JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

C. Focus on Appraisal Reform

1. Conferences

b. "Public and Private Control of Appraisal Procurement", held with the help of the Georgia Alumni Chapter, Atlanta, GA. January 8, 1988. Includes the handout, the registration materials and follow-up correspondence

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PUBLIC AND PRIVATE CONTROL OF
APPRAISAL PROCUREMENT

THE PROGRAM

See V. C. 1. a. of the James A. Graaskamp Collection of Teaching Materials for Barnard's speech in Baltimore, MD on 4/23/87. See V. C. 2. a. for text of the legislation

8:30 - 9:00 a.m.	--Registration
9:00 - 9:15 a.m.	--Introductory Comments James A. Graaskamp Ph.D.
9:15 - 10:15 a.m.	--The Federal Initiative From the Viewpoint of the Committee on Government Operations Hon. Douglas Barnard
10:15 - 10:30 a.m.	--Coffee Break
10:30 - 11:30 a.m.	--Perspectives on the Federal Initiative from an Appraisal Practitioner Carl Schultz MAI SRPA
11:30 - 12:00 a.m.	--Questions and Answers
12:00 - 1:00 a.m.	--Lunch
1:00 - 2:00 p.m.	--Letters of Engagement to Control Appraisal Procurement Professor James A. Graaskamp Chairman, Real Estate and Urban Land Economics
2:00 - 3:00 p.m.	--The Real Estate Appraiser--The Elusive Goal of Professionalism John R. White MAI
3:00 - 3:15 p.m.	--Break
3:15 - 4:00 p.m.	--Critical Implications of Control and the Concept of an Appraisal Standards Board William Kinnard Ph.D. MAI SRPA
4:00 - 4:30 p.m.	--Questions and Answers

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QUALIFICATIONS OF J. CARL SCHULTZ, JR., MAI, SREA, CRE

Principal of Schultz, Martin, Carr & Associates (formerly Albritton, Schultz & Associates) and an associated principal of The Real Estate Counseling Group of America. Exclusively engaged in real estate consulting and valuation for the past 22 years. Was a Partner in Wight, Couch & Schultz and Vice President of Landauer, national appraisal and consulting firms.

TYPE OF WORK PERFORMED:

Experience has involved most types of real estate, including commercial, multi-family, and special purpose properties, with major involvement in recent years in the valuation and analysis of numerous southeastern and Caribbean resorts and recreational properties including condominiums, timeshare developments, golf courses, hotels, marinas, and coastal islands. Has also performed loan and property portfolio analyses of several major mortgage companies and real estate investment trusts for banks and accounting firms. Has been engaged in the acquisition estimates for the Metropolitan Atlanta Rapid Transit Authority, airport expansion, and proposed tollroads, as well as the valuation of rural and timber lands.

EDUCATION/TEACHING:

Graduate of University of Georgia in 1963. Received BBA Degree with major in Real Estate. In addition to completing numerous courses offered by the American Institute of Real Estate Appraisers, has attended the American Land Development Association conference on Recreation, Resort, and Community Development and the House and Home Recreation Resort Seminar. Has taught appraisal courses nationally for the American Institute of Real Estate Appraisers, Society of Real Estate Appraisers, and the Mortgage Bankers Association.

MEMBER OF:

- American Institute of Real Estate Appraisers--MAI #4478. (Pres., Georgia Chapter, 1980; Board of Directors, 1981-1983; National Professional Recognition Award, 1976-81; Certified through Education Program until 12/31/86; Member of National Governing Council, 1982-1985; Chairman, National Professional Standards Committee, 1985 and 1986)
- American Society of Real Estate Counselors--CRE (Georgia Chapter Chairman 1986)
- Society of Real Estate Appraisers--SREA #510. (Senior Real Estate Analyst; Pres., Atlanta Chapter, 1972-73)
- Atlanta Board of REALTORS, (President, 1984; REALTOR of the Year, 1978; Board of Directors, 1980-86)
- Georgia Association of REALTORS (Board of Directors, 1978-1986; Metro Regional Vice President, 1984; Secretary, 1986)
- National Association of REALTORS (Board of Directors 1986-1987)
- Rho Epsilon National Real Estate Fraternity (National President, 1974-1976)
- Georgia Land Development Association
- Distinguished Practitioning Lecturer, University of Georgia College of Business Administration, 1975-76

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PUBLIC AND PRIVATE CONTROL OF APPRAISAL PROCUREMENT

January 8, 1987
Atlanta, Georgia

10:30--11:30 Perspectives on the Federal Initiative from an Appraisal Practitioner--Carl Schultz, MAI, SREA, CRE

I. INTRODUCTION

A. Estimated 250,000 to 300,000 appraisers nationwide.

B. Very little current control. Several states require real estate brokerage license:

California--Certified appraisals.

Nebraska--licenses appraisers under the real estate commission. They just included standards in their law.

Louisiana--recently passed a bill to certify appraisers, which includes appraisal standards similar to those of the American Institute of Real Estate Appraisers.

C. Professional organizations--numerous with only a few requiring education, exams, experience, continuing education, along with standards and ethics enforcement.

D. Public confused over designations. Many require only application and a fee.

E. Professional organizations with standards enforcement find it difficult, extremely expensive, and time consuming in their attempts to discipline or expel members. Expulsion from the most prominent organizations almost always result in a law suit.

F. Many procurers of appraisal services look upon the appraisal as a burden that may kill a deal rather than a document to be relied upon. These clients frequently have a financial interest in the deal. The reference here is to the individual controlling the procurement of the appraisal assignment and not necessarily the corporate or financial entity that the appraisal is supposed to protect.

G. Historically many appraisers have been pressured to come up with the "right number" or you won't do any more of our work. This does not excuse the appraisers for unethical conduct but is considered by many to be the primary reason some appraisers force valuations.

II. Possible Solutions

A. DO NOTHING. Some professional organizations are saying, "If it ain't broke, don't fix it." Maybe it's not broken but it sure isn't well. Doing nothing is no solution. Most leaders of responsible appraisal organizations recognize the likelihood of some form of regulation of appraisers in the near future.

B. LICENSING--similar to real estate, barbers, beauticians, etc. This type regulation is usually state sponsored, mandatory, and therefore requires grandfathering. This is no solution if it would automatically certify or license many unqualified appraisers. Would further confuse the public for many years. Strict enforcement of standards would give the profession another black eye and further discredit the appraisers that are competent and abide by meaningful standards. Most proponents of licensure and grandfathering are the professional organizations that sell designations and persons who do an occasional appraisal, therefore, would find it difficult to pass an meaningful exam.

C. FEDERAL LEGISLATION. The real estate reform act of 1987, as proposed by Congressman Douglas Bernard of Augusta, Georgia, was introduced into the United States Legislature November 20, 1987.

1. BRIEF SUMMARY

a. Establishes a Federal Interagency Appraisal Council with absolute power over Certified Appraisers, State Certification Boards and Appraisal Standards where federally covered transactions are affected (See Section 103. Functions of Council).

b. Twelve voting members representing 12 Federal Agencies (FHLBB, FDIC, Federal Reserve, National Credit Union, SEC, VA, FHA, FNMA, FHLMA, Farmers Home Administration, and GSA). Non-voting members are the IRS and Secretary of Transportation.

c. Federal agencies transfer authority to establish and regulate appraisal standards and appraiser qualification requirements to the Federal Interagency Appraisal Council (Federal Bank Regulatory Agencies, VA, FHA, FNMA, FHLMC, SEC, Federal Financial Institutions Examination Council, GSA, and the Farmers Home Administration).

d. Advisory--Real Estate Appraiser Committee (12 members) and Real Estate Appraisal User Committee (14 members), all appointed by the Chairman of the Interagency Council.

e. Full time for three years, then part time.

f. Funding--Maximum $100 per certified appraiser and transaction fee based on a graduated basis with respect to the value of the transaction not to exceed $5,000.

2. BENEFITS OF FEDERAL LEGISLATION

a. Requires uniformity among states.

b. May be the most expiditious way to certify appraisers, if passed.

c. Requires all federal agencies to have similar standards (May become a problem since the various agencies have dissimilar appraisal needs, i.e. the appraisal for mortgage loan purposes usually has different requirements than an appraisal for disposition purposes.)

d. Requires states to assure the ready availability to appraisers of adequate and reliable information regarding property values and the terms and conditions of real estate sale transactions.

e. The threat of federal legislation is forcing professional appraisal organizations to join together to suggest meaningful regulation. Without this threat in all likelihood very little would have been accomplished for many years.

3. PROBLEMS/OBJECTIONS FROM A PRACTIONER VIEWPOINT

a. Bill does not specify any appraisal standards--left up to 12 representatives of federal agencies.

b. Significant concern about federal agencies establishing standards. Several agencies, such as GSA and to some extent the Federal Home Loan Bank Board, have established meaningful standards. Other agencies, however, have no appraisal standards. Will the standards developed by the 12 representatives be meaningful or political?

c. Standards and qualification requirements for appraisers will be controlled by non-appraisers. Could cause substantial problems such as was recently encountered with attempts to write a federal regulation to replace Memorandum R41c of the Federal Home Loan Bank Board.

d. Could appraisal standards be modified to accomplish some type of social reform, i.e., establish special standards in certain situations to force feasibility/value.

e. Cost--federal and state agencies are bound to cost substantially more than a state agency. Can the typical appraiser afford the administrative cost of a federally controlled system.

f. Non-qualified members on the Interagency Council. There will be no appraisers. I know of no state board or commission that is totally controlled by persons not involved in the profession.

g. The Interagency Appraisal Council transforms into a part-time position after three years. The appraisal profession should not be regulated by part-time participants.

D. APPRAISAL PROFESSION SOLUTION. Proposed by several of the leading professional organizations--State Certification of Appraisers similar to the Certified Public Accountants with a Standards Board and an Appraiser Qualification Board established by the "Appraisal Foundation".

1. Nine organizations have developed Uniform Appraisal Standards including The American Institute of Real Estate of Appraisers, the American Society of Appraisers, the American Society of Farm Managers and Rural Appraisers, the International Association of Assessing Officers, the International Right-of-Way Association, the National Association of Independent Fee Appraisers, the National Society of Real Estate Appraisers, the Society of Real Estate Appraisers, and the Appraisal Institute of Canada.

2. The "Appraisal Foundation" was incorporated November 30, 1987, and the public trustees were selected at a meeting on December 7, 1987. The Foundation was formed by eight of the organizations involved in the establishment of Uniform Appraisal Standards excluding the Appraisal Institute of Canada. The main purposes of the Foundation are "To establish and improve uniform appraisal standards...; and to establish appropriate criteria for the certification and recertification of qualified appraisers..." The Foundation's organizational meeting will be held January 11, 1988. To date the Foundation has been formed and the 20 trustees have been selected including three public trustees. Twelve of the trustees represent the eight appraisal organizations and five represent industry related and educational organizations. The initial members of the special class of membership which have voting rights but no financial requirements shall be a representative from the American Bankers Association, the American Real Estate and Urban Economics Association, the Mortgage Bankers Association, the Real Estate Educators Association, and the Urban Land Institute. Initial funding will be provided by the eight appraisal organizations. A.I.R.E.A. and S.R.E.A. have each committed one million dollars to the Foundation.

3. Two appraisal organizations have been working closely on a model state certification bill. Separate drafts from each organization are extremely similar with only insignificant differences, if any. A copy is included with the handout material.

BRIEF SUMMARY--State Certified Real Estate Appraiser Law (AIREA AND SREA)

a. Definitions

"Appraisal" or "real estate appraisal" means an analysis, opinion or conclusion relating to the nature, quality, value or utility of specified interests in, or aspects of, identified real estate. An appraisal may be classified by subject matter into either a valuation or an analysis. A "valuation" is an estimate of the value of real estate or real property. An "analysis" is a study of real estate or real property other than estimating value.

"Appraisal report" means any communication, written or oral, of an appraisal.

"Appraisal Foundation" means the Appraisal Foundation that was incorporated as an Illinois Not for Profit Corporation on November 30, 1987.

"Certified Appraisal" or "certified appraisal report" means an appraisal or appraisal report given or signed and certified as such by a state certified real estate appraiser. When identifying an appraisal or appraisal report as "certified", the State certified real estate appraiser must indicate which type of certification is held. A certified appraisal or appraisal report represents to the public that it meets the appraisal standards defined in the Act.

"State certified real estate appraiser" means a person who develops and communicates real estate appraisals and who holds a current, valid certificate issued to him or her for either general or residential real estate under the provision of the Act.

b. Certification Use

Only State certified real estate appraisers may identify a report as "certified". This does not preclude a person not certified from appraising real estate in the State for compensation. Certification is, therefore, voluntary on the part of the appraiser but can be required by the client.

c. Real Estate Appraiser Board

Established as an adjunct to the appropriate regulatory commission or department an independent Real Estate Appraiser Board appointed by the Governor of seven members, two of whom shall be public members and five of whom shall be real estate appraisers. NOTE: The number may vary from state to state depending upon the needs of the particular state.

The real estate appraiser members first appointed shall be designated members in good standing of nationally recognized real estate appraisal organizations that require appraisal experience, education, and testing in order to become a designated member, and require adherence to standards of professional practice in order to retain such designation.

Some states may want to set up an independent board or commission.

d. Powers of the Board

1. To define the type of education experience, appraisal experience, and equivalent experience that will meet the statutory requirements of the Act.

2. To establish the examination specifications for each category of State certified appraisers.

3. To approve or disapprove applications for certification and issue certificates.

4. To define the continuing education requirements for the renewal of certification.

5. To review the standards for the development and communication of real estate appraisals and to adopt regulations explaining and interpreting the standards.

6. To establish administrative procedures for all disciplinary proceedings.

7. To censure, suspend, and revoke certificates pursuant to disciplinary proceedings.

8. To perform such other functions and duties as may be necessary in carrying out the provision of the Act.

e. Powers of the Commission

1. To receive applications for State certification.

2. To establish the administrative procedures for processing applications for State certification.

3. To maintain a registry of names and addresses of people certified under the Act.

4. To retain records and all application materials submitted to it.

5. To assist the Board in such other manner as the Board may request.

f. Fees

To be established by the Commission to include an application fee, an examination fee, a reexamination fee, a fee for renewal of certification, and a delinquent renewal fee. (The fees established by the Louisiana Bill include an application fee of $200, an examination fee of $100, an annual certification renewal fee of $100, and a delinquent renewal fee of $25.

g. Certification Process

Includes an application, appropriate fees, and a signed pledge to comply with the standards set forth by the Act and that he or she understands the types of misconduct for which disciplinary proceedings may be initiated against a state certified real estate appraiser.

h. Classes of Certification

Two classes:

1. The state certified residential real estate appraiser shall consist of those persons meeting the requirements for certification relating to the appraisal of residential real property of one to four units, and up to twelve units when a net income capitalization analysis is not required by the terms of the assignment. (NOTE: This should allow where secondary mortgage market terms permit appraisals of up to 12 units.)

2. The state certified general real estate appraiser shall consist of those persons meeting the requirements for certification relating to the appraisal of all types of real property.

3. Other classifications could be added in those states were classifications are deemed appropriate, such as an agricultural classification.

i. Examination Requirement

An original certification shall not be issued except to those who possess the following:

1. Knowledge of technical terms commonly used in or related to real estate appraising, appraisal report writing, and economic concepts.

2. Understanding of the principles of land economics, real estate appraisal processes, and of problems likely to be encountered in gathering, interpreting, and processing data in carrying out appraisal discipline.

3. Understanding of the standards for the development and communication of real estate appraisal as provided in the Act.

4. Knowledge of theories of depreciation, cost estimating, methods of capitalization, and the mathematics of real estate appraisal that are appropriate for the classification of certificate applied for.

5. Knowledge of other principles and procedures as may be appropriate for the respective classifications.

6. Basic understanding of real estate law.

7. Understanding of the types of misconduct for which disciplinary proceedings may be initiated against a State certified real estate appraiser.

j. Examination Prerequisites

1. General Classification--A college degree or successful completion of not less than 150 classroom hours of courses in subjects related to real estate appraisal from a nationally recognized appraisal organization or a college or university approved by the Board, plus 15 classroom hours related to standards of professional practice and the provisions of the Act.

2. Residential Classification--A college degree or successful completion of not less than 60 classroom hours of courses in subjects related to real estate appraisal from a nationally recognized appraisal organization or a college or university approved by the Board, plus 15 classroom hours related to standards of professional practice and the provisions of the Act.

k. Experience Requirement

The equivalent of two years of experience in the appropriate real property appraisal supported by adequate written reports or file memoranda. Such experience acquired within a period of five years immediately preceding the filing of the application for certification. Each applicant must furnish under oath a detailed list of appraisal reports or file memoranda and upon request a sample of appraisal reports which the applicant has prepared in the course of his or her appraisal practice.

l. Term of Certification

Three years.

m. Nonresident Certification

Includes provisions for nonresidents to become certified.

n. Reciprocity

Provides for reciprocity among states who have similar certification requirements.

o. Use of Term

The term "State certified real estate appraiser" may only be used to refer to individuals who hold the certificate and may not be used following or immediately in conjunction with the name or signature of a firm, partnership, corporation, or group; or in such manner that it might be interpreted as referring to a firm, partnership, corporation, group, or anyone other than an individual holder of the certificate.

p. Continuing Education

Not less than 30 classroom hours of instruction (equivalent to ten hours per year for the three year certification period).

q. Disciplinary Proceedings

The rights of any certified appraiser may be revoked or suspended, or the holder may be otherwise disciplined in accordance with the provisions of the Act. The Board may investigate and may revoke or suspend the rights of a certificate holder or otherwise discipline a State certified real estate appraiser for various acts or omissions, such as:

1. Procuring or attempting to procure a certificate by false statement, fraud or misrepresentation.

2. Failure to meet the minimum qualifications established by the Act.

3. Paying money other than provided by the Act to procure a certificate.

4. A conviction, including a conviction based upon a plea of guilty or nolo contrendre, of a crime which is substantially related to the qualifications, functions, and duties of a person developing real estate appraisals and communicating real estate appraisals to others.

5. An act or omission involving dishonesty, fraud, or misrepresentation with the intent to substantially benefit the certificate holder or another person or with the intent to substantially injure another person.

6. Violation of any of the standards for the development or communication of real estate appraisals.

7. Failure or refusal to exercise reasonable diligence in developing an appraisal, preparing an appraisal report or communicating an appraisal.

8. Negligence or incompetence in developing an appraisal, in preparing an appraisal report, or in communicating an appraisal.

9. Willfully disregarding or violating any of the provisions of the Act or the regulations of the Board.

10. Accepting an appraisal assignment when the employment itself is contingent upon the appraiser reporting a predetermined estimate, analysis, or opinion, or where the fee to be paid is contingent upon the opinion, conclusions, or valuation reached, or upon the consequences resulting from the appraisal assignment.

11. Violating the confidential nature of governmental records to which he or she gained access through employment or engagement as an appraiser by a governmental agency.

12. Entry of a final civil judgment against the person on grounds of fraud, misrepresentation or deceit in the making of an appraisal of real property.

NOTE: In a disciplinary proceeding based upon a civil judgment, the State certified real estate appraiser shall be afforded an opportunity to present matters in mitigation and extenuation, but may not collaterally attack the civil judgment.

q. Due Process--provided by the Act.

r. Hearing and Judicial Review--provided by the Act.

s. Standards of Practice

A state certified real estate appraiser must comply with the Uniform Standards of Professional Appraisal Practice promulgated by the Appraisal Standards Board of the Appraisal Foundation.

t. Classification of Services

Permits the certified appraiser to accept an "appraisal assignment" which means an engagement for which an appraiser is employed or retained to act, or would be perceived by third parties or the public as acting, as a disinterested third party in rendering an unbiased analysis, opinion, or conclusion relating to the nature, quality, value, or utility of specified interests in, or aspects of, identified real estate, or "specialized services" which means all services which do not fall with the definition of an "appraisal assignment". The term "specialized services" may include valuation work and analysis work. Regardless of the intention of the client or employer, if the appraiser would be perceived by third parties or the public as acting as a disinterested third party in rendering an unbiased analysis, opinion, or conclusion, the work is classified as an "appraisal assignment" and not "specialized services".

Examples of "specialized services" include specialized marketing, financing, and feasibility studies which may include estimates of value, analyses, opinions, and conclusions given in connection with activities such as real estate brokerage, mortgage banking, real estate counseling, and real estate tax counseling.

u. Contingent Fee

A State certified appraiser may not accept a fee for an "appraisal assignment" that is contingent upon the appraiser reporting a predetermined estimate, analysis, or opinion or is contingent upon the opinion, conclusion, or valuation reached, or upon the consequences resulting from the appraisal assignment. A State certified real estate

appraiser who enters into an agreement to perform specialized services may be paid a fixed fee or a fee that is contingent on the results achieved by the specialized services provided this fact shall be clearly stated in each written or oral report in a prominent location in such report and also in each letter of transmittal and in the certification statement made by the appraiser in such report.

v. Retention of Records

Three years from submittal of the report or the final disposition of any litigation, whichever is longer, including copies of all written contracts engaging his or her services and all reports and supporting data assembled and formulated by the appraiser.

III. SUMMARY OF CONCLUSIONS

A. Some form of appraiser regulation is probable.

B. The threat of the Barnard Bill has encouraged various professional appraisal organizations to adopt uniform Standards and the Appraisal Foundation.

