bring up, but I didn't realize how many substantive problems exist in the world of appraising. I remember 25 years ago when I entered the business; it seemed uncomplicated. Over the ensuing 25 years, I've been through the energy crisis of the early 70s, the recessions that followed, the new financing

techniques and the problems of measuring their impact on value, and two or three tax law changes. Now, suddenly, I must deal with problems of environmental issues and federal, state and local regulations that I think are really taking typical appraisers way beyond their capabilities. I can't imagine how we can keep up with all these issues.

What do we really expect of the appraiser? Do appraisers measure the actions of the marketplace or must we really be investigators now, requiring that each piece of property have a radon test and borings to see if there's anything toxic under the ground? How do we know where these sites are that are going to affect our properties? Does everyone really expect the appraiser to know that within 2,000 yards of a property is a toxic waste site that affects the subject property? Until it's actually known to the public, I can't imagine the appraiser being responsible for covering all of those activities. It's almost frightening when we hear some of the things that are going on around the country and how appraisers and others involved in real estate--brokers, lenders, closing attorneys, surveyors--now tend to be held responsible for an item that nobody knew about before the fact. It may be the business that created the problem is no longer viable and is off the hook. These are issues of deep concern that could destroy the appraisal profession. Appraisers cannot be held accountable for all environmental matters that pertain to property.

Of course, the other issue that we have been discussing is the regulation of the appraisal industry itself. I see that as inevitable. I think we must go forward in an attempt to get the best possible regulation we can, one that will protect the industry and the public interest at large.

Dorchester: Thank you, Carl. One of the things that has come out of today's discussion is that we don't agree on what an appraisal is. I think we've also demonstrated that we don't necessarily agree as to what a standard is. When is a standard an ethic? When is an ethic a standard? A lot of fundamental work has to go on in these areas.

The question also was raised as to whether we are dealing with real estate appraising or something broader. Those decisions are not made; they are in process and some difficult times lie ahead of us before we articulate the answers.

We didn't really talk much about licensing today, but I suspect that behind these discussions is still the question of licensing as an alternative. Associated with that is the question of where uniform standards and the certification process are going to be placed. Should these be real estate commission functions? What are we going to do among the various states to obtain uniformity and to overcome territorial disputes? That perhaps is one of the major battles ahead that could impact the success of all the great ideas that we've had today.



We've talked about a mixture of national and state oversight. I like that word "national" rather than "federal," and I think that we agreed there's good reason to have a national focus on many issues. I heard that greater standards bring greater liability. I think that's good. I don't think that's anything to be afraid of, but obviously we must look at all potential liability issues very carefully. There is no reason to create undue liabilities if, in fact, they don't contribute to the notion of protection of the public interest.

Also implicit in our discussion is the fact that appraisers today are being called on to do something that they have never done before, and that is to manage processes that involve legislation at the national or state level. We have a woefully small band of individuals who are terribly busy and untrained for that task. Bob Kabel could tell us from a client's standpoint how difficult it is to work with us. I think it's something we have to recognize; if we don't, we could mismanage our own, hard-won processes.

Finally, I leave you with some more pearls of wisdom. There's Humphrey's Law of Bicycling, which says the shortest route has the steepest hills. We're going to take some short routes along the way but you had better understand there are going to be a few steep climbs. Murphy's Fourth Corollary says it's impossible to make anything foolproof because fools are ingenious. We aren't going to come up with perfect solutions because there are just

too many ways around too many problems. We are going to make mistakes as we go forward. And finally there is Hoopnagel's Axiom, which says nothing is so insignificant that it can't be blown out of proportion. I want to congratulate all of you today for talking about significant things and keeping them in good proportion.

## Part V -- SUMMARY AND CONCLUDING STATEMENTS

Jaffe: It became clear when I saw the program that I have a different role than everyone else. Everyone else has talked about what they know. I have to talk about what everyone else knows.

This forum has been built around two issues: the broad issue of regulation and the increasingly broad issue of environmental regulation affecting real estate and, in particular, affecting the lives of people who are interested in value. These two concerns have taken us down a number of roads, and I've identified five topics that seem to me to be most germane to this conference.

First is the self-regulatory issue. David Craig, Bob Foreman, and Carl Schultz spoke to this yesterday. Although details of the model are still to be worked out, considerable time and effort have been put forth and now we're at a stage where something's going to happen soon. At the same time, we have Congressman Barnard's hearings dealing with widely noted industry problems, which parallel the self-regulatory movement.

Second, Bill Pittenger talked about the Federal Home Loan Bank Board's series of interpretive memoranda, which have received widespread publicity. The Board in some sense has gone its way also to deal with regulatory issues. And then yesterday Jim

Graaskamp raised other issues consistent with the regulation of the appraisal industry.

There also has been discussion on the choice of the model, and what might be the best approach. The accounting profession, with its CPA designation, the AICPA, and the Financial Accounting Standards Board, has been the preferred model and the one that's believed to have the best chance. Don Dorchester mentioned The International Assets Valuation Standards Committee, which in Europe has gone a great deal further than the U.S. has in terms of issuing guidance notes and background material relevant to a standards board.

Consistent with that, a third topic is the production of uniform standards. This raises a number of issues and difficulties because of the various interests involved. For example, certain appraisal groups may see the possibility of extending appraisal standards beyond real estate. Certain groups may have other motivations. Also there was discussion about the fact that these standards are very consistent with those of the Appraisal Institute but seem to be only a subset of its Code of Ethics. Those three topics seem to be related.

The fourth topic was what I call environmental awareness. Jim Harrington talked about the brave new world of environmental ordinances and legislation. Bob Ferguson talked about the same brave new world for the appraisal profession, with its legal

obligations, liability, and information requirements. I think it's fair to state that most of us, even if we regard ourselves as relatively informed about such issues, must say "Well, obviously, we're not very well informed at all. There's a lot more going on than we've been thinking about." There are huge implications for these environmental issues.

Finally, the last topic is what I characterized yesterday as methodological issues. What should appraisers do about XYZ? What should appraisers know about environmental concerns and legislation? What should appraisers know about the evaluation of special events, as Gail Beron mentioned? Or what should appraisers be doing about the importance of modern market research, as Bill Mundy discussed? This research forum has put on the table an extensive array of topics that are of timely and critical importance to the appraisal profession.

Yet despite all this information, we probably have raised more issues than answered questions, as is usually the case. I've framed six key questions that offer a basis for this morning's discussion.

First, what political concerns exist or will continue to exist regarding the support, adoption, and implementation of the self-regulation plan? Various people have raised questions about divergent interests and the legislative process itself. There

are obviously political issues associated with the program, one of which is "how will this be handled?"

Second, what actions are necessary to garner the support and advice of the Federal Home Loan Bank, and other interested organizations, in implementing the self-regulation plan? There is already a close relationship with the FHLBB but additional assistance may be needed.

Third, what are the small technical areas that need further, careful critical analysis, assuming the proposal goes forward? The lack of integrity language in the standards of practice was mentioned. A variety of smaller, very narrow issues seem to me to be relatively important if we're going to succeed with a self-regulatory plan.

Fourth, what changes need to be made to the educational curriculum and its materials, or other appraisal resources, in response to environmental issues? We have virtually no material available now. What kinds of things need to be done?

Fifth, what, if anything, is the appraisal community doing about methodological issues concerning the treatment of special events and market research? Is there a need for additional attention on methodological issues? Personally, I believe there is. I believe methodology is one of the sloppiest areas in the

appraisal profession, which is ironic because appraisers are supposed to be specialists in methodology.

And finally--this is more rhetorical I suspect--how can and will this industry self-regulate itself? Self-regulation is a tough business it seems to me, and yet because of the threat of federal regulation, we're going to go forth. How will this take place? And what kinds of problems are along the way?

These are the tougher questions that were raised. Let's open the discussion and see what happens.

Foreman: I think we had one other issue, and that is the dichotomy between the appraiser's view of his or her role in society and society's view of that role. While we've always said our role is to be students of the marketplace, society is beginning to perceive of us as warrantors of conditions, implying that we are somehow certifiers of conditions that exist. I think that dichotomy needs to be articulated and clearly communicated. Will we accept and take the responsibility for society's perception of our role, or are we going to take a clearer stand on what I think our role has been traditionally?

Dorchester: As I indicated yesterday, I am still concerned that we have a lot of players in the standards business but we might not necessarily have a lot of players in the regulation business. At the moment I think there is still a great deal that's going to

have to be done to establish effective statutory functions and standards.