C. A system of State Certification utilizing the Appraisal Foundation as the basis for Standards and Qualification of Appraisers should be given an opportunity similar to the Certified Public Accountants.

D. Federal legislation or a joint resolution of Congress supporting the Appraisal Foundation, State Certification of Appraisers, and requiring the various federal agencies to adopt the Uniform Standards, would enhance the probability of success.

E. In whatever system is adopted, grandfathering should not be allowed. If we are going to certify appraisers, they should be qualified by testing and experience.

STATE CERTIFICATION FOR REAL ESTATE APPRAISERS

Model Legislation

Proposed By:

American Institute of Real Estate Appraisers
and
Society of Real Estate Appraisers

December 24, 1987

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MODEL CERTIFICATION LEGISLATION

AN ACT

To enact Chapter ( ) of the State of _____, relative to real estate appraisers; to provide for the certification of real estate appraisers; to create the real estate appraisers Board; to provide for membership, compensation, powers, and duties; to provide for certification requirements and for the renewal, suspension, and revocation of certification; to provide for fees; to provide for penalties; and to provide for related matters.

Be it enacted by the Legislature of _____

Section 1. Chapter ( ) is hereby enacted to read as follows:

Chapter ( ). State Certified Real Estate Appraisers Law

Sec. 0001. Short title

This Chapter shall be known and may be cited as the "State Certified Real Estate Appraisers Law".

Sec. 0002. Definitions

The following terms as used in this Act have the following meaning:

(1) "Appraisal" or "real estate appraisal" means an analysis, opinion or conclusion relating to the nature, quality, value or utility of specified interests in, or aspects of, identified real estate. An appraisal may be classified by subject matter into either a valuation or an analysis. A "valuation" is an estimate of the value of real estate or real property. An "analysis" is a study of real estate or real property other than estimating value.

(2) "Appraisal report" means any communication, written or oral, of an appraisal.

(3) "Appraisal Foundation" means the Appraisal Foundation incorporated as an Illinois Not for Profit Corporation on November 30, 1987. The purposes of the Appraisal Foundation are:

(a) To establish and improve uniform appraisal standards by defining, issuing and promoting such standards;

(b) To establish appropriate criteria for the certification and recertification of qualified appraisers by defining, issuing and promoting such qualification criteria; to disseminate such qualification criteria to States, governmental entities and others; and

(c) To develop or assist in the development of appropriate examinations for qualified appraisers.

(4) "Board" means the Real Estate Appraisal Board established pursuant to the provisions of this Act.

Explanatory Note: This board would be within the Executive Branch of the State under which it is constituted.

(5) "Certified appraisal or Certified appraisal report" means an appraisal or appraisal report given or signed and certified as such by a state certified real estate appraiser. When identifying an appraisal or appraisal report as "certified", the State certified real estate appraiser must indicate which type of certification is held. A certified appraisal or appraisal report represents to the public that it meets the appraisal standards defined in this Act.

(6) "Commission" means the [insert the appropriate state regulatory Commission or Department].

(7) "Real Estate" means an identified parcel or tract of land, including improvements, if any.

(8) "Real Property" means one or more defined interests, benefits, and rights inherent in the ownership of real estate.

(9) A "State certified real estate appraiser" means a person who develops and communicates real estate appraisals and who holds a current, valid certificate issued to him or her for either general or residential real estate under the provisions of this Act.

Sec. 0003. Certification use

A. No person, other than a State certified real estate appraiser, shall assume or use that title or any title, designation, or abbreviation likely to create the impression of certification as a real estate appraiser by this state. A person who is not certified pursuant to this Act shall not describe or refer to any appraisal or other evaluation of real estate located in this state by the term "certified".

B. This shall not preclude a person who is not certified as a state certified real estate appraiser from appraising real estate for compensation.

Sec. 0004. Real Estate Appraiser Board

A. There is hereby established as an adjunct to [insert the appropriate regulatory Commission or Department] an independent Real Estate Appraiser Board which shall consist of seven members, two of whom shall be public members and five of whom shall be real estate appraisers.

> Explanatory Note: The number of members of the Board may vary depending on the needs of the particular state.

B. The Governor shall appoint the members of the Real Estate Appraiser Board.

> Explanatory Note: The state legislature may be involved in the appointment and/or confirmation of the Board, if desirable.

C. The real estate appraiser members first appointed to the Board shall be designated members in good standing of a nationally recognized real estate appraisal organization that as of June 1, 1987, required appraisal experience, education, and testing in order to become a designated member, in addition to adherence to standards of professional practice in order to retain such designation.

D. Each real estate appraiser member of the Board appointed after January 1, 199_, must be a State certified real estate appraiser. At least one-half of the appraiser members shall hold the general appraisal certificate.

E. The term of each member shall be three years; except that, of the members first appointed, two shall serve for two years and two shall serve for one year.

F. Upon expiration of their terms, members of the Board shall continue to hold office until the appointment and qualification of their successors. No person shall serve as a member of the Board for more than two consecutive terms. The appointing authority may remove a member for cause.

G. The public members of the Board shall not be engaged in the practice of real estate appraising.

H. The Board shall meet not less frequently than once each calendar quarter to conduct its business. Places of future meetings shall be decided by the vote of members at meetings. Written notice shall be given to each member of the time and place of each meeting of the Board at least 10 days before the scheduled date of the meetings.

I. The members of the Board shall elect a chairperson from among the members to preside at Board meetings.

> Explanatory Note: Sections G, H, and I have been included as suggestions. Actual meeting schedules and operating procedures will vary depending on state requirments.

J. A quorum of the Board shall be four members. At least three of these four members shall be appraiser members.

K. Each member of the Board shall be entitled to a per diem allowance of _____ dollars ($___) for each meeting of the Board at which the member is present and for each day or substantial part thereof actually spent in the conduct of the business of the Board, plus all appropriate expenses.

Sec. 0005. Powers of the Board

A. The Board shall adopt rules and regulations in aid or in furtherance of this Act.

B. The Board shall have the following powers and duties:

(1) to further define by regulation and with respect to each category of State certified real estate appraiser the type of educational experience, appraisal experience, and equivalent experience that will meet the statutory requirements of this Act;

(2) to establish the examination specifications for each category of State certified real estate appraiser, to provide or procure appropriate examination questions and answers, and to establish procedures for grading examinations;

(3) to approve or disapprove applications for certification and issue certificates;

(4) to further define by regulation and with respect to each category of State certified real estate appraiser, the continuing education requirements for the renewal of certification that will meet the statutory requirements provided in this Act;

(5) to review from time to time the standards for the development and communication of real estate appraisals provided in this Act and to adopt regulations explaining and interpreting the standards;

(6) to establish administrative procedures for disciplinary proceedings conducted pursuant to the provisions of this Act;

(7) to censure, suspend and revoke certificates pursuant to the disciplinary proceedings provided for in Sec. 0022 of this Act; and

(8) to perform such other functions and duties as may be necessary in carrying out the provisions of this Act.

C. Actions of the Board shall not be reviewable by the Commission.

Sec. 0006. Powers of the Commission

A. The Commission shall have the following powers and duties:

(1) to receive applications for State certification;

(2) to establish the administrative procedures for processing applications for State certification;

(3) to maintain a registry of the names and addresses of people certified under this Act;

(4) to retain records and all application materials submitted to it; and

(5) to assist the Board in such other manner as the Board may request.

Sec. 0007. Fees

A. The Commission shall charge and collect fees not in excess of the following:

(1) An application fee for certification of $_____.

(2) An examination fee of $_____.

(3) A reexamination fee of $_____.

(4) A fee for renewal of certification of $_____.

(5) A delinquent renewal fee of $_____.

Sec. 0008. Certification Process

A. Applications for original certification, renewal certification and examinations shall be made in writing to the Commission on forms approved by the Board.

B. Appropriate fees, as fixed by the Commission pursuant to Sec. 0007 must accompany all applications for original certification, renewal certification and examination.

C. At the time of filing an application for certification, each applicant shall sign a pledge to comply with the standards set forth in this Act and state that he or she understands the types of misconduct for which disciplinary proceedings may be initiated against a State certified real estate appraiser, as set forth in this Act.

Sec. 0009. Classes of Certification

A. There shall be two classes of certification for State certified real estate appraisers:

(1) The State certified residential real estate appraiser classification shall consist of those persons meeting the requirements for certification relating to the appraisal of residential real property of one to four units, and up to twelve units when a net income capitalization analysis is not required by the terms of the assignment.

Explanatory Note: This should be allowed where secondary market forms permit appraisals of up to twelve units and a net income capitalization analysis is not required.

(2) The State certified general real estate appraiser classification shall consist of those persons meeting the requirements for certification relating to the appraisal of all types of real property.

Explanatory Note: Other classifications could be added in those states where such classifications are deemed appropriate.

B. The application for original certification, renewal certification and examination shall specify the classification of certification being applied for and previously granted.

Sec. 0010. Examination requirement

A. An original certification as a State certified real estate appraiser shall not be issued to any person who has not demonstrated through a written examination process that he or she possesses the following:

(1) Appropriate knowledge of technical terms commonly used in or related to real estate appraising, appraisal report writing, and economic concepts applicable to real estate;

(2) Understanding of the principles of land economics, real estate appraisal processes, and of problems likely to be encountered in gathering, interpreting, and processing of data in carrying out appraisal disciplines;

(3) Understanding of the standards for the development and communication of real estate appraisals as provided in this Act;

(4) Knowledge of theories of depreciation, cost estimating, methods of capitalization, and the mathematics of real estate appraisal that are appropriate for the classification of certificate applied for;

(5) Knowledge of other principles and procedures as may be appropriate for the respective classifications;

(6) Basic understanding of real estate law; and

(7) Understanding of the types of misconduct for which disciplinary proceedings may be initiated against a State certified real estate appraiser, as set forth in this Act.

Sec. 0011. Examination Prerequisites

A. General Classification - As a prerequisite to taking the examination for certification as a State certified general real estate appraiser, an applicant shall present evidence satisfactory to the Board that he or she has a college degree or has successfully completed not less than 150 classroom hours of courses in subjects related to real estate appraisal from a nationally recognized appraisal organization or a college or university approved by the Board, plus 15 classroom hours related to standards of professional practice and the provisions of this Act.

B. Residential Classification - As a prerequisite to taking the examination for certification as a State certified residential real estate appraiser, an applicant shall present evidence satisfactory to the Board that he or she has a college degree or has successfully completed not less than 60 classroom hours of courses in subjects related to real estate appraisal from a nationally recognized appraisal organization or a college or university approved by the Board, plus 15 classroom hours related to standards of professional practice and the provisions of this Act.

[Explanatory Note: The Appraisal Foundation will assist in development of additional criteria and qualifications for appraiser classifications.]

Sec. 0012. Experience requirement

A. An original certification as a State certified real estate appraiser shall not be issued to any person who does not possess the equivalent of two years of experience in real property appraisal supported by adequate written reports or file memoranda. Such experience, or the equivalent thereof, must be acquired within a period of five years immediately preceding the filing of the application for certification.

B. Each applicant for certification shall furnish under oath a detailed listing of the real estate appraisal reports or file memoranda for each year for which experience is claimed by the applicant. Upon request, the applicant shall make available to the Board for examination, a sample of appraisal reports which the applicant has prepared in the course of his or her appraisal practice.

Sec. 0013. Term of Certification

A. The term of a certificate issued under the authority of this Act shall be three years from the date of issuance. The expiration date of the certificate shall appear on the certificate and no other notice of its expiration need be given to its holder.

Sec. 0014. Nonresident certification

A. Every applicant for certification under this Act who is not a resident of this state shall submit, with the application for certification, an irrevocable consent that service of process upon him or her may be made by delivery of the process to the Secretary of State if, in an action against the applicant in a court of this state arising out of the applicant's activities as a State certified real estate appraiser, the plaintiff cannot, in the exercise of due diligence, effect personal service upon the applicant.

Sec. 0015. Nonresident certification by reciprocity

A. If, in the determination by the Board, another state is deemed to have substantially equivalent certification requirements, an applicant who is certified under the laws of such other state may obtain a certificate as a State certified real estate appraiser in this state upon such terms and conditions as may be determined by the Board.

Sec. 0016. Renewal certificate

A. (1) To obtain a renewal certificate as a State certified real estate appraiser, the holder of a current, valid certificate shall make application and pay the prescribed fee to the Board not earlier than 120 days nor later than 30 days prior to the expiration date of the certificate then held. With the application for renewal, the State certified real estate appraiser shall present evidence in the form prescribed by the Board of having completed the continuing education requirements for renewal specified in this Act.

(2) If the Board determines that an applicant has failed to meet the requirements for renewal of certification through mistake, misunderstanding, or circumstances beyond the control of the applicant, the Board may extend the term of the certificate for a period not to exceed six months, upon payment by the applicant of a prescribed fee for the extension.

(3) If the applicant satisfies the requirements for renewal during the extended term of certification, the beginning date of the new renewal certificate shall be the day following the expiration of the certificate previously held by the applicant.

B. If a person fails to renew a certificate as a State certified real estate appraiser prior to its expiration or within a period of extension granted by the Board pursuant to this Act, the person may obtain a renewal certificate by satisfying all of the requirements for renewal and by the payment of a late renewal fee.

Sec. 0017. Basis for denial

A. (1) The Board may, in accordance with the provisions of this Act relating to hearings, deny the issuance of a certificate as a State certified real estate appraiser to an applicant on any of the grounds enumerated in this Act.

(2) To assist in determining whether grounds exist to deny the issuance of certification to an applicant, the Board may require the fingerprinting of every applicant for an original certificate.

Sec. 0018. Principal place of business

A. (1) Each State certified real estate appraiser shall advise the Board of the address of his or her principal place of business and all other addresses at which he or she is currently engaged in the business of preparing real property appraisal reports.

(2) Whenever a State certified real estate appraiser changes a place of business, he or she shall immediately give written notification of the change to the Board and apply for an amended certificate.

(3) Every State certified real estate appraiser shall notify the Board of his or her current residence address. Residence addresses on file with the Board are exempt from disclosure as public records.

Sec. 0019. Certificate

A. (1) A certificate issued under authority of this Act shall bear the signatures or facsimile signatures of the members of the Board and a certificate number assigned by the Board.

(2) Each State certified real estate appraiser shall place his or her certificate number adjacent to or immediately below the title "State Certified Residential Real Estate Appraiser" or "State Certified General Real Estate Appraiser" when used in an appraisal report or in a contract or other instrument used by the certificate holder in conducting real property appraisal activities.

Sec. 0020. Use of term

A. (1) The term "State certified real estate appraiser" may only be used to refer to individuals who hold the certificate and may not be used following or immediately in connection with the name or signature of a firm, partnership, corporation, or group; or in such manner that it might be interpreted as referring to a firm, partnership, corporation, group, or anyone other than an individual holder of the certificate.

(2) No certificate shall be issued under the provisions of this Act to a corporation, partnership, firm or group. This shall not be construed to prevent a State certified real estate appraiser from signing an appraisal report on behalf of a corporation, partnership, firm or group practice.

Sec. 0021. Continuing Education

A. As a prerequisite to renewal of certification, a State certified real estate appraiser shall present evidence satisfactory to the Board of having met the continuing education requirements of this Article.

B. The basic continuing education requirement for renewal of certification shall be the completion by the applicant, during the immediately preceding term of certification, of not less than 30 classroom hours of instruction in courses or seminars which have received the approval of the Board.

C. In lieu of meeting the requirements of subdivison (B) an applicant for re-certification may satisfy all or part of the requirements by presenting evidence of the following:

(1) Completion of an educational program of study determined by the Board to be equivalent, for continuing education purposes, to courses approved by the Board pursuant to subdivision (B); or

(2) Participation other than as a student in educational processes and programs approved by the Board which relate to real property appraisal theory, practices or techniques, including, but not necessarily limited to, teaching, program development and preparation of textbooks, monographs, articles, and other instructional materials.

D. The Board shall adopt regulations for implementation of the provisions of this article to the end of assuring that persons renewing their certifications as State certified real estate appraisers have current knowledge of real property appraisal theories, practices, and techniques which will provide a high degree of service and protection to those members of the public with whom they deal in a professional relationship under authority of the certification. The regulations shall prescribe the following:

(1) Policies and procedures for obtaining Board approval of courses of instruction pursuant to subdivision (B);

(2) Standards, policies, and procedures to be applied by the Board in evaluating applicant's claims of equivalency in accordance with subdivision (C);

(3) Standards, monitoring methods, and systems for recording attendance to be employed by course sponsors as a prerequisite to Board approval of courses for credit.

E. In adopting regulations pursuant to Subpart 1 of paragraph (D), the Board shall give favorable consideration to courses of instruction, seminars, and other real property appraisal educational courses or programs previously or hereafter developed by or under the auspices of professional appraisal organizations and utilized by those associations for purposes of designation, or indicating compliance with the continuing education requirements of such organizations.

F. No amendment or repeal of a regulation adopted by the Board pursuant to this section shall operate to deprive a State certified real estate appraiser of credit toward renewal of certification for any course of instruction completed by the applicant prior to the amendment or repeal of the regulation which would have qualified for continuing education credit under the regulation as it existed prior to the repeal or amendment.

G. On or after January 1, 19__, a certification as a State certified real estate appraiser that has been revoked as a result of disciplinary action by the Board shall not be reinstated unless the applicant presents evidence of completion of the continuing education required by this Act. This requirement of evidence of continuing education shall not be imposed upon an applicant for reinstatement who has been required to successfully complete the examination for State certified real estate appraiser as a condition to reinstatement of certification.

Sec. 0022. Disciplinary Proceedings

A. The rights of any holder under a certificate as a State certified real estate appraiser may be revoked or suspended, or the holder of the certificate may be otherwise disciplined in accordance with the provisions of this Act, upon any of the grounds set forth in this Section. The Board may investigate the actions of a State certified real estate appraiser, and may revoke or suspend the rights of a certificate holder or otherwise discipline a State certified real estate appraiser for any of the following acts or omissions:

(1) Procuring or attempting to procure a certificate pursuant to this Act by knowingly making a false statement, submitting false information, refusing to provide complete information in response to a question in an application for certification or through any form of fraud or misrepresentation;

(2) Failing to meet the minimum qualifications established by this Act;

(3) Paying money other than provided for by this Act to any member or employee of the Board to procure a certificate under this Act;

(4) A conviction, including a conviction based upon a plea of guilty or nolo contendre, of a crime which is substantially related to the qualifications, functions, and duties of a person developing real estate appraisals and communicating real estate appraisals to others;

(5) An act or omission involving dishonesty, fraud, or misrepresentation with the intent to substantially benefit the certificate holder or another person or with the intent to substantially injure another person;

(6) Violation of any of the standards for the development or communication of real estate appraisals as provided in this Act;

(7) Failure or refusal without good cause to exercise reasonable diligence in developing an appraisal, preparing an appraisal report or communicating an appraisal;

(8) Negligence or incompetence in developing an appraisal, in preparing an appraisal report, or in communicating an appraisal;

(9) Willfully disregarding or violating any of the provisions of this Act or the regulations of the Board for the administration and enforcement of the provisions of this Act;

(10) Accepting an appraisal assignment (as defined in Sec. 0026 of this Act) when the employment itself is contingent upon the appraiser reporting a predetermined estimate, analysis or opinion, or where the fee to be paid is contingent upon the opinion, conclusion, or valuation reached, or upon the consequences resulting from the appraisal assignment;

(11) Violating the confidential nature of governmental records to which he or she gained access through employment or engagement as an appraiser by a governmental agency; or

(12) Entry of a final civil judgment against the person on grounds of fraud, misrepresentation or deceit in the making of any appraisal of real property.

B. In a disciplinary proceeding based upon a civil judgment, the State certified real estate appraiser shall be afforded an opportunity to present matters in mitigation and extenuation, but may not collaterally attack the civil judgment.

Sec. 0023. Due process

A. Before suspending or revoking any certification, the subcommittee shall notify the appraiser in writing of any charges made at least twenty days prior to the date set for the hearing and shall afford him or her an opportunity to be heard in person or by counsel.

B. The written notice may be served either personally or sent by registered or certified mail to the last known business address of the appraiser.

C. The Board shall have the power to subpoena and issue subpoenas duces tecum and to bring before it any person in this state, and to take testimony by deposition, in the same manner as prescribed by law in judicial proceedings in the courts of this state.

Sec. 0024. Hearing and Judicial Review

A. The hearing on the charges shall be at a time and place prescribed by the Board and in accordance with the provisions of the Administrative Procedures Act of this state.

B. If the Board determines that a State certified appraiser is guilty of a violation of any of the provisions of this Act, it shall prepare a finding of fact and recommend that the appraiser be reprimanded or that his or her certification be suspended or revoked. The Decision and Order of the Board shall be final.

C. Any final Decision or Order of the Board shall be reviewable by a Court of appropriate jurisdiction as to questions of law only. Any application for review made by an aggrieved party shall be filed within thirty days after the final Decision or Order of the Board.

D. If an application for review of a final Decision or Order of the Board is filed, the case shall be fixed for trial within thirty days from the filing of an answer by the Board. If the court finds that the Board has regularly pursued its authority and has not acted arbitrarily, it shall affirm the Decision or Order.

Sec. 0025. Standards of practice

A. A State certified real estate appraiser must comply with the Uniform Standards of Professional Appraisal Practice promulgated by the Appraisal Standards Board of the Appraisal Foundation.

> Explanatory Note: If certification legislation is passed or will become effective before the above described Standards are issued, the Uniform Standards of Professional Appraisal Practice that have been approved by the eight major appraisal organizations should be substituted in the interim period.

Sec. 0026. Classification of Services

A. A client or employer may retain or employ a State certified real estate appraiser to act as a disinterested third party in rendering an unbiased estimate of value or analysis. A client or employer may also retain or employ a State certified real estate appraiser to provide specialized services to facilitate the client's or employer's objectives. In either case, the appraisal and the appraisal report must comply with the provisions of this Act.

B. For the purposes of this Act, the term "appraisal assignment" means an engagement for which an appraiser is employed or retained to act, or would be perceived by third parties or the public as acting, as a disinterested third party in rendering an unbiased analysis, opinion, or conclusion relating to the nature, quality, value, or utility of specified interests in, or aspects of, identified real estate.

C. For the purposes of this Act, the term "specialized services" means those appraisal services which do not fall within the definition of appraisal assignment. The term "specialized services" may include valuation work and analysis work. Regardless of the intention of the client or employer, if the appraiser would be perceived by third parties or the public as acting as a disinterested third party in rendering an unbiased analysis, opinion or conclusion, the work is classified as an appraisal assignment and not "specialized services".

> Explanatory Note: Examples of specialized services include specialized marketing, financing, and feasibility studies and may include estimates of value, analyses, opinions and conclusions given in connection with activities such as real estate brokerage, mortgage banking, real estate counseling, and real estate tax counseling.

Sec. 0027. Contingent fees

A. A State certified real estate appraiser may not accept a fee for an appraisal assignment (as defined in Sec. 0026 of this Act) that is contingent upon the appraiser reporting a predetermined estimate, analysis or opinion or is contingent upon

the opinion, conclusion or valuation reached, or upon the consequences resulting from the appraisal assignment.

B. A State certified real estate appraiser who enters into an agreement to perform specialized services (as defined in Sec. 0026 of this Act) may be paid a fixed fee or a fee that is contingent on the results achieved by the specialized services.

C. If a State certified real estate appraiser enters into an agreement to perform specialized services for a contingent fee, this fact shall be clearly stated in each written and oral report. In each written report, this fact shall be clearly stated in a prominent location in such report and also in each letter of transmittal and in the certification statement made by the appraiser in such report.

Sec. 0028. Retention of records

A. A State certified real estate appraiser shall retain for three years, originals or true copies of all written contracts engaging his or her services for real property appraisal work, and all reports and supporting data assembled and formulated by the appraiser in preparing the reports.

B. This three year period for retention of records is applicable to each engagement of the services of the appraiser and shall commence upon the date of the submittal of the appraisal to the client unless, within such three year period, the appraiser is notified that the appraisal or report is involved in litigation, in which event the three year period for the retention of records shall commence upon the date of the final disposition of such litigation.

C. All records required to be maintained under the provisions of this Act shall be made available by the State certified real estate appraiser for inspection and copying by the Board on reasonable notice to the appraiser.

Sec. 0029. Partial invalidity

A. If any provision of this Act or its application to any person or in any circumstance is declared by a court of competent jurisdicition to be invalid or unenforceable, provisions constituting the remainder of the Act and the application of those provisions to other persons and in other circumstances shall not be affected.

APPRAISAL PROCUREMENT SEMINAR

James A. Graaskamp

I. The traditional approaches as a simple , idealistic logic and economic rationale are based on the principle of substitution--specifically that buyers and sellers have alternatives of nearly equal acceptability, or sentiment, not to mention access to cash capital and freedom from irritation and duress.

A. MARKET COMPARISON methods are preferred, but the appraisal profession has found it difficult to develop objective methods for neutralizing differences and selecting properties objectively. Moreover, prices on investment properties are engineered to accomplish accounting objectives of the parties.

B. The INCOME APPROACH is schizophrenic as to whether it is measuring economic productivity, the sum of liability, or the change in spendable cash for ownership through control of property rights.

C. The COST APPROACH has moved from unethical according to the National Association of Realtors (NAR) in 1925, to pivotal in 1935, to embarrassing in 1985 since no one is sure if fiduciary responsibility requires a cost approach to avoid a sin of omission in the event of unforeseen disputes about value.

II. However, none of these methodologies as logic systems structure the behavioral process required of the appraiser and his client. The client assumes that the task is defined when you ask for an appraisal and the appraiser assumes the client understands the rationale and appropriate application of fair market value or probable price. Both are more concerned with form than the substance of careful recognition of the problem for which the appraisal will serve as a benchmark.

A. Objective appraisal

1. Validate purchase price as appropriate.
2. Identify change in price over time, if any.
3. Independent inspection of property and review of property management effectiveness.
4. Liquidating value of asset currently.
5. Future value of present assets.
6. Historical return on investment or future return on investment, real or nominal.

B. Definition of value to be sought

1. Alternative definitions of value and related assumptions.
2. Which definition of value is to be applied to which problem.
3. Market value vs. probable price.

C. Definition of assets to be valued

1. Property rights to be appraised
2. Accounting rules to defining assets, collectively (going concern) or individually (liquidating).

D. Definition of methods to be used

1. What constitutes comparative market data?
2. What constitutes objective market comparisons?
3. What constitutes an income approach to value?
4. Relevance of the cost approach to appraisal and appraisal adjustments?
5. Which appraisal methods are appropriate to which appraisal functions?

E. Definition of elements income approach

1. Cash or accrual accounting.
2. Going concern value or value attributed to land and buildings.
3. Accounting rules for income.
4. Forecasting rules for changing income and expenses.
5. Estimating rules for changing income and expenses.
6. Provision for resale cost.
7. Conformity with historical pattern and leases in place for project.

F. Definition of appraiser/client relationship

1. Who is considered an independent participant for preparation of financial data, asset management plans, and engineering disclosure?
2. Frequency of appraisal and volume of business as source of bias.
3. Who is the arbiter of methods for integrating information into cohesive standardized formats suitable for measuring comparative performance?

III. Ironically, quality control of the appraisal process is in the hands of the customers for appraisal services, specifically those who stand to lose by permitting current conditions to continue. Historically, reform of the appraisal process has always been in the control of the customer who invests or guarantees real estate capital.

A. Historical origins of the three approaches

1. The cost approach and the life insurance industry.
2. The income approach, academia, and the FHA.
3. The market approach and the National Association of Realtors.

B. Standardized reporting requirements of the American Institute of Real Estate Appraisers begin with Canon 5 of their Code of Ethics.

1. The Institute has never issued white papers on specific appraisal problems to standardize professional response to changing issues of common interest.

2. Recently the Institute has tried to issue white papers as guidelines.

C. More recent efforts at quality control include:

1. The Home Loan Bank redirecting appraisal attention to R-41-b.

2. FNMA and FHLBMC and requirements for appraising multi-family development.

3. Residential form appraisal for FNMA, VA, FHA, and FHLBMC.

D. The Royal Institute of Chartered Surveyors and the European Common Market Accountants have been developing a standardized language and procedure for the valuation of and reporting balance sheet assets.

E. Development of consistent appraisal performance standards for pension programs requires a six-step process:

1. Development of written policy statement by pension fund trustees relative to reporting of real estate asset values by money managers responsible for real estate.

2. A written appraisal standard followed by a specific real estate fund manager's report covering both minimum standards shared with an association of managers and unique features believed to provide better communication to fund trustees of important underlying facts and assumptions inherent in the appraisals.

3. A standard letter of engagement when contracting for appraisal services implementing the written policies of sponsor and money manager.

4. A standard procedure for in-house appraisal reviews in the interim between independent outside appraisal reviews, including tolerance for variance before reporting changed values.

5. Auditing and monitoring of appraisal reports by specially trained, CPA reviewers as part of the accounting audit process.

6. Spot checking of appraisal procedures and a review process for disapproval of appraisal firms found to be likely of misinformation or misapplication of technique by ERISA.

F. An early effort at appraisal control was a Letter of Engagement used at First Asset Realty Advisors (FARA) together with knowledgeable efforts to select the best local assessors.

1. The best appraisers are difficult to pick by reputation as the big names delegate their work to apprentices.

2. Some appraisers admit to being intimidated and avoiding the assignment or charging extra for the assignment, anticipating that FARA will be more demanding.

3. On balance, we are getting better appraisals than most of the funds we have seen in our research but at a higher average cost.

G. The FARA letter was followed by an effort by the National Council of Real Estate Investment Fiduciaries (NCREIF) to develop guidelines.

IV. Appraisal procurement must address three major areas of concern:

A. Policy directs from board of directors resolution controlling

1. decisions for which appraisal data will be a bench mark,

2. selection of appraisers to eliminate business bias, and

3. priority of appraised value by independents relative to inside appraisal procedures.

B. Protocol for providing professional information to the appraiser and production of data sources within appraisal.

1. Accounting for revenues and expenses.

2. Role of property management program.

3. Details for future appraisal budgets.

4. Disclosure of negative data on tenant, toxic materials, life safety systems, or engineering issues.

C. Control of content and quality of appraisal reports through purchasing policies.

EXHIBIT 1

DEFINITION OF MARKET VALUE
AND
MOST PROBABLE PRICE

CURRENT OFFICIAL DEFINITION OF MARKET VALUE

The most probable price in cash, terms equivalent to cash, or in other precisely revealed terms, for which the appraised property will sell in a competitive market under all conditions requisite to fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress.

Fundamental assumptions and conditions presumed in this definition are:

1. Buyer and seller are motivated by self-interest.

2. Buyer and seller are well informed and are acting prudently.

3. The property is exposed for a reasonable time on the open market.

4. Payment is made in cash, its equivalent, or in specified financing terms.

5. Specified financing, if any, may be the financing actually in place or on terms generally available for the property type in its locale on the effective appraisal date.

6. The effect, if any, on the amount of market value of atypical financing, services, or fees shall be clearly and precisely revealed in the appraisal report.

(1) American Institute of Real Estate Appraisers, The Appraisal of Real Estate, Eighth Edition, Chicago, IL, 1983, p. 33.

CONTEMPORARY DEFINITION OF MOST PROBABLE PRICE

"Most Probable Selling Price", as defined by Professor Richard U. Ratcliff:

> The most probable selling price is that selling price which is most likely to emerge from a transaction involving the subject property if it were exposed for sale in the current market for a reasonable time at terms of sale which are currently predominant for properties of the subject type. [1]

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[1] Unpublished quotation, Richard U. Ratcliff speaking on his book Valuation for Real Estate Decisions, Santa Cruz, CA, Democratic Press, 1972.

EXHIBIT 2

REPORTING REQUIREMENTS OF THE
AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS

4

Reporting Requirements of the American Institute of Real Estate Appraisers

Canon 5 of AIREA Regulation 10 (Code of Professional Ethics and Standards of Professional Conduct) establishes the minimum requirements for both written and oral appraisal reports prepared by members and candidates of the Institute. The explanatory comments for Canon 5 state:

> The Institute requires its Members, in arriving at an analysis, conclusion or opinion concerning real estate, to employ all of the recognized appraisal methods and techniques that will materially contribute to a proper evaluation of such real estate or to a solution of the real estate problem under consideration. As a corollary to this rule, the Institute also requires that the appraisal process contain a clear statement of all of the assumptions made, together with a reasonably complete summary of the work done in arriving at each analysis, conclusion or opinion concerning real estate contained in the report. . . . A Member of the Institute must preserve his or her supporting data relating to a written appraisal report.

There are a number of specific reporting rules; some are obligatory and others are recommendations that should be followed unless there are substantial reasons, disclosed in the report, for not doing so.

PROPERTY DESCRIPTION

A clear and reasonably complete description of the property may include the street address, legal description, ownership, building name, and any other information that will assist in identifying the property. The identification may be part of the larger property description section of the report or a separate one- or two-sentence capsule included in the introduction to the report.

Property Identification

A complete address may suffice for a conforming residential property. For other properties an address should be included if one is available; if there have been recent changes in the street names or numbering schemes, both the present and prior addresses should be included. If the property is a vacant lot, the property address might be "the lot lying between or adjacent to" a property with an assigned street address. If only a part of the

address is the subject of the report, or if the report covers a project identified by the address plus adjacent excess land, the address portion of the property identification should make this clear. For example:

1250 Sleepy Hollow Lane
Centerland, California 92660

1250 Sleepy Hollow Lane
(previously known as 940 Tallow Street)
Centerland, California 92660

The 50′ by 120′ lot situated between
1050 and 1056 Main Street
Centerland, California 92660

456 Main Street
Centerland, California 92660
except for the rear 75 feet of
that address facing on the alley

320 Main Street
Centerland, California 92660
plus the rear 75 feet of
318 Main Street

Legal Description

A legal description of the property, if available, should be included. A reasonably short description can be included in the body of the report; a lengthy legal description may be placed in the addenda. If the description is at all complex, it is advisable to provide the source of the description—e.g., deed, title policy, assessor's records, or record of survey. If a legal description is not available, the report should say so and a clear map identifying the property should be included in the report. For example:

Lot 23 of Tract 4630 per map recorded in Page 23 of Book 4215 on July 15, 1957, in the Official Records of Simon County.

Exhibit B in the Addenda of this report contains a metes and bounds legal description as it appeared on the Grant Deed transferring ownership of the subject property to the Cowly Corporation on July 15, 1978.

As of the date of this appraisal, a legal description conforming to the portion of the Smith Ranch that is the subject of this appraisal had not been prepared. The subject property is outlined in red on the map labeled "Plat of Land" on page 23 of this report. It is assumed that a legal description that is adequate for the transfer of real property and that conforms to the property delineated on this map will be prepared.

Ownership data assist in the clear identification of property. For example:

The subject property consists of that 42.5 acres of vacant unimproved land which was acquired by Mr. Frank L. Smith on December 30, 1979, by Grant Deed recorded in Page 1521, Book 43762 of Deeds, in the Collins County Courthouse.

Even if there is a six-page detailed description of the property elsewhere in the report, the property identification and description portion is enhanced by a concise description of the property, such as:

The subject property is a six-year-old, three-story office building containing 24,320 square feet of gross building area. It is located on a 52,320-square foot parcel of land with 126 feet of frontage on Main Street.

STATEMENT OF FACTS, CONDITIONS, AND ASSUMPTIONS

It is good business practice for the appraiser and the client to agree in advance on the assumptions and limiting conditions that will apply to the report. Many appraisers include a copy of assumptions and limiting conditions with the appraisal proposal or contract. This portion of the report sets forth not only general assumptions and conditions that would apply to every report, but also any specific assumptions that apply to the particular appraisal.

Some assumptions and limiting conditions make a report a limited appraisal report; in such cases, there are additional requirements, which will be discussed and illustrated later in this chapter.

STATEMENTS RELATIVE TO NEIGHBORHOOD DECLINE

All written appraisal reports concerning residential real estate that state that a neighborhood is undergoing decline or is about to undergo decline must contain the specific facts or reasoning from which the opinion or conclusion of neighborhood decline is drawn.

DATE OF VALUE

The date of value is usually included in the letter of transmittal, in the introductory section of the report, and in the concluding valuation statement. This date is not to be confused with the date the transmittal letter was prepared, the date the assignment was started, or the date of inspection. Any or all of these dates may be the same as the date of value, but they usually are not. The only mandatory date is the date of value, but good business practice dictates that other significant dates also be identified, e.g., the transmittal date (the date the completed report is transmitted to the client), the date of inspection, the date of verification, and the date of photographs.

REASONING THAT SUPPORTS THE VALUATION

Unless the appraisal report is a limited report—one that does not show all of the appraiser's reasoning—and has been properly qualified as such, the reader must be able to follow the appraiser's thought processes from the data presented to the conclusions formed. A "limited report" must comply with the special requirements of a limited report (see pp. 27-28).

SPECIAL DISCLOSURES

Fractional Interests

All appraisal reports that involve a valuation of a fractional interest, i.e., less than the whole fee simple estate, must clearly state that the value reported relates only to a fractional interest in the real estate involved, and that the value of this fractional interest plus

the value of all other fractional interests may or may not equal the value of the entire fee simple estate. Typically, this is included in the statement of assumptions and limiting conditions. A common example is a report of a leasehold interest appraisal. The qualifying statement is required to demonstrate to the reader that the sum of the lessor's and lessee's interests is not necessarily equal to the fee simple estate.

Larger Parcel

All appraisal reports relating to the valuation of a geographic portion of a larger parcel or tract of real estate must clearly state that the value reported is for that portion only and should not be construed as applying with equal validity to other portions of the larger parcel or tract. In addition, it must be clear that the value reported for the portion plus the value of all other geographic portions may or may not equal the value of the entire parcel or tract. This statement typically appears in the assumptions and limiting conditions section of the report.

Personal Interest or Bias

All written appraisal reports must state that the appraiser has no present or contemplated future interest in the property appraised, and that the appraiser has no personal interest or bias with respect to the subject matter or the parties involved in the appraisal. If a statement of this nature cannot be made, the report must clearly and frankly disclose all such personal interest or bias.

PROFESSIONAL CONTRIBUTION OF OTHERS

Written appraisal reports are to acknowledge the professional contributions of others in arriving at the analyses, conclusions, or opinions concerning real estate contained in the appraisal report or state that no one other than the person or persons signing the report prepared the analyses, conclusions, and opinions therein.

If several professional appraisers work on a report, and all agree to and sign it, they include a statement similar to the following in their certificate:

> No one other than the appraisers whose signatures appear below has prepared the analyses, conclusions, and opinions concerning real estate which are included in this report.

If the appraisers were assisted by a cost estimator who worked only on the cost portion of the report, they may use something similar to the following:

> The assistance of John A. Doe, who prepared the cost estimate used in this report, is acknowledged. Except for Mr. Doe's assistance, no one other than the appraisers whose signatures appear below prepared the analyses, conclusions, and opinions concerning real estate which are included in this report.

If another appraiser, who asks not to be identified because of personal or policy considerations, was consulted and contributed substantially to the report, the statement might be:

> The assistance and counsel of another appraiser not employed by this firm and who

> requests that he not be identified is hereby acknowledged. Except for this appraiser's assistance, no one other than the undersigned prepared these analyses, conclusions, and opinions concerning real estate contained in this report.

Canon 5 does not require a member of the Institute to acknowledge assistance received in obtaining the data on which the appraisal report is based, assistance received in the physical preparation of the report (e.g., taking photographs; preparing charts, maps, or graphs; or typing or printing), or any other assistance that does not directly involve the exercise of judgment in arriving at the analyses, opinions, or conclusions concerning real estate.

The rule requiring acknowledgment of the professional contributions of others does not reduce the responsibility of those who sign a written appraisal report; in evaluating such reports, clients, mortgage lenders, and other users are entitled to rely on the signatures of all who sign. Therefore, although others may participate in the preparation of a written appraisal report, any member of the Institute who signs or cosigns a report must accept responsibility for the contents of the entire report.

PUBLIC DISCLOSURE

The recommended public disclosure statement of the Institute's Code of Ethics (Canon 7, Regulation 10) is:

> Disclosure of the contents of this report is governed by the Bylaws and Regulations of the American Institute of Real Estate Appraisers of the National Association of Realtors. Neither all nor any part of the contents of this report (especially any conclusions as to value, the identity of the appraiser or any reference to the American Institute of Real Estate Appraisers or to the MAI or RM designation) shall be disseminated to the public through advertising media, public relations media, news media, sales media or any other public means of communication, without the prior written consent and approval of the author.

This statement is meant to preclude the potential misuse of the Institute's name and professional designations that can arise when a member's client elects to publicize the results of an appraisal report. Excessive or exploitative use of designations, sometimes out of appropriate context, does not serve the interests of the Institute, which its members should seek to protect. A client may be inclined to excerpt or quote portions of the report in promotional literature, and such practices are a potential source of great damage.

The language of a report can be misquoted, used out of context, or printed without reference to the assumptions or limiting conditions contained in the report, and may thus give a false impression of the report, the appraiser, or the profession. Although the specific use of a report is generally a matter of negotiation between the appraiser and the client, the Institute encourages its members to be aware of potential abuses and, whenever possible, to include appropriate contractual restrictions on a client's freedom to reproduce or republish an appraisal report.

CERTIFICATE

According to the Institute's Code of Ethics, all written reports must contain a certificate substantially in the following form:

> I (we), the undersigned, do hereby certify that I (we) have (or have not) inspected the subject property and that to the best of my (our) knowledge and belief, the statements

of fact contained in this report, upon which the analyses, opinions, and conclusions expressed herein are based, are true and correct; also, this report sets forth all of the limiting conditions affecting the analyses, opinions, and conclusions contained in this report; also, this report has been made in conformity with and is subject to the requirements of the Code of Professional Ethics and Standards of Professional Conduct of the American Institute of Real Estate Appraisers of the National Association of Realtors.

The American Institute of Real Estate Appraisers conducts a voluntary program of continuing education for its designated members. MAIs and RMs who meet the minimum standards of this program are awarded periodic educational certification.

One of the following statements also must be included:

I am certified under this program through_____.
I was last certified under this program through_____.
I have not been certified under this program.

LIMITED APPRAISAL AND REPORT

A distinction is made between a limited appraisal, as defined by Canon 4 of Institute Regulation 10, and a limited report, as defined by Canon 5 of Regulation 10. In Canon 4 limitations on the scope of the appraisal process are treated; in Canon 5 limitations on the completeness of the report are addressed.

A limited appraisal could consist of an investigation and analysis that do not meet the requirements of established procedures of the Institute. For example, when a limited time schedule is required by the client, portions of the investigation and analysis may be curtailed or omitted. One of the approaches to value that would normally be included may be omitted, or certain reasonable assumptions may be made relative to highest and best use without the full investigation normally undertaken. However, before an appraiser can accept and perform such an assignment, three important requirements must be met.