The appraisal industry has tended to look at the concept of regulation as the imposition of an unattractive outside force. I view regulation as the possibility of legitimizing for the first time an industry that has operated out of garages, back bedrooms, automobiles--anything but the front office. The products of appraisal services go to front offices and are an integral part of major financial decisions. Even small numerical decisions are enormously important in scale to the people that they impact. I'm talking about single-family residential valuations. They are of immense importance to those involved in the consumer side of that transaction. If the regulatory process is well-managed it perhaps will provide us a niche in the economy that does not presently exist.

Another issue that you raised is educating appraisers about environmental hazards. I'd like to talk about education in a broader sense. There is a substantial amount of disagreement in the practical application of appraisal fundamentals.

Unfortunately--and this is a personal opinion--the principles haven't changed, but much of the methodology available today is either terribly shopworn or underutilized. I think there is going to be a large struggle as we go forward in the standards area because of these differences in ability. Education is going to be important to help people make sure they don't transgress,



but it's also going to ensure that, given our standards, we have people out there that can do good work. I worry that one of the weakest elements of the whole notion of regulation is whether the industry can do what it claims that it should do. We're going to have to wrestle with that over many years.

My remarks yesterday were primarily related to The International Asset Valuation Standards Committee. Let me emphasize a few points about the international perception of current events. First, the field of appraising, as we call it in the United States, or the field of valuation as it's referred to around the world, is essentially financial in its genesis. In other words, a very strong distinction would be made in the world community between a real estate commission, which would guide the activities of those who are involved in brokerage, and the kinds of controls or types of regulation that would affect valuers. The international community would see those as separate. Around the world far less is said about regulating the activities of valuers than is said about the implementation of standards.

Second, it is important as we look around the world to accept that one cannot appraise real estate in the United States differently than it is appraised in Europe, Japan, Indonesia, or Australia. We have a world economy. We have globally active investors and therefore we need to assure them that there is common understanding and continuity in international finance.

One shouldn't need a Ph.D. in order to understand the contribution of valuation services.

Schultz: It appears to me that the major issues are working out the details of implementation. I'm really concerned about us attempting to control or regulate all appraisers. I really believe we need to concentrate on real estate appraisal and those areas which are closely associated with it.

Beron: I wonder how we best deal with hotels, or nursing homes, or other similar properties.

Schultz: It is a difficult issue that needs clarification. Obviously, I'm concerned about real estate appraisals that include personal property or chattels. I think we need to have standards there, too.

Beron: I wonder if we can't relate what Bob Foreman said about appraisers functioning as "warrantors of conditions" to the problem of limiting the exposure for appraisers in the environmental areas.

Harrington: As I stated yesterday, anything that affects the value of property is going to affect your business. Laws are changing so fast that it is very difficult for even the so-called environmental specialists--whether they're lawyers or consultants--to stay on top of them. I don't think it's

realistic to expect that every appraiser should become an expert on environmental issues. But he or she is going to have to be able to work with consultants. And he or she will have to recommend environmental professionals for certain types of review. There are many law firms in Chicago, Washington, and New York that are called on by investment bankers, brokers, appraisers, and purchasers to render opinions about potential environmental liability in specific parcels of property. Appraisers need to become more sensitive to what's happening on the regulatory legislative front, to have a voice in matters that are going to impact real estate value. On the educational side you need to get materials out to all your people to alert them. You need to include an environmental component in any kind of training course, any kind of certification, so that people will recognize important issues.

Foreman: I have a concern. I know that we should be more attuned to environmental issues, but if we start training our members to be aware of every environmental hazard, are we not inviting the courts to interpret that we are warranting conditions. Our position has always been that we are trying to simulate the typical buyer-seller function, that we are not more informed than the marketplace as a whole. If we try to take on the larger role, well, we will really open up the door to lawsuits and litigation. I would like to see us do a more careful job of establishing the line beyond which we do not have expert opinion.

Harrington: I agree that you shouldn't pretend to be environmental experts. But Congress decided last fall that the prudent buyer has to investigate where hazardous or toxic substances may have been disposed. It made that decision for you.<sup>48</sup>

Dorchester: I wonder if there aren't environmental firms out there right now, Jim, that would tell you they are in the appraisal business. For example, I wonder if there aren't mining engineers who would tell you that at least a part of their work involves appraising.

Harrington: From what I have seen in the environmental consulting and law firm operations, they don't come up with an ultimate opinion as to value. What they do come up with is an opinion as to potential liabilities associated with the real estate. Now there may be some basis for dialogue if one could identify reasonable trade groups to deal with and what the roles of environmental engineers and lawyers are in valuation. That is ultimately going to happen. The questions are how much is it worth and who puts the opinion on it? Lawyers and engineers can tell you that it will take, say, \$20 million to clean-up a given site. But the appraiser still must develop an indication of value.