1. Prior to accepting a limited assignment, the member must advise the client that the assignment calls for something less than the work required for a full and complete appraisal and that the appraisal report will be qualified to reflect the limited scope of the assignment.
2. The limited scope of the assignment must be sent forth in the appraisal report (and in any testimony concerning the appraisal) in a clear, precise manner.
3. The scope of the assignment must not be so limited that the results obtained are meaningless or could mislead the client or the public.

These requirements deal with a limitation on the scope of the appraisal process; Canon 5 deals with a limitation on the completeness of the report. It is quite possible that a complete investigation and analysis were undertaken but, by prior agreement, only the conclusions are set forth and the data and reasoning are retained in the appraiser's file. The result is what is typically referred to as a letter report (see Chapter 5).

Although part or all of the data and reasoning can be omitted, the following must be included: the certificate of appraisal, an adequate identification of the property, a date of value, the required limiting conditions referred to in the certificate of appraisal statement, acknowledgment of the contributions of others, and the statement of nonbias. To omit any of these items would make the report meaningless or misleading.

A limited report must meet the same three conditions listed above for a limited appraisal. There are also requirements for preparing an expanded appraisal report, which contains more than is required by Institute standards. In these cases, the same three rules apply.

The first condition of prior client advice is best met by an agreement in writing. This can be part of the proposal letter or can be contained in a specific instruction from the client or the attorney of the client.

THE EVALUATION REPORT

The preface to the Institute's Regulation 10 clearly states that it applies to both valuation and evaluation reports. The word *valuation* is used to refer to the estimate of the value of a particular parcel of real estate at a particular point in time. The word *evaluation* is used in the broader sense as an evaluation of the nature, quality, or utility of any parcel of real estate. Examples of evaluation reports include marketability studies, feasibility reports, land-use studies, investment decision analyses, and cost-benefit studies.

When the reporting rules of Canon 5 apply to valuation assignments only, the qualifying phrase "a valuation of a particular parcel or tract of real estate" is used. In all other instances, the reporting rules apply equally to evaluation and valuation reports as do the general considerations of good communication.

7

The Narrative Report

In a narrative appraisal report, the appraiser is afforded the best opportunity to present data and reasoning that support the conclusions reached. As stressed earlier, good organization is essential.

LETTER OF TRANSMITTAL

Transmittal letters introduce the report and present it to the client. A good transmittal letter should be concise and in compliance with accepted standards of business correspondence. It is useful to begin the letter with a reference to the terms and circumstances of the authorization of the assignment. Important points that may be included in a transmittal letter are:

1. Date of the letter (not necessarily or usually the same as the date of value).
2. Client name and address; if it is a corporate client, a reference to the individual who will receive the report should be included. Include the person's title.
3. A reference that will identify the property by name or street address and possibly a file or purchase order reference.
4. Appropriate salutation.
5. Reference to the authorization that initiated the assignment.
6. Reference to the inspection, investigation, and analyses undertaken by the appraiser for the purpose of forming an opinion of value.
7. A concise statement of the value conclusion and the date of value.
8. An indication that the value conclusion is subject to certain assumptions and limiting conditions set forth in the body of the accompanying report.
9. A clear reference that the letter itself is not the appraisal but that it merely serves to transmit the appraisal report that follows.
10. The signatures of all appraisers who bear responsibility for the analyses and conclusions within the report.

Some appraisers choose to incorporate the certificate of value within the transmittal letter; others choose to include it within the body of the report. A typical transmittal letter is presented in Example 7.1.

EXAMPLE 7.1. Transmittal Letter

(Appraiser's Letterhead)

May 13, 1981

Our File No. 758.3
Your Reference No. 8046-C-52

Universal Investment Company
123 Main Street
Middletown, CA 99990

Attn: Mr. William D. Jones, President

Re: Appraisal Report
Office Building at 300 Broad Street
Middletown, California

Gentlemen:

In response to your authorization letter of March 1, 1981, we have conducted the required investigation, gathered the necessary data, and made certain analyses that have enabled us to form an opinion of the market value of the fee simple interest in the above-captioned subject property.

Based on the inspection of the property and the investigation and analyses undertaken, we have formed the opinion that, as of April 8, 1981, and subject to the assumptions and limiting conditions set forth on page 8 of this report, the subject has a market value of:

FOUR MILLION SEVEN HUNDRED FIFTY THOUSAND DOLLARS
$4,750,000

The narrative appraisal report that follows sets forth the identification of the property, the assumptions and limiting conditions, pertinent facts about the area and the subject property, comparable data, the results of the investigations and analyses, and the reasoning leading to the conclusions set forth.

Respectfully submitted,

Jane A. Adams
John B. Roe, MAI

INTRODUCTION TO REPORT

The opening section of the report sets forth the purposes and objectives of the appraisal, an identification of the property and the property rights appraised, and a definition and explanation of important concepts fundamental to the report. Many appraisers list the assumptions and limiting conditions of the report in this section.

Purpose of Report or Objective of Appraisal

The purpose of the report is to communicate the data and reasoning leading to a conclusion. The purpose of the appraisal, or objective of the assignment, is usually to arrive at a supportable opinion. In a simple assignment, the appraiser may express both ideas in a brief paragraph such as:

> The objective of this appraisal is to estimate the market value of the City National Bank Building as of April 5, 1981. The purpose of this report is to present the data and reasoning that the appraiser has used to form the opinion of value.

Other, more complex appraisal assignments require a more detailed statement of the appraisal problem as illustrated in Example 7.2.

Property Rights Valued

If the assignment concerns the appraisal of a fee simple estate interest, it may be sufficient to describe the property rights in the statement of purpose. A separate statement may be required for more complex fractional interests.

Identification of Property

The property should be clearly and unambiguously identified by as many different means as possible, including:

1. Legal description (if lengthy, it may be put in the addenda and referred to within the identification section of the report).
2. Street address, including any qualifiers if the parcel is more or less than that encompassed by the street number.
3. Assessor's parcel number if numbers tend to remain the same from year to year in the jurisdiction involved.
4. Reference to the nearest intersection (e.g., "the parcel with 100 feet of frontage on the north side of Main Street, located 360 feet west of the centerline of the intersection of Main Street and Baldwin Avenue").
5. Reference to any common name for the property, such as the "City National Bank Building."
6. Identification by property type, such as "the three-story, wood-frame office building at the southwest corner of Pierce and Franholm Avenues."
7. Reference to ownership and transfer such as "the 20-acre portion of the southwest quarter of Section 15, Range 10 N. Township 5 S, transferred to Frank Smith by deed recorded November 10, 1980, in Book 3516, Page 431 of Official Records."

EXAMPLE 7.2. Statement of Objective

The objective of this appraisal assignment is to undertake the investigations and analyses required to reach four supportable estimates for each of the following premises:

Premise A

Assuming the lawsuit to overturn the county's approval of Environmental Impact Report No. 568 is unsuccessful and the joint venture is permitted to proceed with development of the Moonrise Bay Hotel and commercial project described herein,

A-1. Estimate the market value of the site "as is."
A-2. Estimate the market value of the project, assuming completion in accord with the plans and specifications identified and described herein.
A-3. Estimate the market value of the project, assuming completion in accord with the plans and specifications identified and described herein and also assuming completion of the leasing of the commercial space at market rent levels.
A-4. Estimate the amount of time after completion of construction for the commercial space to be leased.
A-5. Estimate the occupancy level and average daily rate for the hotel during its first full year of operation and estimate the time after completion for the hotel to achieve stabilized occupancy.

Premise B

Assuming the decision of the court is to sustain the Environment Alliances lawsuit to overturn Environmental Impact Report No. 568 on the basis of the arguments in their petition,

B-1. Estimate the highest and best use of the subject site as is.
B-2. Estimate the market value of the subject site as is.
B-3. Estimate the highest and best use of the subject site as if joined with the adjacent 12.5-acre Coffin parcel described herein.
B-4. Estimate the market value of the subject site and the adjacent 12.5-acre Coffin site as if they were joined.

Ownership and Recent History

It is good practice to list current ownership and the date, price, and terms of acquisition. If there have been several transfers in recent years, it is also helpful to mention these. If the appraisal is of a parcel seriously encumbered by other rights created by easements or deed reservations, these must be clearly explained. Some corporations, lenders, and public agencies require a five- or ten-year property history as a part of their appraisal requirements. Salient facts can be enumerated as follows:

> This appraisal is of the leasehold estate created by the ground lease executed December 31, 1947, between the Crafton Estate Company, as lessor, and the Loomis Company, as lessee. Through successive assignments of the leasehold interest, the leasehold estate is now vested in the name of Donbrow Realty Company, a California corporation. The lease and assignments of lease are reproduced as Exhibit D in the Addenda of this report. A synopsis and analyses of the lease begins on page 53 of this report.

Definitions of Significant Terms

Appraisal terms and legal concepts should be defined early in the report. In almost every instance, there should be a definition of *market value,* perhaps with a discussion of significant elements of the definition.

The appraiser should use the definition of market value appropriate to the particular assignment. In condemnation work, market value may be defined by statute or legal precedent in the jurisdiction involved. Assignments for lending institutions may require a definition imposed by one or more regulatory agencies. The appraiser may prefer to use the definition of market value in *Real Estate Appraisal Terminology.* Example 7.3 shows one way of presenting a definition of market value.

Other terms that may require definition include *highest and best use, market rent, market feasibility,* and, in condemnation work, *special benefits, severance damages, the part taken,* and *the larger parcel.* The authority or source of any definitions should be cited. Some appraisers incorporate the definitions in the "Assumptions and Limiting Conditions."

Assumptions and Limiting Conditions

Canon 5 of the Code of Professional Ethics and Standards of Professional Conduct of the American Institute of Real Estate Appraisers requires the appraiser to "clearly and unequivocally set forth all facts, assumptions and conditions upon which the appraisal is based." A variety of assumptions and limiting conditions might apply, depending on the appraisal. A list of those the appraiser may require appears in Example 7.4. Alternate wordings as used by different appraisers are given.

This section of the report may be called "Contingent and Limiting Conditions" or "Premises, Assumptions, and Limiting Conditions." Some appraisers prefer to place the entire section at the end of the report near the certificate of value. Others prefer to put specific conditions in the introductory section and general assumptions and limiting conditions at the end of the report. By placing all assumptions and limiting conditions early in the report, the reader is alerted to the premises underlying the data analysis and reasoning of the appraisal.

EXAMPLE 7.3. Market Value Definition and Implications

Market value is defined in *Real Estate Appraisal Terminology*[1] as:

"The most probable price in terms of money which a property should bring in competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably, and assuming the price is not affected by undue stimulus.

"Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

"1. buyer and seller are typically motivated.

"2. both parties are well informed or well advised, and each acting in what they consider their own best interest.

"3. a reasonable time is allowed for exposure in the open market.

"4. payment is made in cash or its equivalent.

"5. financing, if any, is on terms generally available in the community at the specified date and typical for the property type in its locale.

"6. the price represents a normal consideration for the property sold unaffected by special financing amounts and/or terms, services, fees, costs, or credits incurred in the transaction."

An understanding of the most likely segment of the investment submarket capable of bidding on the property is essential. Appraisers study and adopt the motivations of the potential buyer group which will exert the greatest pressure on the price structure.

1. American Institute of Real Estate Appraisers and Society of Real Estate Appraisers, *Real Estate Appraisal Terminology*, revised edition, ed. Byrl N. Boyce (Cambridge, Mass.: Ballinger Publishing Company, 1981), pp. 160-161.

EXAMPLE 7.4. Assumptions and Limiting Conditions

GENERAL CONDITIONS

1. That the term *fair market value*, as herein used, is defined as "the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available" (Cal. Code of Civ. Proc., Title 7, Sec. 1263.320).
2. That the date of value to which the opinions expressed in this report apply is set forth in the letter of transmittal. The appraiser assumes no responsibility for economic or physical factors occurring at some later date which may affect the opinions herein stated.
3. That no opinion is intended to be expressed for legal matters or that would require specialized investigation or knowledge beyond that ordinarily employed by real estate appraisers, although such matters may be discussed in the report.
4. That no opinion as to title is rendered. Data on ownership and the legal description were obtained from sources generally considered reliable. Title is assumed to be marketable and free and clear of all liens and encumbrances, easements, and restrictions except those specifically discussed in the report. The property is appraised assuming it to be under responsible ownership and competent management and available for its highest and best use.
5. That no engineering survey has been made by the appraiser. Except as specifically stated, data relative to size and area were taken from sources considered reliable, and no encroachment of real property improvements is assumed to exist.
6. That maps, plats, and exhibits included herein are for illustration only, as an aid in visualizing matters discussed within the report. They should not be considered as surveys or relied upon for any other purpose.
7. That no opinion is expressed as to the value of subsurface oil, gas, or mineral rights and that the property is not subject to surface entry for the exploration or removal of such materials except as is expressly stated.

FOR COURT OR HEARING TESTIMONY

8. That testimony or attendance in court or at any other hearing is not required by reason of rendering this appraisal unless such arrangements are made a reasonable time in advance.
9. That, because the date of value used herein is the date of trial, the appraiser reserves the right to consider and evaluate additional data that become available between the date of this report and the date of trial and to make any adjustments to the value opinions that may be required.

FOR DISCLOSURE OF PROFESSIONAL ASSISTANCE

10. That, although the valuation contained in this report is the work product of the appraiser, specialized professional studies relating to the engineering cost estimate prepared by Frank L. Doe, Registered Land Engineer, have been relied on in formulating conclusions.

FOR DISCLOSURE OF PERSONAL INTEREST

11. That the appraiser acknowledges personal interest, limited to ownership of ten shares of stock in the American Telephone and Telegraph Company, in the subject of this appraisal, but concludes that such interest will not affect his professional judgment, and that he has made full disclosure of such interest to the client.

continued

FOR TITLE REPORT NONAVAILABILITY

12. That, because no title report was made available to the appraiser, she assumes no responsibility for such items of record not disclosed by her normal investigation.

FOR QUESTIONABLE SOIL OR GEOLOGIC CONDITIONS

13. That no detailed soil studies covering the subject property were available to the appraiser. Therefore, premises as to soil qualities employed in this report are not conclusive but have been considered consistent with information available to the appraiser.

14. That, since earthquakes are common in the area, no responsibility is assumed due to their possible effect on individual properties unless detailed geologic reports are made available.

FOR A LIMITED APPRAISAL

15. That, at the request of the client, the scope of this appraisal report has been limited to include the valuation of only the land and/or improvements that the appraiser considers to have been affected by the proposed taking and construction.

16. That, at the request of the client, the valuation herein reported relates to only a fractional interest in the real estate involved, and that the value of all other fractional interests may or may not equal the value of the entire fee simple estate considered as a whole. The fractional interest appraised relates to only the leasehold estate.

FOR IMPROVED PROPERTY

17. That the appraiser has personally inspected the subject property and finds no obvious evidence of structural deficiencies except as stated in this report; however, no responsibility for hidden defects or conformity to specific governmental requirements, such as fire, building and safety, earthquake, or occupancy codes, can be assumed without provision of specific professional or governmental inspections.

18. That, although no termite inspection report was available, the appraiser personally inspected the subject property and found no significant evidence of termite damage or infestation.

19. That no consideration has been given in this appraisal to personal property located on the premises, or to the cost of moving or relocating such personal property; only the real property has been considered.

20. That consideration has been given in this appraisal to certain items of equipment located on the property and itemized herein, which, in the opinion of legal counsel, are to be considered in the property valuation.

21. That rental areas herein discussed have been calculated in accord with standards developed by the American Standards Association as included in *Real Estate Appraisal Terminology*.

22. That income and expense data herein relied upon were provided by Realty Management Corporation but do not represent an audited return.

FOR PROPOSED CONSTRUCTION

23. That the plans and specifications furnished by the client and prepared by Franklin Jones, AIA, March 10, 1979, upon which this valuation is predicated, are assumed to show the intent of the builder, but the appraiser assumes no responsibility for their correctness or for undisclosed modifications. A copy of the plans and specifications is in the appraisal files.

continued

FOR AGRICULTURAL PROPERTY

24. That no consideration has been given in the appraisal to the value, if any, attributable to growing crops on any portion of the property appraised.
25. That the present owner will be allowed to harvest the current crop.

FOR PARTIAL TAKING

26. That this project will be constructed in the manner proposed as described briefly in this report and in detail in the condemnor's construction plans.
27. That during the proposed construction, existing access and utilities will remain usable by properties presently dependent upon them, or these will be rerouted without disruption in service during the proposed construction, after which they will be replaced to provide usage equal to or better than previously existed.

FOR PIPELINE CONSTRUCTION UNDER AN EASEMENT

28. That the top of the proposed pipeline will have sufficient cover to permit any legal use not specifically prohibited by the wording of the acquisition easement deeds. Copies of these deeds are included in this report.
29. That topsoil replaced after construction will be equal to or better than displaced topsoil.
30. That the excess subsoil will be removed from each parcel where it would adversely affect the parcel after construction.
31. That the construction area of all parcels will be cleared of debris after construction.
32. That the trench area of parcels not under agricultural use will be mounded to accommodate expected settlement after construction.
33. That no consideration is given to potential damage that may or may not arise from ultimate subsidence in the trench area.
34. That construction will be confined to the right-of-way as described in this report.
35. That the condemnor will pay for restoration of all items of permitted use that may be damaged by his entry to and/or over the easement area, regardless of when such items were installed unless such damage occurs from an entry necessary for the removal of items prohibited by the easement language.
36. That where the proposed pipeline crosses watercourses and/or storm water drainage ways, it shall be constructed at a sufficient depth and with sufficient erosion control so as not to interfere with natural water flow or to divert such water flow over adjacent lands.

FOR POSSIBLE UNLAWFUL CONDUCT

37. That the appraiser has become aware, through the media, that certain aspects of the subject property operations are being investigated by the Internal Revenue Service. The value opinion herein reported is based upon reliance on the legality of the subject property operation and resulting financial statements. However, the appraiser reserves the right to consider and evaluate data that become available as a result of the IRS investigation and to make any required adjustment to the value opinion.

FOR REVIEW WITHOUT INSPECTION

38. That the appraiser's sole role in this appraisal was that of review and approval and did not include personal inspection of the property appraised or the market data used.

Scope of Investigation

Some appraisers add a section in the introduction that details the scope of investigation undertaken. This may be presented in a generalized form or in detail. If included, it can be either a narrative or an outline. See Example 7.5.

EXAMPLE 7.5. Scope of Investigation

As part of this appraisal, the appraiser made a number of independent investigations and analyses. She relied on data retained in her office, which is updated regularly for use in all assignments. Listed below are the investigations undertaken and the major data sources.

AREA AND NEIGHBORHOOD ANALYSIS

Examined South Quincy Regional Planning Report for demographic data, land use policies and trends, growth forecasts, and employment data. Reviewed 1979 Planning Update and interviewed Ralph G. Calvin, assistant planning director, in 1980, to ascertain development patterns and trends for portion of Quincy lying west of Interstate 13. Interviewed the following industrial brokers active in the area: Margaret L. Raines of Industrial Realtors, Frank P. Major of Northlake Realtors, and Samuel P. Smith of Morris Industrial Brokers.

SITE DESCRIPTION AND ANALYSIS

Consulted Quincy Planning and Engineering Departments, Public Utility Company, and Suffex County Geologists Office. Reviewed American Title Report 40-31245 prepared January 5, 1980. Physically inspected site on October 1, 1980, walked perimeter of property, and photographed subject site, surrounding area, and street scenes.

IMPROVEMENT DESCRIPTION AND ANALYSIS

Reviewed plans and specifications prepared by Wilson and Wilson, AIA, and inspected similar building at 3150 Crosstown Lane by same architect and builder. Interviewed Judith G. Wilson on October 6, 1980.

MARKET DATA PROGRAM

Vacant and improved transfers were obtained by researching all transfers occurring between January 1, 1979, and October 15, 1980, which were industrially zoned and located west of Interstate 13 and within the Quincy Metropolitan Area. Copies of deeds and financing instruments were obtained from the courthouse and an attempt was made to contact buyers, sellers, or both to verify transaction data and ensure that the sales were at arms length. Details of the verified sales are included in the addenda as Exhibit E.

RENTAL DATA PROGRAM

The brokers listed in "Area and Neighborhood Analysis" above were questioned on the most recent industrial leases consummated in the subject's vicinity. They also provided data on expenses from three similar properties. The appraiser used recent lease data on other properties on file. Morris Industrial Realtors has maintained an industrial property inventory for the past four years, which was consulted for vacancy information.

EXHIBIT 3

GUIDE NOTE 1
To the Standards of Professional Practice

VALUATION OF REAL ESTATE INTERESTS INTENDED FOR SYNDICATION AND VALUATION OF REAL ESTATE PARTNERSHIP INTERESTS

GUIDE NOTE 1
To The Standards of Professional Practice

VALUATION OF REAL ESTATE INTERESTS INTENDED FOR SYNDICATION AND VALUATION OF REAL ESTATE PARTNERSHIP INTERESTS

Effective May 3, 1985

Introduction

The syndication of real estate has become an important element in the current real estate market. The process of syndication often begins when an individual or group (the syndicator) purchases interests in real estate for the purpose of transferring it to a limited partnership and then selling limited partnership interests to investors. Problems arise for an appraiser when he or she is asked to value the real estate interests at the time of their purchase by the syndicator because the syndicator frequently is buying more than real estate. Problems also arise when the syndicator sells limited partnership interests to investors because of the inherent difficulty involved in separating the value of the interests in real estate from the aggregate value of the limited partnership interests.

In the syndication industry the price of the interests in real estate at the time of acquisition by the syndicator is sometimes referred to as wholesale value; and the aggregate price of the individual partnership interests to be sold by the syndicator is sometimes referred to as aggregate market value, retail value, or syndication value. If these terms are used by an appraiser, however, they must be defined clearly and precisely so that the users of the report and the public will not be confused or misled.

Valuation problems often relate to non-real estate items or conditions involved in the sale and purchase transaction such as special financing and guarantees of occupancy or income. These items are difficult to isolate and evaluate even when all facts are known. In the context of syndication purchases, the problem of analyzing comparable sales is more difficult than usual because it is extremely difficult to obtain all relevant data.

When a syndicator sells the real estate partnership interests to investor purchasers, the sale price of a limited partnership interest includes a variety of items such as tax benefits, management services, and other benefits in addition to the interests in real estate.

The syndication of real estate involves the marketing of highly specialized interests, both real and personal, to a specifically defined group of purchasers with varying motivations. Unless extreme care is taken to distinguish the exact nature of the interests being appraised, valuation conclusions can be greatly distorted or misleading, and an appraiser may become liable to third parties under security and tax regulations that have often been described as punitive.

Basis for Proper Valuation

1. Acquisition by the Syndicator

All appropriate approaches should be used to estimate value. When analyzing comparable sales in the sales comparison approach, all transactions should be specifically analyzed to determine whether non-real estate items were included in the price. If non-real estate items were included, they should be separately identified and their effect on the sale price should be carefully considered.

A limited assignment should be accepted only in unusual circumstances.

2. Sale of Partnership Interests by the Syndicator

Syndicators frequently assert that the aggregate price they are paid by investors who purchase partnership interests establishes the market value of the interests in real estate that are the subject of the syndication. The market value of the interests in real estate is an important item in a syndication because the value of the improvements is used to establish the basis for depreciation which in turn creates substantial tax benefits. The appraiser, however, must carefully analyze the aggregate sale price of the partnership interests sold to investors and separate the value of the interests in real estate from the contributory value of the non-real estate interests sold. Rarely would the retail price of the individual partnership interests sold to investors equal the market value of the interests in real estate. It is essential that the appraiser understand that the partnership interests sold by the syndicator include many non-realty items such as tax shelter, potential capital appreciation, ability to invest in a major property that an investor might be incapable of investing in alone, and management services for the investment.

When valuing fractional interests in a real estate partnership, an appraiser must be certain that all market data is comparable and be acutely aware of what was included in each investment package utilized in the valuation process. In this connection an appraiser can appraise the partnership interest involved either by breaking it down into separate components or by considering it as a whole with all the components properly identified.

Unacceptable Practices

1. Failing to determine whether non-realty items were included in the price of comparable sales.

2. Using the retail price of the aggregate fractional interests in the partnership or the aggregate market value of the partnership as the market value of the real estate interests being appraised.

3. Combining the value of non-real estate items with the value of the real estate interests being appraised without proper identification and analysis.

4. Failing to describe and measure the effects of submarket or atypical financing on the value of the real estate interests being appraised.

EXHIBIT 4

APPRAISAL POLICIES AND PRACTICES OF INSURED INSTITUTIONS AND SERVICE CORPORATIONS (R 41c)

FEDERAL HOME LOAN BANK BOARD
OFFICE OF EXAMINATIONS AND SUPERVISION
MEMORANDUM R-41c

TO: Professional Staff—
Examinations and Supervision

September 11, 1986

FROM: Francis M. Passarelli

Appraisal Policies and Practices of Insured Institutions and Service Corporations

SYNOPSIS: THIS MEMORANDUM REVISES AND REPLACES R-41b. IT DOES NOT REPRESENT ANY SHIFT IN BOARD POLICY BUT IT DOES ENCOMPASS SIGNIFICANTLY GREATER DETAIL, SPECIFICALLY WITH REGARD TO "APPRAISAL MANAGEMENT," ADDING GUIDELINES WHICH ARE APPROPRIATE TO ENSURE ACCEPTABLE APPRAISAL PROCEDURES IN THE CURRENT MARKET. THE GUIDELINES LISTED ARE GENERALLY STANDARDS OF PRACTICE UTILIZED BY THE LEADING NATIONAL PROFESSIONAL APPRAISAL ORGANIZATIONS. THE MEMORANDUM ALSO CONTAINS THE NEW DEFINITION OF MARKET VALUE, AS RECENTLY ADOPTED BY BOTH THE FEDERAL HOME LOAN MORTGAGE CORPORATION (FREDDIE MAC) AND THE FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNIE MAE). R-41b IS HEREBY RENDERED OBSOLETE AND IS RESCINDED.

Introduction

The soundness of an association's or service corporation's mortgage loans and real estate investments depends to a great extent upon the adequacy of appraisals utilized to support such transactions. This memorandum sets forth the standards and reporting requirements utilized by the Federal Home Loan Bank Board in determining compliance with the appraisal requirements of Insurance Regulation 563.17-1(c)(1)(iii).

Management Policies

Loan and investment policies established by an institution's board of directors should reflect both the overall operational policies of the institution as well as the regulatory limitations under which it must conduct its business. Such policies should be clearly defined and set forth in a manner that provides effective supervision of the institution's operations by the directors.

Prudent loan policy should identify the types of credit arrangements the institution offers as well as the procedures to be followed in the underwriting of each of these arrangements. In secured credit transactions, such policies should definitely address the need to establish the value of collateral offered by borrowers in order to ensure that the institution is appropriately protected throughout the life of the credit arrangement. To a great extent, the complexity and diversity of the credit arrangements offered will determine the types of appraisal services the institution's underwriting staff will require. It is the board of directors' and senior officers' responsibility to ensure that the appraisal services provided, whether by fee or staff appraisers, properly reflect the collateral lending posture of the institution, as well as its lending policies.

Similarly, the board of directors is responsible for establishing appropriate guidelines and procedures relative to other investments of an institution. Appraisal services utilized by the institution in evaluating such transactions should reflect the institution's regulatory obligation to operate in a safe and sound manner. Failure to ensure that appraisal services match the needs of the institution will be considered an abdication of this responsibility and is representative of an unsafe and unsound operating policy.

In formulating its loan and investment policies, the board of directors should recognize that appropriate appraisal services are most often produced by fee or staff appraisers, who are both competent and knowledgeable and have properly equipped facilities within which to prepare adequate appraisals. Each association or service corporation should be able to demonstrate that the appraisers approved by the board of directors possess the requisite experience, education and facilities to perform in an acceptable fashion.

Appraisal skills and technology are not static and attendance at courses and participation in the activities of professional appraisal organizations are factors to be considered by the board of directors in selecting both fee and staff appraisers. Memberships in professional appraisal organizations as well as continuous professional development should be encouraged to ensure that the appraisers whose services are being utilized are actively increasing their knowledge and skills over time. Management should periodically review the performance of all approved appraisers for compliance with the standards and reporting requirements of the Federal Home Loan Bank Board and take whatever steps are necessary to eliminate poor quality or inappropriate work products.

Appraisal Management

Appraisals serve as an important basis in the decision process involved in the underwriting of secured credit transactions as well as investment decisions involving interests in real property. Management must ensure that appraisals utilized in these decisions:

1. Are prepared in accordance with the standards and reporting requirements of the Federal Home Loan Bank Board and conform with the institution's written appraisal guidelines. Management should provide appraisers approved by the institution with a copy of both the board's requirements, as promulgated herein, and the institution's written guidelines. Management should also assist appraisers in obtaining the information needed to comply with these requirements. Such information includes leases, purchase agreements, profit and loss statements from the security property, etc.
2. Are sufficiently current to reduce the likelihood of material changes in actual market conditions from those upon which the loan or investment decision were predicated. (Though not exclusively definitive, "sufficiently current" may be deemed to be an appraisal made six months prior to the approval of the loan or investment.)
3. Reflect the market value of the rights in realty offered as security or involved with the transaction. All other values or interests appraised must be clearly labeled and segregated, i.e., value of chattels, value of financing terms, business value, furniture, furnishings and equipment value, etc.
4. Contain sufficient information to assist management and/or the board of directors in establishing the loan amount as well as other significant terms involved in the credit arrangement.
5. Support the classification of the asset as a real estate loan or other type of credit arrangement.
6. Are prepared by appraisers, independent from the borrower or the seller of the real estate, and approved by the institution's

(Continued on page 4)

(From page 3)
board of directors. It is suggested the board review the prior work and references of newly engaged appraisers. Final board of directors' approval should be recorded in the board's minutes.

7. Contain adequate information relative to both current and projected market conditions and their resulting impact upon the estimated value of the property to enable an institution to determine whether its financial position will be properly protected over the life of the credit arrangement or term of investment. The scope of such information will depend upon the property type, the structure of the credit or investment arrangement and the financial realities of the contemplated transaction.

8. Are presented in a narrative style format, unless *both* of the following conditions are met:
   a. A form report is utilized which is appropriate for the specific appraisal assignment, i.e., the form is designed for both the property type and the interests being appraised.
   b. A form report is utilized, including all attachments, that results in a totally self-contained appraisal, as defined elsewhere in this memorandum.

9. Are based upon the following definition of market value:
   The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:
   a. buyer and seller are typically motivated;
   b. both parties are well informed or well advised, and each acting in what he considers his own best interest;
   c. a reasonable time is allowed for exposure in the open market;
   d. payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
   e. the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

10. Correctly employ all recognized appraisal methods and techniques that are necessary to produce a credible analysis, opinion, or conclusion. Exclusion or omission of any recognized method for cause must be fully justified.

11. Consider, analyze and disclose in reasonable detail:
    a. Any current agreement of sale, option, or listing of the property being appraised.
    b. Any prior sales of the property being appraised that occurred within the following time periods:
       (1) one year preceding the date when the appraisal was prepared for one to four family residential property, and
       (2) three years preceding the date when the appraisal was prepared for all other property types.
    c. A sales history of comparables, if the subject property is located in a speculative market, which has experienced dramatic price fluctuations relative to regional norms, covering the speculative time period involving the comparable sales.

12. Contain the following information where an analysis, opinion or conclusion of a proposed project, improvement or change in use is involved: (i) plans, specifications, or other documentation in sufficient detail to identify the scope and character of the proposed improvements; (ii) evidence indicating the probable time of completion of the proposed improvements; (iii) clear and appropriate evidence supporting development costs, anticipated rent levels or per unit sales levels, occupancy projections, and the anticipated competition at the time of completion; and (iv) all value changes projected to occur from the conception of a project to its completion and/or stabilized occupancy should be set forth in sufficient detail so that the continuum of present v estimates over the life of the credit arrangement or investme can be reconciled with the values reported in the appraisal. Included as documentation should be an explanation of how discount and capitalization rates used in generating the presen value estimates were deduced.

    In addition to the above requirements, whenever value is estimated as of completion and/or stabilized occupancy, the appraisal must contain the following information:
    a. The date or dates when the value estimate or estimates apply.
    b. Factual data supporting the reasonableness of all conditions and assumptions impacting each value conclusion cited in the appraisal. Such information must be presented in sufficien detail and directly linked to current market information so that the appraiser's logic, reasoning, judgment and analysis indicate to a third-party reader the reasonableness of the value or values reported.
    c. An explanation of the appraisal techniques selected and the data used to arrive at the final value estimate(s).
    d. A fully documented and supported highest and best use analysis and conclusion which coincides with the date(s) of the value estimate(s).
    e. A definitive statement as to whether the value estimate reflects the worth of the property at stabilized occupancy and whether the appraiser considered and included the effect of income and expenses during the projected absorption period in developing a value estimate as of the date of completion.

13. Accurately reflect the impact upon value of any changes in plans and specifications from those utilized in an appraiser s analysis o a proposed project, improvement or change in use.

    In all instances where an institution utilizes an appraisal bas upon preliminary plans and specifications in a loan or inves ment decision, it shall take appropriate steps, prior to the disbursement of any funds, to ensure the validity of the appraisal, relative to the decision, has not been negated. Further whenever significant changes in plans and specifications occur after a loan or investment decision has been made, the institution's management shall take appropriate steps to ensure its financial position is appropriately protected. Typically, such steps will involve either having the original appraiser recertify his value estimate after examining the final plans and specifications for the project or a new appraisal will be obtained based on the final plans and specifications.

    For the purposes of this paragraph, significant changes in plans and specifications are defined as those which directly affect the value of the property, e.g., changes in the scope, character or timing of the proposed improvements.

14. Contain a properly documented and supported estimate of the highest and best use of the property appraised, which is consistent with the definition of market value cited in this memorandum. Such estimate must consider the effect on use and value of the following factors: existing land use regulations, reasonably probable modifications of such land use regulations, economic demand, the physical adaptability of the property, neighborhood trends, and the optimal usage of the property. In addition, the appraisal must consider the effect on the property being appraised of anticipated improvements as of the appraisal date.

    In all appraisals, incuding those involving proposed construction, development or changes in use, the appraiser must specifically address and consider in his analysis the anticipated economic feasibility, as well as cite all significant market data utilized in de veloping his/her conclusions. Such analyses must be presented i sufficient detail to support the appraiser s forecast of the probable success and the conclusion of highest and best use of the project.

    In all instances where the appraiser relies on feasibility/marketability studies prepared by a third party to support his esti-

mate of highest and best use, he must:

a. Attest that such study has been thoroughly examined and that he fully concurs with its findings and conclusions, and;
b. Specifically identify both the study examined as well as set forth within the body of the appraisal, a summary of the significant data, analyses and conclusions presented in the study. Such summary must be presented in sufficient detail, so that further reference to the study is unnecessary by a third-party reader of the appraisal, and;
c. Have available for future examination by users of the appraisal, a complete copy of the feasibility/marketability study prepared by the third party.

15. Report the market value to a single purchaser as of the date of completion for all properties, wherein 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 fully reflect all appropriate deductions and discounts as well as the anticipated cash flows to be derived from the disposition of the asset over time. Appropriate deductions and discounts are considered to be those which reflect all expenses associated with the disposition of the realty, as of the date of completion, as well as the cost of capital and entrepreneurial profit.

16. For properties under construction, conversion or proposed, report the market value of the subject property as of the date of completion, excepting those properties described in paragraph 15 immediately above, where anticipated market conditions indicate stabilized occupancy is not likely as of the date of completion. Such valuations shall fully reflect the impact upon the "as if completed value" of all pertinent operating expenses as well as the anticipated pattern of income during the absorption period. In addition, the value estimate must reflect the impact of rental and other concessions, including the costs associated with preparing the improvement for occupancy by tenants.

17. Contain a summary of actual income and expenses experienced by the subject property where it is an existing income or revenue producing property. In addition, all such appraisals must contain a complete reconciliation of all deviations projected by the appraiser in his forecast of future financial performance from those historically realized by the property.

18. Report the "as is" value of the subject property as of the date when either the appraisal was prepared or when the property was last inspected. The date of the "as is" value estimate should be sufficiently current to reduce the likelihood of material changes in the actual market conditions from those upon which the loan or investment decision were predicated. In addition to any other value estimates contained in an appraisal, the "as is" value must be reported.

19. Consider and report the effect on value, if any, of the terms and conditions of any agreement establishing a fractional interest or estate, where the objective of the report is to estimate the value of such fractional interest or estate. All such appraisals must clearly demonstrate that the value of any fractional part or estate has been evaluated by an analysis of appropriate market data. Such analyses must recognize that it is generally considered inappropriate to arrive at either the value of the whole or its parts by simply summing the fractional interests or subdividing the value of the whole into proportional parts.

All analyses involving fractional interests or estates, where the combined value of all interests or estates is not reported, must definitely establish with market evidence whether the terms and conditions of the agreement creating the estates or fractional interests reflects market rates and terms.

In addition to the above requirements, all analyses involving fractional interests or estates must disclose whether the final value estimate of such fractional interests or estates included non-realty components, i.e., tenant or borrower's credit quality, other non-realty contractual arrangements, etc. Further, whenever such value estimate includes non-realty components, the value assignable to them must be specifically disclosed in the appraisal.

All appraisals, where there is a clear indication that the subject property is encumbered by a lease instrument or legal limitations upon its operation [e.g., when inspection reveals occupancy of the property by tenants or the property is subject to rent control statutes], must consider and report the impact of the terms of the lease or such legal limitations upon the value of the estate being appraised.

Appraisal Content

Prior to the approval of a loan or investment transaction, each appraisal accepted by an institution must be prepared in writing and contain sufficient information to enable the persons who receive or rely on the report to understand it properly. Appraisals which fail to set forth, in a clear and accurate manner, the analytical process followed by the appraiser, in a fashion that will not be misleading to the persons who receive or rely on the report, will be considered unacceptable.

The content of each appraisal accepted by an institution shall follow generally accepted and established appraisal practices, as reflected in the standards of nationally recognized professional appraisal organizations and as noted in the body of this memorandum.

Specifically, each appraisal must:

1. Be totally self-contained so that when read by any third party, the appraiser's logic, reasoning, judgment and analysis in arriving at a final conclusion indicate to the reader the reasonableness of the market value reported.
2. Identify via a legal description the real estate being appraised.
3. Identify the property rights be appraised.
4. Describe all salient features of the property being appraised.
5. State that the purpose of the appraisal is to estimate market value as defined in this memorandum.
6. Set forth the effective date of the value conclusion(s) and the date of the report.
7. Set forth all relevant data and the analytical process followed by the appraiser in arriving at the highest and best use conclusion.
8. Set forth the appraisal procedures followed, the data considered, and the reasoning that supports the analyses, opinions, and conclusions arrived at by the appraiser. The analytical process followed by the appraiser must be presented so that:
   (a) It includes a complete explanation of all comparable data adjustments utilized in the analysis together with appropriate market support for each adjustment, and;
   (b) It contains descriptive information for all comparable data presented with sufficient detail to demonstrate the transactions were conducted under the terms and conditions of the definition of value being estimated or have been adjusted to meet such conditions; have a highest and best use equivalent to the best use of the subject property, and; are physically and economically comparable to the subject property.
9. Set forth all assumptions and limiting conditions that affect the analyses, opinions, and conclusions in the report; however, such assumptions and limiting conditions must not result in either a non-market value estimate or one so limited in scope that the final product will not represent a complete appraisal. A summary of all such assumptions and limiting conditions must be presented in one physical location within the appraisal.
10. Include a manually signed certification by the appraiser that is similar in content to the following form:
    - the statements of fact contained in this report are true and correct.

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- the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest or bias with respect to the parties involved.
- my compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report.
- my analyses, opinions, and conclusions were developed, and this report has been prepared, in accordance with the standards and reporting requirements of the Federal Home Loan Bank Board.
- I have made a personal inspection of the property that is the subject of this report. [If more than one person signs the report, this certification must clearly specify which individuals did and which individuals did not make a personal inspection of the appraised property.]
- no one provided significant professional assistance to the person signing this report. [If there are exceptions, the name of each individual providing significant professional assistance must be stated.]

Related Considerations

Appraisal reports prepared for the purpose of influencing in any way the action of a Federal Home Loan Bank, the Federal Home Loan Bank Board, a Federal Savings and Loan Association, any institution the accounts of which are insured by the FSLIC, any member of the Federal Home Loan Bank System, or the Federal Savings and Loan Insurance Corporation are subject to the provisions of Title 18, United States Code. It is encumbent upon all appraisers to diligently adhere to generally accepted professional appraisal standards of practice and the provisions and requirements of the Federal Home Loan Bank Board's standards and reporting requirements relating to the preparation of appraisal reports prepared for these entities.

Francis M. Passarelli
Director [FHLBB]

Kinnard Writing R-41c Seminar

With the Federal Home Loan Bank Board's release of Memorandum R-41c, the Society is preparing an accompanying seminar.

Dr. William N. Kinnard, Jr., SREA, the author of "R-41b and the Appraiser," will also be the author of the Society's new R-41c offering.

The seminar should be available for chapter presentation by late 1986.

Pilot Presentation of R-41c and the Appraiser, Tucson, Arizona, Arizona Inn, November 7; Dr. William N. Kinnard, Jr., SREA, instructor. Contact: Thomas A. Baker, 2500 N. Tucson Blvd., Suite 100, Tucson, AZ 85716; (602) 881-1700; sponsored by Tucson #116; 7 hours recertification credit.

Pilot Presentation of R-41c and the Appraiser, San Diego, California, Inter-Continental Hotel, November 20; Dr. William N. Kinnard, Jr., SREA, instructor. Contact: Don Knox/Janan Fussell, 4452 Park Blvd., #302, San Diego, CA 92116; (619) 295-1670; sponsored by San Deigo #33; 7 hours recertification credit.

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"Highest and Best Use," one of the four magazine advertisements which have been placed throughout the year to promote Society members, will appear during the latter part of 1986 in the following publications: *Corporate Real Estate*, *National Law Journal*, *Trial*, and *Mortgage Banking*.

During the last quarter of 1986, those who request copies of the Directory of Designated Members will receive the 1987 issue, which will be mailed in January. For those who need immediate information, copies of local listings from the current directory are available.