<sup>48</sup>Reference is to the Superfund Amendment and Reauthorization Act of 1986 (see Note 12 and accompanying text).

Jaffe: In a different vein, Jim, you had mentioned that there was an unmet need for the appraisal profession to redirect part of its research efforts toward environmental concerns. We're all aware that legislation may have one of three effects with respect to changes in the value of property. It may increase the value of property because of the elimination of certain activities. It may have an adverse effect. Or it may not have any effect at all. Is it your view that much of the legislation that's coming out now and in the next few years is going to substantially reduce property values? Will it make transactions difficult? Or do you think we need more environmental legislation?

Harrington: I think the public perception of the need for environmental legislation is about seven years behind the fact. If you identify what has gone wrong in the past, the law to correct was passed two to seven years ago and perhaps amended in the last year. We're in a stage of implementing one of the most detailed sets of regulatory requirements this country has ever seen on behalf of our environment.

But an equal concern is that the new laws are going to impinge on the ability to develop plans and to respond to changing economic conditions. Most national associations aren't going to get involved in local regulations but they need to be watching Congressional activity. Who from the real estate industry really watched what was happening with the SARA amendment? It was supposed to be a break for the real estate industry but I think

it has had an opposite effect. You need somebody in Washington reading the bills and making comments for you.

Mundy: We are setting ourselves up because we are in effect becoming experts on the value implications of hazardous waste sites. I think we're building a set of expectations in the minds of the public that will be very difficult for the industry to meet.

Dorchester: It's one thing to say that we set ourselves up. However, it's another thing to say that we can use reasonable cautions and apply reasonable standards. Why shouldn't we have both the opportunity and the obligation to answer questions of value within the range of standards available to us?

We're not going to pretend to be doctors but in the valuation or evaluation of toxic waste cases medical questions come into play. Somewhere along the line someone has to be able to resolve those issues. Years ago David Montonna said the code of professional ethics should be one line long: "Thou shalt not assume anything."<sup>49</sup> It was his view and it was the view of the founders of the Appraisal Institute that it was incumbent upon appraisers to discover all things that properly bore on the question of value. Well, since then we've spent over 50 years finding that a lot more things bear on value than we first realized. This is why we

<sup>49</sup>David L. Montonna (1898-1973), appraiser, author, and educator, was president of the American Institute of Real Estate Appraisers in 1957.

need market standards that people can understand, that they can depend on. They need to know that within the standards there are certain degrees of competency that relate to the performance of appraisal services.

Foreman: What we're saying, then, is that caveat emptor no longer applies and that buyers and sellers should not be asked to take certain levels of risk as market participants. It concerns me that we are nearly becoming a riskless society--that there are always experts or others besides the investor that absorb risk. I concede that obvious risk can be laid off on experts, but I think certain levels of risk have to stay with the market participant.

Dorchester: So that there is no misunderstanding, I totally concur. I do say, however, that the endorsement of the unknown should be addressed by the standard. It should not be left to a given legal action where the facts of the case may obscure important principles.

Schultz: Perhaps the Appraisal Standards Board can address this issue by developing a guide note about what is--and what is not--expected of the appraiser. From there we can outline our liability, rather than let the courts decide for us. We're probably talking about three years before the Board comes up with guide notes on environmental issues. Perhaps we need to ask the Institute to look beyond the Appraisal Standards Board to develop

something in a more timely manner, such as within the next twelve months.

Craig: We are talking about this from an environmental standpoint but the public and the courts are not aware that an appraisal is made as of a certain date. An appraiser should not be held to any more than he or she knows as of the date of the value estimate. Yet we now have the FSLIC, for instance, comparing two appraisals made four years apart and saying the first appraiser is liable for the difference between them despite radical changes in the economy. And I think the same point applies to environmental questions; an appraiser should be held to what the state-of-the-art is at the time of the appraisal and what should be visible by walking over the site. But because that is not made clear in our standards some courts construe that values are "guaranteed" forever. That is something we need to address.

Jaffe: Well, is there a state-of-the-art defense in this area?

Ferguson: It's called errors and omissions insurance.

Beron: Which you can't get...<sup>50</sup>

<sup>50</sup>In April 1986 an Errors and Omissions Insurance Task Force was established to explore the feasibility and needs of a captive group insurance program for Appraisal Institute members. As of September 1987 two major studies were complete, with recommendations to follow.