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EXHIBIT 6

RICS Guidance Notes on the Valuation of Assets - 2nd Edition

Guidance Note No. GN 22

LAND AND BUILDINGS
DEFINITIONS OF 'OPEN MARKET VALUE' AND 'FORCED SALE VALUE'

Guidance Note No. GN 22

LAND AND BUILDINGS DEFINITIONS OF 'OPEN MARKET VALUE' AND 'FORCED SALE VALUE'

1. Open Market Value

1.1 'Open Market Value' is intended to mean the best price at which an interest in a property might reasonably be expected to be sold by Private Treaty at the date of valuation assuming:

(a) a willing seller;

(b) a reasonable period within which to negotiate the sale taking into account the nature of the property and the state of the market;

(c) values will remain static throughout the period;

(b) the property will be freely exposed to the market;

(e) no account is to be taken of an additional bid by a special purchaser.

1.2 The Institution stresses that if a valuer considers it appropriate to apply any qualifying words to 'Open Market Value', the meaning of those words should be discussed and agreed with the client before instructions are finally accepted. The Valuer should incorporate in his report the agreed meaning of the qualifying words.

1.3 It is emphasised that this definition can in no way override any statutory definition of market value which may have to be adopted for the purpose of valuations for Capital Gains Tax, compensation cases, etc.

2. Forced Sale Value

2.1 'Forced Sale Value' is the Open Market Value as defined above with the proviso that the vendor has imposed a time limit for completion which cannot be regarded as a 'reasonable period' as referred to in Para. 1.1.

2.2 If the term 'Forced Sale Value' is used members are advised that the time limit should be discussed and agreed with the client.

Guidance Note No. GN 23

THE VALUATION OF PLANT AND MACHINERY ASSETS

1. General

1.1 The Companies Act 1967 requires that assets shall be classified in the balance sheet under headings appropriate to the company's business and further that fixed assets, current assets and assets that are neither fixed nor current be separately identified but the Act contains no definitions of these classes of assets, although it refers to investments, goodwill, patents and trademarks in terms which recognise the possibility that such assets may be so classified. It should be noted that the very word 'fixed' is somewhat of a misnomer; ships, motor vehicles, railway engines and heavy movable equipment including cranes will be included although some may be classified as 'neither fixed nor current'. Smaller items of plant and machinery, particularly where they are movable, are often classified, for accounting purposes, as neither fixed nor current.

1.2 As a matter of practicality, many companies use a minimum expenditure level to account for capital expenditure; thus any item costing less than a specified amount is written off to revenue in the year of purchase whereas strictly speaking such expenditure could be charged to a fixed asset account.

1.3 Current assets (which will include stocks and work in progress) are in general those assets which are expected to be consumed or realised in the ordinary course of business in the short term.

1.4 The precise nature of the asset is not the only criterion as regards classification. Assets considered to be 'fixed' in one business would not necessarily be so in another.

1.5 When Valuers are asked to make a valuation whether it be of land and buildings or plant and machinery for inclusion in a company's accounts (whether by incorporating the valuation in the accounts or by a reference in a note or in the directors' report) it is essential that there should be a clear understanding by all concerned of what is being valued and the date of the valuation. Valuation Reports and Certificates should clearly define inclusions and exclusions. It is also essential that there should be a clear understanding of the basis of valuation and the proposed treatment of that valuation in the accounts, etc., in order to ensure that there is a proper comparison between the valuation and the book amount of the same assets. Unless this understanding exists between the directors, the accountants and the valuers concerned, there is always the risk that misleading comparisons will be drawn.

2. Basis of Valuation

2.1 Basic accounting concepts postulate that accounts are on a going concern basis, that is to say that the enterprise will continue in operational existence for the foreseeable future. The normal basis of valuation of plant and machinery where the valuation is to be incorporated or referred to in the accounts, etc., of a company should therefore be its open market value on the assumption that the plant and machinery will continue in its present existing use in the business of the company. Normally this existing use basis of valuation will be depreciated replacement cost, i.e., the estimated cost as new at the date of the valuation including the cost of installation less an allowance for depreciation (i.e., wear and tear, age and obsolescence). Account should be taken in the valuation, however, of special factors such as scarcity value or the possible limitation of value caused by limited natural resources or the building housing the plant having a limited life or being held on a limited tenure or with limited planning consent. Further it is necessary to consider both individual and overall values of the plant. See GN 11

2.2 In some cases an existing use basis of valuation will not be appropriate. It would almost certainly be inappropriate to use an existing use basis of valuation of plant and [illegible] in which they are housed are valued on an alter- See GN 1 and BP

the effect on the value of plant and machinery. In these circumstances the following alternatives would be available:

(a) where the plant and machinery could be moved to and used by the company at another site, the valuation would be on a depreciated replacement cost basis, but making an allowance for the costs of removal and reinstallation;

(b) where plant and machinery is to be disposed of rather than used in the company's business it would then be valued on an open market value basis. If there is a time limit on the disposal, forced sale value may be the proper basis of valuation.

2.3 Where the land and buildings have not been valued, then the plant and machinery should be valued on the basis that would have been appropriate had the land and buildings been valued.

See GN 24

2.4 Definitions of open market value and forced sale value are given in GN. 24. These definitions are to be used for the purpose of valuations which are to be used in company accounts, etc., and they cannot override any statutory definitions of market value which may have to be adopted for the purpose of valuation for capital gains tax, compensation cases, etc.

2.5 In all instances, it is essential that, in advance of the valuation being carried out, there should be a clear understanding with the company and its accountants (and probably its auditors) of what is to be valued, the reasons for the valuation, the use to be made of the valuation and all the surrounding circumstances so that the appropriate basis can be determined.

3. Plant and Machinery forming part of a Building

3.1 Problems have arisen when valuing land and buildings where there are items of plant and machinery which are regarded by the valuer as forming part of the building but which the accountant may wish to segregate for accounting purposes. Valuers when valuing premises will normally include all items of plant and machinery on the premises which provide the services to the land and buildings and which the open market regards as an integral part of the premises for letting or sale or as security for a loan.

See GN 25

3.2 A list of such items is given in GN 25 but it is stressed that the list is not comprehensive and merely indicates, as a general guide to valuers, those items that would usually fall to be included in the value of the premises.

3.3 Normally process plant and machinery should not be included in the valuation of the premises.

3.4 It is possible that some or all of these types of plant and machinery normally included in the valuation of the premises may be needed to be separated for accounting purposes, for instance when it is expected that they have a shorter useful life than the rest of the premises and depreciation is being provided accordingly.

3.5 An apportionment of a valuation as between:

(i) land and buildings; and

(ii) the plant and machinery element;

may also be necessary in order to correspond with the headings adopted by the company in its accounts.

3.6 In such circumstances Valuers will have to indicate clearly that their valuation is of the whole and that any apportionment is an allocation of their overall valuation between the different components. This should also be stated in the notes to the Company Accounts if the apportioned figures are referred to therein.

4. Dies, Moulds, Patterns and Spare Parts

4.1 As a general rule, dies, moulds, patterns, jigs, drawings, designs and similar items should be excluded from a valuation.

4.2 In the normal course of events, spare parts would not be valued as part of the unit as it is often the practice for these to be carried in stock, and only auxiliary items necessary

4.3 In both cases, Valuers should consult with the directors and auditors in order to take the appropriate action.

5. Plant and Machinery Register

5.1 It is recommended that all companies be encouraged to maintain an up-to-date plant and machinery register showing as a minimum, the location of each item of plant and machinery, its date of acquisition, original cost and any further capital expenditure as this assists considerably in a valuation and its reconciliation with the company accounts.

6. General

6.1 Valuers are advised to discuss with the Company Accountants and Auditors the requirements of the valuation before carrying out the detailed valuation.

6.2 Reports and Certificates should incorporate suitable savings clauses covering the treatment in the valuation of such items as assets on hire purchase, government grants and goodwill.

7. Consent

7.1 The Valuer's Certificate should state that his written consent to any reference to his valuation in company accounts and/or directors' reports or any company statement or circular must be obtained before such documents are published. All Valuation Certificates should, therefore, incorporate a paragraph to the effect that:

> 'Neither the whole nor any part of this Valuation Certificate or any reference thereto may be included in any published document, circular or statement nor published in any way without the Valuer's written approval of the form and context in which it may appear.'

Guidance Note No. GN 24

PLANT AND MACHINERY DEFINITIONS OF 'OPEN MARKET VALUE' AND 'FORCED SALE VALUE'

1. Open Market Value

1.1 'Open Market Value' is defined as the best price at which an interest in the plant and machinery might reasonably be expected to be sold at the date of valuation by either Private Treaty, Public Auction or Tender, as may be appropriate assuming:

(a) a willing seller;

(b) a reasonable period within which to negotiate the sale, taking into account the nature of the plant and machinery and the state of the market;

(c) values will remain static throughout the period;

(d) the plant and machinery will be freely exposed to the market;

(e) no account is to be taken of an additional bid by a special purchaser;

(f) the plant and machinery may be valued, either

(i) as a whole in its working place, or

(ii) as individual items for removal.

2. Forced Sale Value

2.1 'Forced Sale Value' is defined as the open market value as defined above with the proviso that the vendor has imposed a time limit for completion which cannot be regarded as a reasonable period as referred to in above.

2.2 If the term 'Forced Sale Value' is used members are advised that the time limit should be discussed and agreed with the client.

Guidance Note No. GN 25

PLANT AND MACHINERY
ITEMS OF PLANT AND MACHINERY NORMALLY INCLUDED IN VALUATIONS OF LAND AND BUILDINGS

1. The following observations are intended to apply in the valuation of assets comprised in the majority of industrial and commercial types of property. Factory premises of a specialised nature will often require individual treatment and segregation to meet particular circumstances. In the case of sale, fire insurance, rating, etc., different criteria may apply. The list which follows, however, whilst not comprehensive, indicates those items usually valued on the basis that they form part of the 'building' service installations as opposed to those provided as part of the industrial or commercial processes carried on by the occupier. It follows that the valuation of land and buildings would normally exclude all items of plant, machinery and equipment which may have been installed wholly or primarily in connection with the occupiers' industrial or commercial processes, furniture and furnishings, tenants' fixtures and fittings, vehicles, stock, moulds and loose tools. The excluded items may need to be separately valued for balance sheet or other purposes.

2. **Electricity**

   Mains supply cables, transformer houses with transformers, sub-stations and their equipment, generating plant and associated equipment including standby plant, and all wiring and switchgear up to and including the main distribution board in each building, together with:-

   (a) *In non-industrial buildings:*

   Wiring for lighting and power from the distribution board to wall and ceiling points.

   (b) *In industrial buildings:*

   Wiring for lighting to wall and ceiling points.
   Note: (power circuits from the distribution board would normally be excluded on the grounds that these are related to the processes).

   (c) *Externally:*

   Wiring and associated structures for lighting to roads and yards, etc.

3. **Gas**

   Gas mains up to and including meter houses and piping from meter houses for non-process purposes. Where the property includes a gas producer plant this would normally be in connection with the occupier's industrial processes and would, therefore, be excluded.

4. **Water**

   Wells, boreholes, pumps, pump houses, service pipes including those connected to Water Board's mains, water treatment plants, storage tanks and reservoirs and all structures required to contain, support or house such items.

5. **Space Heating and Hot Water**

   5.1 Boilers and associated plant including fuel tanks, pipes and fittings (e.g., radiators and unit fan heaters) primarily supplying or using steam or hot water for space heating and other non-process purposes.

6. Air Conditioning and Ventilation

Air conditioning plant and trunking and fan extractors and ventilators except where forming part of a computer installation or primarily serving plant and machinery used in industrial or commercial processes.

7. Fire and Security

Hydrants, pumps and mains, sprinkler systems, smoke detectors and annexed fire and burglar alarm systems.

8. Drainage

8.1 Surface water and foul water drains and sewers.

8.2 Sewage disposal plants not primarily concerned with treating water and other liquids used in the processes of trade effluents.

9. Lifts and Gantries

9.1 Passenger and goods lifts, escalators and travelators designed to benefit the general occupation of a building.

9.2 Rails and supporting gantries for overhead travelling cranes where forming an integral part of the structure of a building.

Note:
Hoists, conveyors, elevators, overhead cranes, jib and derrick cranes would normally be excluded.

10. Structures

10.1 The decision upon which items should be included will, to some extent, depend upon general experience and the practice adopted by individual trades.

10.2 Among the criteria will be the degree of attachment, permanence and size. Structures which are necessary for the provision of the services or have been installed or erected other than for the industrial or commercial processes carried out on the property would normally be included in the valuation of land and buildings. Such items might include the following:

Boiler houses, Chimneys (brick and steel) and Economiser Chambers;
Pits;
Stagings;
Internal Buildings;
Permanent Partitions;
Railways;
Bridges and Housings for Conveyors;
Fences;
Roads, Yards and Hard Standings.

10.3 Structures which are ancillary to, or form a part of an item of Process Plant and Machinery, would normally be excluded.

Guidance Note No. GN 20

ASSET VALUATIONS IN ACCORDANCE WITH THE INSURANCE COMPANIES ACT 1974

1. When valuing assets of Insurance Companies it is necessary to comply with the terms of The Insurance Companies (Valuation of Assets) Regulations 1976 (SI 1976 No. 87) made under Sections 78 and 86 of The Insurance Companies Act 1974. (*See Footnote*)

   The Regulations are effective from 1st May, 1976, and revoke SI 1974 No. 2203.

   The Regulations apply to all general business assets, and all long-term business assets but unit linked property assets are excluded and subject to separate requirements. The Regulations apply to nine categories of assets: those likely to be of direct concern to members are 'Land' and 'Debts'. 'Land' includes land and buildings and any interest in land. An option to purchase is considered to be an interest in land and consequently must be valued.

   The Regulations apply to all insurance companies authorised to carry on any class of insurance business in the United Kingdom.

   Whilst Valuers will wish to read the Regulations as a whole, the following are probably of principal interest:

2. **Regulation 3**

   2.1 Para. (4) provides in effect that the most recent 'proper valuation' made under Regulation 7 is a maximum. If the Valuer makes a qualification to the valuation (e.g. the absence of HAC has not been verified or some other adverse factor) a lower value may have to be adopted by the insurance company. If there has been a change in circumstances since the last 'proper valuation' (e.g. a change in market conditions with rising yields) which make it likely that the valuation figure is not realisable, then the appropriate lesser amount is to be taken.

   2.2 This could mean in practice that an up-to-date revaluation may have to be made or further advice obtained and insurance companies can be expected to consult with their valuers.

   2.3 Similar considerations apply to certain other categories of assets including 'debts' valued under Regulation 6.

3. **Reulations 4 and 5**

   3.1 These Regulations concern the valuation of assets of dependents (as defined in Regulation 2(2)). If members are instructed to value assets of this category of companies they should consult with their clients as to the advice and valuations required to comply with the Regulations in the particular circumstances.

4. **Regulation 6**

   4.1 This prescribes the method of valuing 'debts' which include mortgages.

   4.2 If due within twelve months the value is the amount which can reasonably be expected to be recovered. This will include a debt which would become due within twelve months if the insurance company exercised any right to require payment.

   4.3 If due beyond twelve months the value is the amount which would reasonbly be paid for an assignment of the debt with the benefit of the security. Thus in 1979, for example, a standing mortgage of £100,000 for 20 years fixed at 7½% in 1965 would have fallen to be valued at a discount; consideration must also be given to the other conditions of the debt,

Note: These regulations should be read in conjunction with SI 1976 No. 2039 (which freed from the admissibility limits investments by insurance companies in Government and public authorities and increased the limit of admissibility set to certain debts from individuals) and SI 1980 No. 5 which enables insurers to elect, subject

the status of the mortgagor and the nature of the security and the strength of the cover provided by it for the debt. Where the security is land members may be asked to comment on its nature and/or the value of the land.

4.4 Members may be asked to advise on the value of a 'salvage right' where the insurance company have a right to possess or sell an asset.

5. Regulation 7

5.1 This deals with the valuation of 'land'. The value to the insurance company for the purposes of the Regulation will not be greater than the amount obtainable (after deducting reasonable sale expenses) if the land were sold at the most recent 'proper' valuation. This basis is governed by Regulation 3 (4) upon which comments are made above.

5.2 A 'proper valuation' is defined in Regulation 2 and is the amount realisable by an open market sale and must have been made not more than three years before the relevant date. This valuation must have been made by a 'qualified valuer' (see Regulation 2) viz. a person who is a Fellow or a Professional Associate of the Royal Institution of Chartered Surveyors (or a Fellow or an Associate of the ISVA or the RVA) who must have knowledge and experience in the valuation of land or by any other person approved by the Secretary of State for the Department of Trade.

5.3 As a 'person' can include any body of persons corporate or unincorporate it follows that a firm may or may not be a 'qualified valuer'. Where one or more of the partners is not a 'qualified valuer' the valuation must be made by, and the valuation report signed by, a partner who is a 'qualified valuer'.

5.4 It is recommended that the Valuer should produce the figure for the 'proper valuation' leaving the insurance company to assess the deduction for reasonable expenses of sale (according to the latter's judgement of the appropriate method of disposal). Members are advised to make it quite clear when submitting a valuation that it takes no account of the expenses of sale. Members should be prepared, if requested, to advise on the amount of sale expenses according to the circumstances.

5.5 The relevant date of valuation must be given to the Valuer by the insurance company.

5.6 It is to be noted that valuations do not have to be made by independent persons so that if they are 'qualified valuers' both directors and employees of the insurance company can undertake the valuation.

5.7 Land not so valued is excluded from being taken account of for the purposes of the Regulations (see Regulation 3(1)). This allows a company, if it so wishes, to exclude relatively small holdings.

5.8 Land occupied by the company is to be valued as if with the benefit of vacant possession; it would be wrong to value it on the basis of a sale as an investment with an assumed lease to the company at a rent.

5.9 Land is to be valued as free and clear of any mortgage or charge.

5.10 The Regulations cover land in the UK and overseas.

6. Regulation 8

6.1 This applies special valuation rules to equipment which includes 'plant and machinery'. Valuers in this field should note that the rules are severe and apply percentage deductions to a strict time scale on computer equipment and for all other equipment a minimum of 50% deduction on cost in the financial year of acquisition and a complete write-off thereafter. As the rules apply also to dependent companies it is important that Valuers consult with their instructing clients (see comments on Regulations 4 and 5).

6.2 In valuing an 'in hand' agricultural holding the basis of valuation of the land will assume vacant possession and it would appear that the operating capital (except for any item of plant and machinery acquired during the financial year) would have to be ignored.

6.4 Reference should be made to Guidance Note No. GN 25 as to those items of plant and machinery which are normally valued as an integral part of land and buildings and it follows that such items do not fall within the scope of this Regulation. See GN 25

7. Regulation 13

This Regulation provides for life interests to be valued as the amount which would reasonably be paid for an immediate transfer; it also expressly provides for leases and reversions to be valued on the basis prescribed in Regulation 7. It should be noted that reference in this Regulation to property includes all forms of property.

8. Schedule 2

This Schedule prescribes permitted limits for certain categories of assets in relation to the general business amount ot the long term business amount (as defined in Regulation 15(2)). In this connection paragraph 1 should be noted by Valuers. This deals with the position where a valuation of a piece of land (other than land held as security for a debt) or a number of pieces of such land is greater than the aggregate of the valuations of each piece of land valued separately. This will cover the situation for example where the insurance company owns a number of interests (but not all) in a block of property or an island site, which is being assembled for development. Valuers can be expected, therefore, to be asked to advise on the 'lotting' of a portfolio to produce the highest proper valuation in order that the permitted limits can be tested.

9. The Signing of Valuation Certificates under the Insurance Companies Regulations

9.1 It is recommended that members should confirm in their Valuation Certificate that it is a 'proper valuation' made in accordance with the Regulations and the signatory is a 'qualified valuer' (see Regulation 7 above).

9.2 Care must be taken to ensure that the valuation is only signed by a qualified valuer.

9.3 The Institution is advised that where a partnership consists entirely of persons having the specified qualifications or corporate membership then the Valuation Certificate may be signed in the name of the partnership but this should also include a statement to the effect that all the partners have the specified qualifications.

9.4 If one or more of the partners is, therefore, not a corporate member of the Royal Institution of Chartered Surveyors, or the Incorporated Society of Valuers and Auctioneers or the Rating & Valuation Association the Valuation Certificate must be signed by the qualified valuer who has actually made the valuation and a statement included to the effect that the signatory is a qualified valuer within the meaning of the Regulations.

9.5 If the partnership consists entirely of corporate members of the Royal Institution of Chartered Surveyors or the Incorporated Society of Valuers and Auctioneers or the Rating & Valuation Association, the Valuation Certificate can still be signed in the firm's name, even though one or more of the partners may specialise in the valuation of categories of land other than that which is the subject of the valuation. In this event it must be understood that the actual valuation must have been made by a qualified valuer who has the appropriate knowledge and experience in valuing the subject land.

9.6 If the firm (and this may particularly apply in some overseas countries) is not a partnership but a corporate body then the signatory must be a qualified valuer, and a director or secretary, unless so qualified, may not sign the Valuation Certificate. In this case, it is also necessary for a statement to be made to the effect that the signatory is a qualified valuer within the meaning of the Regulations.

9.8 It follows, therefore, that there should normally be only four forms of signature in accordance with the following examples:

(a) Smith, Jones and Robinson

(Where in this case every partner is a qualified valuer within the meaning of Regulation 7).

or

(b) (i) A. Smith or

(ii) A. Smith
for Smith, Jones & Robinson, or

(iii) Smith, Jones & Robinson
A. Smith

In cases (b) (i), (ii) and (iii) A. Smith being a qualified valuer within the meaning of the Regulations and the person fully responsible for the Valuation.

In both cases (a) and (b) The Valuation Certificate must include the statements as to qualifications referred to earlier.

It must not be overlooked that a partnership can contain as a partner a body of persons corporate or unincorporate and in that case the requirements will only be met by the application of examples (b) (i), (ii) or (iii).

Guidance Note No. GN 21

REVIEWING OF VALUATIONS

1. Reviews of a Valuer's Previous Valuations

1.1 Valuers are often asked to carry out reviews of their previous valuations without undertaking a full reinspection of the properties. Valuers should be cautious in accepting such instructions and should have regard to the period of time that has elapsed since the last valuation. It would not normally be appropriate to accept such limited instructions where there has been a material alteration or change in the property portfolio, a material change in the property market, or a material change in the criteria previously adopted. Changes in rental income or other aspects of tenancies from investment properties would not normally be regarded as falling within the ambit of the foregoing circumstances.

1.2 Where such reviews are undertaken the Valuer is advised to obtain from the client a 'letter of comfort' stating that neither material alterations nor changes have taken place in the portfolio.

1.3 Where there have been material alterations or changes in the portfolio it will be necessary for the Valuer to undertake a valuation of those properties new to the portfolio or those where there have been alterations or changes.

1.4 When reporting the results of a review of a previous valuation the valuer is recommended not to refer to a 'desk study' or similar wording but to adopt the following, suitably amended to meet the particular circumstances:

> 'As instructed, we have reviewed our valuations of (date) without reinspecting (all) the properties and on the same criteria as previously used but under current market conditions we are of the opinion that the open market value as at (date) is of the order of £.....'

1.5 Where alterations and changes of a material or significant nature have occurred and a review has still been undertaken, these should be referred to in the review report.

2. Review of Valuations made by another party

2.1 A Valuer may be asked to review in whole or in part a valuation made by a director or internal valuer of the company which owns the property, or to undertake a review of a valuation by another external valuer.

2.2 A Valuer should not accept instructions to undertake a review of a valuation unless he made that valuation, in which case he should follow the recommendations above.

2.3 Unless the Valuer has already inspected the property concerned and is already familiar with the building and location or is afforded the opportunity of carrying out an inspection and has made all other relevant enquiries, or has been supplied with the information that would result from such enquiries, he is in no position to express an opinion as to value except on a restricted basis. See GN 2

2.4 It is recommended that the Valuer should report his own valuation with such qualifications as may be appropriate. There should be no reference to any valuation prepared by another party as otherwise there may be implied criticism which would be unfair and possibly damaging to the other Valuer's reputation if he is afforded no right of reply. See GN 17

2.5 Where a Valuer is instructed to carry out a valuation jointly with another Valuer, this would not be considered to be a review within the ambit of this Guidance Note, even though one of the Valuers may be an internal valuer. See GN 3

EXHIBIT 7

FIRST ASSET REALTY ADVISORS

APPRAISAL ENGAGEMENT LETTER

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First Asset Realty Advisors

First Bank Place
Minneapolis MN 55480

Appraisal Engagement Letter - Preliminary Draft

TO:

RE: Property Identification

Dear _____:

On behalf of First Asset Realty Advisors (FARA), we would like to engage your services for the appraisal of the above property to determine the fair market value of the legal interests owned by a Commingled Fund as of (date of appraisal). To that end and before accepting the assignment, the appraiser should consider the following requirements as to definition and procedure:

1. Fair market value shall be defined as the most probable price at which the property would sell to a knowledgeable buyer on a given date if placed on the market for a reasonable length of time by a well informed seller assuming:

   a. Cash to the seller or cash plus debt owed or assumed by the buyer, where appropriate.
   b. Fee title will be encumbered by leases in place and possible other covenants. Appraiser must indicate remaining market value of these other leasehold or non-possessory interests.
   c. The appropriate exposure on the market has occurred prior to the date of sale.
   d. Buyer motivation is profiled as an assumption by the appraiser.

2. Fee title may be encumbered by leases, mortgages as well as possible conditional use permits and private covenants. FARA is obligated to provide access to all of the appropriate documents at the office of _____ _____ located at _____ _____ during normal business hours. The appraiser is expected to read the leases, mortgage instruments and other encumbrances and relate to them appropriately. If existing debt is assumable by another buyer, then the appraiser can value the sale as cash to the seller with the buyer accepting the mortgage(s) already in place if that would be consistent with the most probable buyers self interest. Otherwise the trustees of the Commingled Fund management (FARA) are interested in a value which is the most probable cash price to the seller and with the buyer accepting the existing encumbrances in terms of leases and covenants, etc.

3. When using the market comparison approach the appraiser must document each comparable sale as to grantor, grantee, public record, plot plan and photograph as well as basic details of construction and existing encumbrances, terms of sale, and seller motivation. All calculations necessary to adjust engineered prices to cash equivalencies must be documented and explained as well as any and all adjustments to relate the comparable price to the subject property must be itemized and explained so that the reader can repeat the mathematical adjustments possible.

4. The income approach must use discounted cash flow from a ten year forecast (and your own forecast if different) in which all major leases are detailed individually and minor leases classified into groups if appropriate. The rationale for roll-over vacancies, absorptions, and expense projections must be itemized with a series of footnotes in the manner of a fully detailed accounting income and balance sheet statement. Normalized income methods including investment bond, Ellwood, or net income multipliers are not acceptable.

5. The appraiser must document his opinion as to the appropriate discount rate applied to each segment of the cash throw-off and after tax cash flow as appropriate, together with financing terms assumed.

6. A cost approach by a responsible service or professional should be supplied with the initial appraisal. If it is not used in the final valuation, then a discussion on why it is not used is required. The appraiser is expected to carefully inspect the property and report his own independent views on the quality of maintenance, deferred maintenance, and tenant housekeeping.

7. The appraiser is regarded as the eyes and property inspector of FARA. To put the property in context the appraiser must supply and evaluate a list of projects which are competitive alternatives in the market areas of the appraiser and indicate rent structures, vacancy rates, turnover rates, and in the case of the new building, coming on stream or about to be built, some indication as to their rentup success and the source of their tenants. Wherever possible the appraiser is to indicate the ownership and character of investment position in these competitive properties and the property management or leasing term involved with each.

Following the initial appraisal at the time of acquisition, the appraiser will be asked to submit a letter of review 180 days after the date of the original appraisal indicating if he would modify any of his critical assumptions at that time, and if so, indicating how this might affect his original value estimate as a specific dollar adjustment, up or down.

At the end of 360 days the appraiser would be expected to perform a thorough review of his original appraisal, specifically focusing on the market approach (Item 3), adjustments indicated for the income approach (Item 4 & 5), and additions and amendments to

First Asset Realty Advisors

First Bank Place
Minneapolis MN 55480

Appraisal Engagement Letter - Preliminary Draft

TO:

RE: Property Identification

Dear _____:

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1. Fair market value shall be defined as the most probable price at which the property would sell to a knowledgeable buyer on a given date if placed on the market for a reasonable length of time by a well informed seller assuming:

   a. Cash to the seller or cash plus debt owed or assumed by the buyer, where appropriate.
   b. Fee title will be encumbered by leases in place and possible other covenants. Appraiser must indicate remaining market value of these other leasehold or non-possessory interests.
   c. The appropriate exposure on the market has occurred prior to the date of sale.
   d. Buyer motivation is profiled as an assumption by the appraiser.

2. Fee title may be encumbered by leases, mortgages as well as possible conditional use permits and private covenants. FARA is obligated to provide access to all of the appropriate documents at the office of _____ _____ located at _____ _____ during normal business hours. The appraiser is expected to read the leases, mortgage instruments and other encumbrances and relate to them appropriately. If existing debt is assumable by another buyer, then the appraiser can value the sale as cash to the seller with the buyer accepting the mortgage(s) already in place if that would be consistent with the most probable buyers self interest. Otherwise the trustees of the Commingled Fund management (FARA) are interested in a value which is the most probable cash price to the seller and with the buyer accepting the existing encumbrances in terms of leases and covenants, etc.

EXHIBIT 8

ALTERNATIVE

LETTER OF ENGAGEMENT

FOR PENSION FUND MANAGER

1. All the requirements of the General Information (revised 10-4-85) form apply to the Update. Data obviously repetitive may be omitted by incorporating the original appraisal by reference, but the need to refer to the original, or to earlier updates, should be minimum. Emphasize the changes.

2. Reinspect the property.

3. Include at least:

   a. A summary description of The Property.

   b. The site plan sketch.

   c. A current photograph.

   d. An updated HABU section. Restate the HABU of the land as if vacant, and of The Property.

   e. Description of national and local economy and market, neighborhood changes (such as evidence of growth and development, or of deterioration), and competition.

   f. Description of property condition, and estimate of cost to correct major curable deficiencies.

   g. Fresh land comps, property comps, and rent comps, including a recap of all leases in The Property over the last 12 months.

   h. Support for growth rates, inflation rate, rates of return, market rental rates and sales projections.

   i. For shopping centers, an updated review of department store (individually) and mall stores (total) sales, gross and per square foot, over the past three years.

Standard

The appraisal report is to be made in conformity with, and is subject to, the requirements of Regulation 10, Code of Professional Ethics of the American Institute of Real Estate Appraisers.

Material HAC will provide:

- A copy of the Investment Analysis And Property Valuation used for the acquisition.
- Current year Operating Statement forecast.
- Cash Operating Statements for previous years our client has owned the property, up to three years.
- Current Rent Roll.
- Current year Budget summary.
- 3rd party mortgage terms, debt service and balance.
- Title Report.
- Survey.
- Site Plan and Rent Plan for regional and community shopping centers.
- Base year operating expenses.
- Selling price and date of properties sold from industrial packages.
- Tenant-by-tenant sales volume reports for retail properties.

Leases and lease extracts may be reviewed at the respective management offices.

Table of Contents

We require a detailed Table of Contents so we may quickly locate specific sections, particularly in the Income Approach. This is especially important on large multi-use properties.

Value Fair Market.

Type Full narrative.

Interest

1. Always appraise the interest of a party that owns the entire property, both land and building, subject to the building leases.

2. When the building is (entirely or partially) on leased land, appraise also the interest of a party that owns the building, subject to the land lease and to the building leases.

3. On some properties our client has a partial interest. Where this is the case, calculate also the proceeds to our client at a sale of the entire p operty at the appraised value.

Financing

Appraise subject to existing mortgage debt.

Content Include:

1. Except for regional and community shopping centers, a site plan sketch showing lot lines, building lines, site square feet (or acres), building square feet, a few dimensions, and atypical easements. Do not use a copy of the survey.

   For industrial buildings, show on the sketch (1) the approximate outline of finished space (office, lab, showroom, high-tech), (2) the square footage of that space, (3) demising walls in multi-occupant buildings, (4) dock doors, and (5) drive-in doors.

2. The effect easements have on property value, if the value of the easements is substantial and the easements are atypical.

3. A discussion of the national and local economies, both in general and in respect to the property type. Cover historic absorption, current vacancy, additional space coming on line, projected future absorption, etc. in support of your forecast of the supply/demand relationship over the next 5 to 6 years. Support your selection of growth rates, inflation rate, and rates of return. Discuss neighborhood and market area status and trends.

4. Zoning:

A zoning map (entire or extract) showing the subject and the subject's zoning, with the subject's location identified.

Your synopsis (we do not want copies of, or excerpts from, zoning ordinances) of particularly pertinent parts of the zoning regulation (such as parking and prohibited uses), and your opinion as to whether the occupant is conforming. In industrial zones, include enough information (including restrictions and covenants running with the land) about set-back, signing, storage, and landscaping to define the quality of the neighborhood.

Where re-use is a consideration, as for example conversion of industrial to retail or office, we want to know the use, height, set-back, and parking restrictions.

5. Real estate tax:

A tax map with the subject outlined in red, and the tax number.

For states other than California, a comparison of the tax with the tax on similar properties, and comment on likely tax changes on The Property.

Base the real estate tax on what it is likely to become as the result of a sale at the appraised value.

6. A description of building condition, grounds condition, housekeeping, and the approximate cost to correct major curable deficiencies.

7. In the Highest And Best Use section, a conclusion on the HABU of the land as if vacant.

8. A Cost Approach. Include in it a Comparison Approach to land value, stating how each sale compares to The Property in respect to location. State the source (preferably published) for cost estimates, and explain the derivation of any soft cost breakouts such as financing, administration, rent-up expenses, leasing commissions, developer profit, and developer mark-up. For the basic depreciation (before the appraiser's adjustments), a published source is preferred over the appraiser's estimate of effective age/life.

9. A Comparison Approach. Include at least 5 sales within the past 12 months. Quality is preferred to quantity. Locate local sales on a map. State the age, and compare the location to The Property.

   Shopping centers: Include at least 5 sales with a Gross Income Multiplier. (To obtain 5 GIM's on regional and community centers you may use sales other than the 5 sales which occurred during the past 12 months, and these sales may be as much as two years old.) Select a GIM for The Property, and include a GIM approach to value.

Regional shopping centers: Include total gross leasable area, GLA sold, and, for GLA sold, the total footage for department stores and the total footage for mall stores.

Industrial: Include clear height; lot coverage; and percent of office, high-tech, or showroom space. Specify single or multi-occupant; if multi, the number of units. Include photographs of the sale and rent comparables, preferably front and rear. These pictures may be photoprints.

10. An Income Approach. Include a discounted cash flow, typically for at least 10 years. Include in the last years cash flow the proceeds from a sale at the end of the last year based on the next year operation.

Use the DCF by applying a yield (IRR or discount) rate to the cash flows to obtain the value indication. (As opposed to using it to obtain an IRR as a check against other value indicators.)

Bottom line cash flows for the 11 years, with the IRR('s) and resulting value(s), should all appear on one page (either alone or with other data).

Show the proceeds of sale calculation, including the calculation of the commission, if any.

In support of the income used in the DCF, on percentage rent spaces show, for each space, the previous year sales, in total and per square foot and support your estimate of sales for the projection period. On a space-by-space basis, for all property types, show income for every year of the DCF, broken down into base rent, percentage rent, reimbursements, CPI, etc. On a summary sheet list all the spaces, with totals for each year.

On all operating statements for office and industrial, we prefer this sequence after income:

Expense
Expense
(etc.)
Total before-tax expenses
Tax
- Total expense
NOI
- Non-recurring
- Tenant improvements
- Leasing commissions
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LANDAUER

JOHN R. WHITE

Honorary Chairman & Director
Landauer Associates, Inc.

For seventeen years over the past quarter century, John R. White under various titles led Landauer Associates, the New York based international real estate consulting company with offices throughout the United States, Europe and Australia. He is now enjoying working on key accounts for Landauer's clientele as Honorary Chairman, Director and principal management shareholder.

During this period he has been a forecaster of real estate markets; a valuation specialist in the largest scale properties; and a consulting intermediary in the purchase, sale and financing of such properties as the Pan Am and General Motors Buildings in New York; L'Enfant Plaza in Washington, D.C.; Bank of the Southwest Building in Houston; and the ground lease extension negotiations and lease re-casting at Rockefeller Center. He also served as consultant to General Motors in the site selection and location of Saturn Corp. in Spring Hill, Nashville area, Tennessee, and to NBC in its current corporate relocation studies.

He has served or is now serving on many different Boards of financial institutions and investment companies as a trustee or director. He is Chairman of Turner Equity Investors, a publicly owned realty trust. He has been both national president of the American Society of Real Estate Counselors and Chairman of the Appraisal Journal, the quarterly publication of the American Institute of Real Estate Appraisers. His awards include:

- The Ellwood Award for Appraisal Excellence, 1975 - New York State Appraisal Society
- The Armstrong Award (twice) for best article in the Appraisal Journal - American Institute of Real Estate Appraisers
- The Realtor of the Year Award, 1981 - The Realty Foundation of New York
- Urban Leadership Award, 1985 - Real Estate Institute of New York University
- Best Article Award, 1985 - Federation Internationale Des Professions Immobilieres (FIABCI)
- Y. T. Lum Award, 1986 - American Institute of Real Estate Appraisers

Mr. White also served as an Adjunct Associate Professor of Real Estate at New York University from 1948 to 1960 and is now Executive in Residence, Columbia Graduate School of Business. He has published 75 articles on real estate economics, finance and valuation. His recent writings include "Real Estate Valuing, Counseling, Forecasting," published by the American Institute of Real Estate Appraisers in 1984 and "The Real Estate Appraiser - The Elusive Goal of Professionalism," published by the American Institute of Real Estate Appraisers in 1987 in the Appraisal Journal.

Mr. White has a AB from Harvard College and an MBA from New York University.

The Real Estate Appraiser–The Elusive Goal of Professionalism

by John R. White, MAI

PREFACE

The purpose of the study presented in this article was to report on the relative progress that real estate appraisers have made towards professional recognition. Part of the study included a survey that focused entirely on members of the American Institute of Real Estate Appraisers. Members and candidates of the Appraisal Institute represent about 17,200 individuals of a total estimated 200,000 or more who practice as appraisers, or occasionally represent themselves as such. An objective analysis led to the inescapable conclusion that the preeminent appraisal body is the Appraisal Institute, because it possesses the highest educational, ethical, and testing standards for appraisers of income property. The Society of Real Estate Appraisers, which started as a single-family dwelling appraisal group, still represents the vast majority of qualified single-family dwelling appraisers.

John R. White, MAI, is managing director of Landauer Associates, Inc., Real Estate Counselors, in New York City. He has written numerous articles on appraisal, economics, and finance, as well as contributing to *Selected Readings in Real Estate Appraising*. He is the author of *Real Estate Valuing, Counseling, and Forecasting*.

The study presented in this article was carried out under the auspices of the Sylvan Lawrence Research and Data Center of the Real Estate Institute of New York University. Funding was provided by the National Council of Real Estate Investment Fiduciaries.

The second part of this article, "Profile of the Modern Appraiser," will appear in the October 1987 issue of *The Appraisal Journal*.

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The survey also concentrated on Appraisal Institute members who are recognized as appraisers of income properties, that is, those providing net operating income (NOI) from tenancies or readily estimable on owner-occupied properties. Although the survey of membership and client opinions and attitudes did not so intend, the responses indicate that the answers came mainly from successful, investment-oriented urban appraisers, and hence may indicate a bias.

Extreme care was taken in the introduction to the survey questionnaire to elicit the need for opinions on the relative status of appraisers, rather than an explanation of how respondents had fared in their personal development and work experience. An effort also was made to evoke opinions directly from clients of appraisers on how appraisers compare to those in other professional pursuits, with special reference to occupations with which appraisers compete. This effort was not entirely successful because the appraisers' thoughts tended to be influenced by their own relative progress. The clients of appraisers were no more specific in their views.

I would like to acknowledge the intelligent and conscientious effort of Edward M. Zevin of the Sylvan Lawrence Research and Data Center, who accomplished most of the research and wrote a portion of the report. To Dean Norman Weinberg of the Real Estate Institute of New York University goes my special thanks for his unwavering confidence in the outcome of the study and in his highly accomplished editing. Last, Suzanne van de Velde and Mary H. Smith must be singled out for the efficiency of their proofreading and production of the finished report.

I would also like to express my thanks to the Appraisal Institute and its officers and members for their whole-hearted cooperation, and for the splendid assistance provided by its staff.

HISTORICAL SETTING

From 1950 through 1965, the United States was in the midst of a 15-year period of economic euphoria and tranquility. This period was marked by very low inflation, correspondingly low interest rates, mild recessionary episodes, and a steady but moderate increase in Gross National Product (GNP), employment, and disposable personal income. Investment real estate was generally in supply-demand balance and patches of significant oversupply were rare. In 1960, for example, internal rates of return (IRR) were around 8%, while mortgage money for 75% to 80% of the value of real estate was available at 5% to 6% interest. In 1965, the Pan Am Building was financed at 5% interest on a 30-year self-liquidating mortgage loan.[1] Property was positively leveraged through conventional financing. A reasonable amount of amortization was paid out of cash flow while leaving sufficient

1. John Robert White, *Real Estate Valuing, Counseling, and Forecasting, Selected Writings of John Robert White* (Chicago: American Inst. of Real Estate Appraisers, 1984), 189.

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income for the developer or investor. Balance sheets had real meaning and did not require what some investment analysts regard as the added prop of appraised values as a substitute for the book value of the improvements.

POLITICAL-ECONOMIC EVENTS AND APPRAISAL METHODOLOGY

In this setting, there were no significant external incentives for changing appraisal methodology. The earlier writings of Frederick M. Babcock, H.E. Hoskold, and Irving Fisher ruled, along with the 4th edition of *The Appraisal of Real Estate.*[2] Babcock's book was a classic in its time.[3] The various residual capitalization techniques used William Inwood's or Hoskold's sinking fund depreciation. The need to forecast future income annually on the assumption of major changes in future lease rentals was never felt. The future was today. Flat rental projections were in vogue. The cost approach to value was still given weight early in the period, on the grounds that there was insufficient market evidence of value in the income capitalization and sales comparison approaches. The tedium of estimating an elusive reproduction cost, reduced by various equally elusive calculations of physical, functional, or economic depreciation, still prevailed.