Harrington: I can't speak on the appraiser's liability with any great deal of knowledge. I think that the problem lies within the narrow environmental community: lawyers, consultants, engineers, and staff people who probably all know each other. They have one state-of-the-art and the rest of the world is about five to seven years behind them. Imagine you get into a law suit. If I'm the plaintiff's counsel, I want to go into the environmental community and identify people to prove that you should have known about an environmental hazard seven years earlier. Is it fair? No. Could a court buy it? Possibly. If you had gone to an environmental consultant seven years ago, he'd have walked in and said, "Oh, yeah, that's bad stuff you got there."

Craig: Wouldn't we as an industry be better off if our standards spoke to those familiar questions of what did he know and when did he know it?

Harrington: I think it's important that you do. Lawyers who are experts in your business and lawyers who are experts on the environmental side could come up with something that makes sense in terms of your traditional role and in terms of the environmental and related regulatory fields.

Foreman: I'd like to ask a hypothetical question. Suppose I'm working on an abandoned fireworks plant. I enter the property and discover three groups of barrels. One set is clearly labeled

as containing PCBs. I think I know what to do with those. The second set has a chemical label and a long chemical formula but I'm not sure what it means. The last set is sealed and unlabeled. My question is: what is the level of prudent investigation by an appraiser under each of those three situations?

Harrington: You would have to walk the site and take a look not only at the barrels but at everything else. In that particular case, I'd immediately say, "Get an environmental professional." Not a lawyer, but a consultant who's familiar with that industry or who can find out about it quickly.

Ferguson: I think the education of the Institute and its chapters has to start immediately. There are many resources out there including the state environmental protection agencies. Get them involved.

Harrington: You also have to be very careful about selecting a consultant. If you call certain companies, everybody in the neighborhood is going to see them arrive in Class 3 protection suits, respirators, and air packs. In many areas as soon as the people see that, property values change.

Schultz: I want to talk more about Bob's example to see what you really think about the appraiser's liability. Let's consider two different scenarios concerning the fireworks plant. One is that

the prospective owner says he or she has had environmental engineers investigate and there is nothing wrong with the site. There is perhaps some clean-up that needs to be done at a certain cost. Therefore, you qualify your report by stating that the client furnished this information and you assume there is no other damage to the environment. Then six months later people discover the town's water supply is contaminated from that property. To what extent is the appraiser responsible? Should the appraiser demand that the client provide a complete environmental study? That's one scenario. My second scenario is one wherein the client furnishes an environmental study that indicates everything's fine. And then six months later it's found that the town's water supply is contaminated. Is the appraiser responsible?

Harrington: I'm going to make a common sense answer to that. When I give opinions on environmental liabilities, much depends on who has provided the technical data and the evidence that accompanies it. If you give an opinion of value to the purchaser who had his own environmental assessment, and you fully disclose, then I think you're protected. If I have a reputable engineering opinion in front of me and I render an opinion on the legal implications of what the engineer has told me, I'm not going to be held liable for the things the engineer didn't find.

Schultz: Except, Jim, we know that our appraisals are used by third parties to make decisions. Suppose Chase Manhattan Bank

made a \$25 million loan on this plant. Now Chase is coming back at the appraiser for its losses.

Harrington: The only hope that we have in both our businesses is that a clearly stated and fully applied qualification is going to provide protection from knowledgeable--I stress, knowledgeable--parties involved in the transaction. I would assume that Chase is a knowledgeable party. I know they get opinions on environmental liability. They don't rely on appraisers.

Foreman: But typical buyers don't test underground water samples. I think at some point, negligence has to relate to what typical practitioners in the field do, does it not?

Harrington: Unfortunately, before you are going to be able to put this down in concrete, you're probably going to have some of your members go to the wall. A court decision will frame what a reasonable appraiser should do.

Kabel: All of this argues for putting the Appraisal Standards Board quickly in place to provide the profession with a reasonable defense.

Beron: I think that we're talking about two different things. We're talking about investigation of liability in a specific case and about setting a standard to define appropriate responsibility. A very short time ago we were concerned about

syndications, cash equivalency, and changes in tax laws. Now we're concerned about environmental issues. Six months or a year from now we might be comparing the dollar to the Deutsch mark or the yen and be looking for new responsibilities to lay on the appraiser. We need to be broad-based in our standards developments so that we can define clearly what an appraiser is expected to be responsible for--in general.

Jaffe: In the few minutes remaining let's return to the other areas of concern. What needs to be done?

Kabel: To me, the most important thing is to get the Foundation filed, the Appraisal Standards Board named, and the certification process going. I think that provides us with a framework and roadmap for what Congress might do. We need to be better prepared to respond to what is actually going to be introduced in the Congress, whether it's by Representative Barnard or someone else. Once a Congressional initiative is taken we may be dealing with a lot of other people. We need to assemble the right people in order to respond in a positive, effective manner.

Schultz: Yet individual groups, particularly the Society of Real Estate Appraisers and the Appraisal Institute, are doing certain things on their own that are not in concert. We're walking down different sides of the same fence, but we're not walking in tandem. I think that's the main problem we have right now.

I'm also deeply concerned about the possibility of establishing the Foundation, going on public record, and then having someone drop something in the legislative hopper that's diametrically opposed to our position. Once we incorporate we need to make sure that that's what Congressman Barnard agrees should happen, and that he will support it fully.

Dorchester: I like the idea of a proactive start for an Appraisal Standards Board that says we are broadly involved in the United States economy. We are not just involved with those home loans or commercial loans that have been making headlines, nor are we a group of people who are flawed in our approaches and performance. We should step forward and speak to our roles in environmental issues and in the financial community.

Pittenger: I would like to change directions slightly because we've been talking a lot about the federal regulators and what they might or might not do. Who are these federal regulators that we're talking about? Are they the 22 year-old examiners who are just learning to spell appraisal? Are they the supervisory agents who are handing down directives to institutions? Are they the Board members themselves who are bestowing the final blessing to regulations and who are actively involved in the political process? Are they the appraisal staff that I am a part of? Sometimes we go to the district appraisers not recognizing that they are in a staff position and do not hold much power. Sometimes we pay that visit to the Board members themselves and

fail to recognize that they are involved in the big picture and are not particularly concerned about nitty-gritty technical issues and day-to-day functions.

Let me talk about the district appraiser staff and some things we can do in that area. District appraisers are a very fragmented group in terms of backgrounds and abilities. We have 12 district banks within the Federal Home Loan Bank system and each one of them tends to look at the role of the appraiser in a slightly different fashion. I can speak for District 4, the Federal Home Loan Bank of Atlanta. I am very proud that in this district the role of the appraiser is taken quite seriously. The appraisers on our staff are all MAIs. That speaks very highly for the Bank and also for the Appraisal Institute. But we also have one district that does not have an appraiser at all. I am deeply concerned about the inconsistency of interpretation that we have within the Federal Home Loan Bank system.

Without question there could be greater consistency of information and interpretation around the country, allowing us to respond more effectively to the needs of the industry.

I also have some concerns about the particular regulation you are looking at right now and have been asked to comment on. As you know, there has been much criticism about the detail of R-41c. However, I personally believe that a detailed and specific regulation is something that we need, because it keeps all of us

honest. And such a regulation keeps those of us who are reviewing the reports honest, too. I urge you to think about that. Finally, don't hesitate to keep the Bank Board informed of what the Appraisal Institute and its industry partners want to accomplish. Two very valid questions have come out of this meeting: How far do we go? What are we expected to do?

Foreman: What we have in many of the regulations are ambiguous elements that result from compromises between different groups. This presents problems for the appraiser during the course of conducting business, and creates difficulties when we try to teach a course and explain how the working appraiser should comply with the material. The area of "appropriate level of market support" many find particularly troublesome.

Schultz: I think that there's a problem within the Bank Board itself. Correct me if I'm wrong, but I believe several years ago the structure was decentralized so that each one of the 12 districts became autonomous. There isn't a chief appraiser who says "Look, we're going to interpret things this way." And as long as we have that, we've got a real problem.

Dorchester: Perhaps we might consider a national uniform standards group that would create standards for situations like this.



Beron: I think we have to be very careful. Bill has raised an important point when he suggests that maybe we want to object to something that is being put on us at the moment.

Craig: I just want to point out that this is the second time within a month that I've heard somebody from the Bank Board say, why don't you give us some help? I find this very helpful and interesting and I think a very positive message is coming through.

Pittenger: Carl, you are absolutely right in your comments about decentralization and problems in that area, but that's the kind of thing that can be overcome. I am an advocate of professionalism. I think we're attempting to go in the same direction together.