The emphasis in rental property, however, was shifting slowly to increased reliance on income capitalization. Although not yet articulated, this method really evolved from a broadly considered overall sales comparison approach. The approach takes into account the comparability of rent, vacancies, operating expenses, real estate taxes, and rates of return. The pure sales comparison approach was somehow confined primarily to land sales and was never really in the forefront of appraisal methodology, except for its relatively rare application in income capitalization. Few appraisers, then or now, agree that there is only one way to derive market value–by comparison–and that the three legs of the valuation stool are the mechanisms by which to estimate market value comparatively. Nevertheless, at the time, income capitalization was considered to be most important. The thesis that every technique is basically comparative was dismissed as theoretical by most appraisers.

THE FEDERAL HIGHWAY PROGRAM

In the mid-1950s, the federally funded interstate highway program was conceived and initiated. The effect on appraisers and the appraisal function was profound. Routes were devised over almost endless tracts of vacant land, usually around the outskirts of the main cities, frequently in a circumferential fashion and sufficiently far removed from the central business district (CBD) to permit the land to be acquired less expensively. Because unimproved land

2. American Inst. of Real Estate Appraisers. *The Appraisal of Real Estate.* 4th ed. (Chicago: American Inst. of Real Estate Appraisers, 1964).
3. Frederick M. Babcock. *The Valuation of Real Estate* (New York: McGraw-Hill, 1932).

or farms were the major types of real estate, followed by homes and smaller commercial or industrial properties, the sales comparison approach was extensively utilized. Most major properties, those normally appraised by the appraisal elite in larger cities, escaped condemnation; appraisal action was primarily in the suburbs and the rural expanses of America.

This was not a business venture to attract people to the practice of real estate appraising. Nor was it a provocation to test the ingenuity of the valuation methodology at the time. Comparative land sales techniques improved simply because appraisers realized the importance of having accurate facts about each sale and because the court system demanded accurate data from appraisers in condemnation and tax reduction proceedings. These small advances tended to be offset, however, by the injudicious and sometimes unethical use of land residual capitalization in condemnation cases involving land with no foreseeable chance of subdivision and development. Between 1950 and 1965, appraisal was characterized by relative stagnate technique, but intensive volume of condemnation business.

URBAN RENEWAL AND ITS EFFECT

The 1950s and 1960s also saw the advent of widescale urban renewal. Under the prevailing federal statutes, the government, in effect, funded a community's effort to restore itself; sometimes in housing for the poor and disadvantaged, and frequently in complete renewal of portions of, or the whole of a CBD. Two of the best illustrations of highly successful renewal processes are in Boston, Massachusetts, and Stamford, Connecticut. In the former, the waterfront area adjacent to the CBD was effectively salvaged, while Stamford's plan successfully provided for a comprehensive reconstruction of the CBD.

Appraisers benefited greatly from urban renewal. First, there were the required condemnation appraisals of the areas designated for renewal. Second, a new land use plan had to be adopted, backed by a market study. Third; the selling price of the land, subject to the land use plan restrictions, had to be estimated. Although there were literally thousands of appraisal assignments throughout the country, this had relatively little effect on the development of appraisal methodology. A few appraisers, including the late William S. Ballard, MAI, Charles F. Seymour, MAI, and I, made a limited contribution by recognizing and articulating the impact of the specific land use standards and controls on market value. These factors tended to be more limiting than existing zoning restrictions and generally had a negative effect on market value. Participation in the formulation of the land use plan, and the need for a market analysis of the proposed quantities of uses out of the total market, broadened appraisers' horizons about the forces that lead to development motivations. Unfortunately for the appraisal profession, many

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of the market study assignments went to planners and economists because of appraisers' general reluctance to assume responsibilities outside the narrow field of real estate valuation.

THE REAL ESTATE INVESTMENT TRUST (REIT) DEBACLE

The REIT debacle of the 1970s did much to deprive appraisers of any luster they may have possessed. Under the misguided notion that money could always be effectively reinvested at a higher rate than its borrowing cost, mortgage, equity, and mixed REITs proliferated in the mid-1960s and thereafter. Reasonable lending criteria were compromised because of the pressure to invest. REIT staffs were generally young, inexperienced people who were not adequately supervised. Both internal staff and independent fee appraisers were caught up in this frenzy. It took only the hard money, high interest, depression-ridden days of the mid-1970s to expose the REITs' investments for their weaknesses, which led to foreclosures and bankruptcies on an unparalled scale. The calamity was caused by the inability of the REITs to pay the interest charges on borrowed capital because of insufficient revenues (interest) from investments in defaulted mortgage loans.

Appraisers' status was diminished significantly by these events. In retrospect, however, the primary problem lay with Wall Street's pressure on fund managers to accept more money for investment, regardless of the problems of managing growth effectively. Others explain this era in terms of the Federal Reserve Bank's policy, even before Chairman Paul C. Volcker, of being too restrictive with the money supply. It does seem that neither the appraiser nor the REIT entrepreneurs could have foreseen the severity of the interest rate rise which, with oversupply, bankrupted the REIT industry. How prescient could appraisers' employers expect them to be?

INTRODUCTION OF NEW TECHNIQUES

Two developments in the mid-1960s, one methodological and the other economic, provided the shock that was needed to stimulate the appraisal business. First was the introduction of the innovative theories of Leon W. Ellwood, MAI. Ellwood's mortgage equity capitalization method was the first real advance in appraisal methodology in 50 years.[4] Second was the onset in April 1966, of the country's first postwar credit crunch. This was triggered by the costs of the Vietnam war being financed by federal borrowing rather than by additional taxation. The economic tranquility of the previous 15 years ended and a 20-year period of increasing financial volatility began, culminating in a prime rate that rose from 9% in 1979, to 21% in 1980, and fell back to 10% in 1981. This financial volatility was predictably followed by a period of rapidly advancing inflation that reached a peak of 14% in 1979.

4. L. W. Ellwood. *Ellwood Tables for Real Estate Appraising and Publishing* (Cambridge, Mass.: Ballinger Publishing Company, 1977).

Appraisers were not, of course, immediately aware, nor prepared for the consequences to real estate of budget deficits, surging interest rates, rampant inflation, and negative leveraging. The consensual outlook was for the economy to climb cyclically to successively higher inflationary peaks. Financial markets were beset with increasing volatility through 1981, and particularly from 1976 to 1981.

THE ELLWOOD ERA—A MAJOR ADVANCE IN PROFESSIONALISM

The creativity of Leon W. Ellwood, MAI, the originator of the Ellwood theory of mortgage equity capitalization, became apparent through his writings and teaching. Elwood's influence was particularly supplemented by his devoted friend and fervent supporter, James E. Gibbons, MAI, who was able to enunciate the Ellwood system of mortgage equity capitalization with greater clarity and meaning for appraisers.[5] Ellwood was the first appraiser to develop mathemetical approaches to revenue changes over a period of time, perhaps even annually, and to assert that stability, or flat rental, was not necessarily what the future held for real estate. He believed strongly in equity capitalization, recognizing that virtually every parcel of real estate is financed with a mortgage or is capable of being mortgaged. He also recognized that amortization payments—all other things being equal—constitute an increase in equity because a debt is being reduced out of cash flow.

Because Elwood originally intended that his system be taught as an algebraic exercise, there was significant confusion among appraisers. That situation was alleviated by Gibbons's teaching and mathematical skills, and the article "Ellwood Without Algebra," by Charles B. Akerson, MAI.[6]

INCREASING FINANCIAL VOLATILITY

In reviewing the economic and financial history of the period from 1950 to 1960 it is very evident that the increasingly higher long-term inflation rate that followed the April 1966 credit crunch was the single most important event to appraisers. Inflation ebbed and flowed following 1966. In brief periods, it produced a false sense of security about the severity of its effects because of stabilization at lower levels. In 1979, a more intense, much more volatile type of inflation took hold. The very severe 1974 to 1976 real estate and economic recession temporarily blunted the effects of inflation. The extreme prosperity of the late 1970s triggered a wild inflation accompanied by extreme swings in interest rate patterns that usually led to successively higher levels of prices and values. Some of the financial instability arose from the policies of the Federal Reserve System under Paul Volcker's leadership. The Fed chose to concentrate on containment of the money supply as the

5. James E. Gibbons. *Appraising in a Changing Economy: Collected Writings of James E. Gibbons* (Chicago: American Inst. of Real Estate Appraisers, 1980).
6. Charles B. Akerson. "Ellwood Without Algebra." *The Appraisal Journal* (July 1970): 325–335.

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dominant factor in restraining inflation, rather than on a more multifaceted program that would have given greater weight to movement in interest rates, credit, and a host of other economic factors.

THE COMPUTER REVOLUTION— A SIGNIFICANT DEVELOPMENT IN APPRAISAL HISTORY

In the early to mid-1970s real estate appraisal work utilizing computers was performed on large mainframe systems through time sharing. Initially, the applications were limited to entering income and expense components, projecting these forward at assumed inflation rates, and combining resultant cash flows with loan and depreciation factors to generate pretax, after-tax, and yield analyses.

Software became more sophisticated around 1976, with the advent of multilease analysis. This enhancement involved entering information on each lease in a property. Fifty to 100 items per lease could be entered, encompassing both current and future occupants of the space in question, to generate a rigorous projection of income.

The introduction of the personal computer in the early 1980s provided the mechanism to bring computerized appraisal techniques to firms that did not have a mainframe system or could not afford timesharing costs. In the early 1980s appraisal software for personal computers was in its infancy. The few programs were slow, hard to use, and sometimes produced incorrect results.

Since then, the number of appraisal software programs on the market has increased. Some of them are of a quite high quality, and provide the user with friendly screen interface, fast calculations, and a variety of reports. The market for programs is, in fact, oversaturated. There is no "industry standard" nor is there any benchmark or comparison of the capabilities of one program versus the other. Appraisers seeking to purchase a program for the first time must do a lot of research into the available software before making an appropriate decision.

Even though personal computers have brought increased appraisal capability to more firms than ever before, a word of caution is in order. Most noncomputer professionals look at the computer as a tool, with which they expect to push a button and get an answer. Even with the best software on the market, the quality of the appraisal will be only as accurate as the data entered and the care given to checking the numbers that emerge. The computer makes the repetitive tasks of changing one or two numbers and rerunning extremely easy, but some users tend to lose sight of the need for quality control because abuse of the system is so easy. In the hands of an irresponsible person, the computer becomes an artifact manipulated to achieve a misleading appraisal result.

SYNDICATION—A BIG BUSINESS

Before the passage of the Economic Recovery Tax Act (ERTA) of 1981, syndication was rather limited and confined primarily to the purchase of subsidized or nonsubsidized apartments for tax shelter purposes by affluent investors seeking to minimize their income tax liability. In the five years following the passage of the act, syndication blossomed as a powerful force that survived the Tax Reform Act of 1984 and will survive the Tax Reform Act of 1986. Some of the imprudent transactions in this period will be exposed for their weaknesses over the ensuing years, and in many cases, appraisers will have to defend their actions.

Many instances of mortgage foreclosures on syndicated property, principally apartment houses have already surfaced. To the extent a recession occurs, the incidence of failure will invariably increase. Among other reasons, many of these properties will be unable to pay the accumulated deferred interest in purchase-money secondary debt financing granted by sellers at below-market interest rate terms, which was possible under the provisions of the 1981 act. Appraisers have had some problems in trying to resolve whether at the same time, under the so-called bundle of rights theory, they can estimate different values for the same property, as dictated by the appraisal instructions, conditions, and assumptions furnished by the client.

THE APPRAISED VALUE BALANCE SHEET

In 1976, The Rouse Company, a major developer of regional shopping centers, decided to include in the company's annual report an appraised value balance sheet in addition to the standard book value balance sheet. As a development company, Rouse had long felt that its stock was fundamentally underpriced because its earnings-price relationship did not reflect the investment health of the company. The relative success and profitability of a development company are difficult to divine for the average shareholder. This results from the tendency of intense development activity to obscure the appreciation sustained by the completed centers, and by the probable success anticipated from the properties under development.

Rouse engaged a national real estate consulting firm, with which they formulated a basis for a review of internal appraisals made in a consultant-approved format and methodology by Rouse financial officers. This led to the adoption of similar activity by many other companies. In the case of one of Rouse's major competitors, Corporate Property Investors, the annual appraisals were not made by the investment company, but by the appraiser-consultant firm. Generally, the method had a very salutary effect on the stock market performance of the shares.

Recently, appraisers are being questioned about their capabilities in relation to appraised value balance sheets. Many critics have concluded that the valuations are optimistic. In the case of open-end real estate funds, they

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claim that the inconsistency of the results has inhibited some analysts from recommending their pension funds to invest in open-end funds. Similarly, due diligence appraisals are now a concern of appraisers because more attention is focused on results as a basis for a public issue of real estate stock or mortgage bonds. Overall, the increased size of urban complexes puts a greater responsibility on the appraiser to recognize every facet that affects value, especially where mixed uses are involved. Renewed attention on marketability and market analyses, as well as market value has positioned appraisers in an evergrowing web of responsibility for their actions.

CLIENTS' INSTRUCTIONS AND APPRAISERS' ETHICS

When clients dictate appraisal assumptions considered to be unrealistic, appraisers must refuse the assignment or disassociate themselves from the valuation result and indicate their reasons in the report. One of the most obvious examples of such assumptions is a market value of a development project assuming a 95% occupancy on completion. Ethical appraisers may operate on this assumption, but they must also make clear what the realistic absorption rate will be, the time required to achieve normal occupancy in that market, the supporting market reasons for their judgments, and the effect on value. Essentially, then, two appraisal results must be presented when appraisers are at odds with the client's instructions. There have been countless occasions when appraisers have refused to proceed further when their research reveals the misleading nature of the appraisal assumptions, and when the client has been unwilling to modify them to comform to the reality of the market.

In a recent interview, Glen M. Sanders, Vice President of Examinations, Federal Home Loan Bank, San Francisco, listed certain assumptions that appraisers make that are not necessarily correct or realistic in terms of the market:

1. A building is finished and rented.
2. The land has been rezoned according to the builder's prediction.
3. The soil is stable.
4. All the utilities are at the site and connected.
5. All fixtures and appliances manufactured off-site are installed.[7]

LIABILITY INSURANCE

The cost of liability insurance for financial services companies has skyrocketed in the past few years. Officers' and directors' liability, and so-called errors and omissions (E&O) policies are now virtually unobtainable except at prohibitive expense. The wave of suits and extremely high awards in liability matters have made appraisers acutely aware of their responsibilities and personal exposure to loss. The difficulty of obtaining insurance for

7. Glen M. Sanders. "Real Estate Loan Review Practices." *Bankers Research* (May 12, 1986):3.

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coverage that was always assumed and in the past did not represent an important part of the appraisers' operating expenses, has made appraisers very cautious and highly sensitive to the possible implications of their assignments.

The usual solutions of offshore coverage, self-insurance, and other means are currently under study. In the interim, appraisers must be conscious of the significance of every statement they make and of the need to have supporting documentation leading to a rational answer, or they may face a legal suit with the possible risk of loss of their net worth.

Areas of particular concern to members of the American Institute of Real Estate Appraisers include the startling increase in the cost of E&O coverage, which bears no relationship to actual losses experienced by carriers. "For some members, the cost has increased over 600% in the past two years despite the fact that no claims were filed," according to Richard B. Gaskins, Executive Vice President of the Appraisal Institute. Gaskins has said that the growing crisis in procuring E&O coverage is not due to unfavorable losses relating to appraiser claims, but rather the result of losses from claims against other professionals such as doctors, attorneys, and accountants.

Obviously, appraisers are taking a very careful look at self-insurance as a logical alternative. The outcome is not known, but it should cause the quality and accuracy of appraisal results to improve dramatically. This very beneficial result for the general public will have as significant an effect on appraisers as the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice. Obviously, appraisal fees will increase as well.

APPRAISERS' PUBLIC RELATIONS PROBLEMS

Historically, the appraiser has never been thought of as a controversial figure in the financial and investment world. An appraisal was rightfully considered an opinion of value in an imprecise science in which judgment prevailed. A series of limiting conditions and assumptions crafted by appraisers through their professional trade organizations provided further insulation from liability actions by clients, or by those claiming a grievance as the result of an appraised value.

Yet periodically throughout the post-World War II era, appraisers have been accused of incompetence, misjudgment, or unethical conduct. Because of the size of the project, administrators of the federal highway program were forced to engage many persons with backgrounds as brokers, managers, and property owners, but with insufficient training and skills in appraising. The extensive condemnation of hundreds of thousands of acres throughout the country led to a volume of appraisal that occasionally revealed the advocate or the incompetent. Judged in the context of the size of the program, the majority of persons did reasonably well in estimating market value.

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Urban renewal caused rumbles as well in the 1960s and 1970s. The problems, however, were primarily attributable to a misunderstanding of the appraisal requirements, or from rather obscure governmental instructions designed to clarify the "write-down" nature of land value, depending on the intensity of the land reuse, in which cleared land was frequently surrounded by only slightly better housing than that of the slums. Recently there has been considerable criticism by the Federal Savings and Loan Insurance Corporation (FSLIC) and the Federal Home Loan Bank Board (FHLBB) about the shoddy quality of appraisals of properties serving as mortgage collateral on loans made by the savings and loan industry. This has provoked governmental bulletins describing in painfully basic fashion the essentials of an appraisal report.

Events of the 1980s have tried the capabilities of the most skilled and knowledgeable Realtors and appraisers. The economic base roller coasted from an extreme peak of prosperity in 1980 and the first six months of 1981, to a relatively severe recession in late 1981 to 1982, followed by four years of unsurpassed prosperity. Interest rate volatility; real estate oversupply; high inflation followed by distinctly lower inflation and interest rates in the 1983 to 1986 period; a historical peak in stock market averages; and through it all, strong investment demand from pension funds, syndicators, insurance companies, and investment groups—all paraded by the appraiser in a confusing melange of events. Surely the difficulties caused by the extraordinary volatility of the times could not be laid at the appraisers' feet.

EDUCATIONAL STANDARDS IN APPRAISING

IS APPRAISING A PROFESSION?

On the founding of the Appraisal Institute in 1932, its president, Philip W. Kniskern, announced that as one of its primary goals "the Institute will foster the development of the science of real estate appraising and will elevate it to the level of a profession as it deserves."[8] Over half a century later, there are still serious doubts as to whether real estate appraisal has achieved these goals. Beginning in the 1960s, when professional institutions in general came under attack, articles appeared in *The Appraisal Journal* questioning the professional status of real estate appraisers. In the majority of cases those who analyzed the issue concluded that appraisal had not yet become a true profession. The criticisms continued, but in the 1970s, appraisers began to speak loosely of the "appraisal profession" as if it were already an accomplished fact. Then in 1979, H. Bob Stellmacher, MAI, announced the arrival of real estate appraisal as "the world's newest profession."[9] Stellmacher

8. Philip Kniskern, "A Message from the President of the Institute," *The Appraisal Journal* (October 1932):2.
9. Bob H. Stellmacher, "Real Estate Appraisal: The World's Newest Profession," *The Appraisal Journal* (January 1979):99.

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admitted that it would be difficult to prove exactly when real estate appraisal had become a profession, but he pointed to public recognition as the key criterion for professional status. A few recent court decisions have also referred to the increasing professional status of the appraiser.

> Until recent years there were only a limited few people trained in the science of real estate appraising, but it has now reached a professional status that should be recognized by the courts. The American Institute of Real Estate Appraisers has developed real estate appraising to almost an exact science.[10]

Clearly, however, not only is the general public far from unanimous in its recognition of appraisal as a profession, but many appraisers themselves continue to deny the professional status of their field. A recent article in *The Appraisal Journal,* based on a study partially funded by the Appraisal Institute, examines what it calls "the failure of the real estate appraisal field to become a profession."[11] In order to examine this difference of opinion, it seems appropriate to begin with the dictionary definition of the word *profession.*

Webster's New International Dictionary provides the following definition of *profession*:

> 4a. A calling requiring specialized knowledge and often long and intensive preparation including instruction in skills and methods as well as in the scientific, historical, or scholarly principles underlying such skills and methods, maintaining by force of organization or concerted opinion high standards of achievement and conduct, and committing its members to continued study and to a kind of work which has for its prime purpose the rendering of a public service.

According to this definiton, the following characteristics are to be found in any profession:

1. Specialized knowledge
2. Practical and theoretical training
3. Continued study
4. High standards of competence and conduct
5. Rendering of a public service as a prime purpose

Further simplified, we may separate the requirements for professional status into two categories:

1. Education and training. The professional must receive and continue specialized training in a chosen field, both theoretical and practical, such as would qualify one as an expert.
2. Ethics and standards. The professional must be committed to the maintenance of high standards, both in the performance of duties and in relations with the public.

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10. *Newport Housing Authority, Inc. v. Hartsell.* Court of Appeals of Tennessee, Eastern Section. 533 S.W.2d 317 (cert. denied by Supreme Court) (1076).
11. James H. Boykin, "Review and Prospects for Real Estate Appraisal Education," *The Appraisal Journal* (July 1985):347.

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Although not an absolute requirement, the members of a profession often form professional societies for the purpose of expressing their professional viewpoint, undertaking various efforts on the group's behalf, and in general maintaining the high standards of the profession as a whole. Appraisers do not have a single all-encompassing professional organization, but the Appraisal Institute is the oldest, largest, and most prestigious. Since its formation in 1932, the Appraisal Institute has remained in the forefront of attempts to achieve professional status for appraisers.

An examination of the real estate appraiser's progress toward professionalism, first from the point of view of education and training, and second from the point of view of ethics and standards follows. Particular emphasis is placed on the efforts of the Appraisal Institute in these areas.

DEVELOPMENT OF THE APPRAISAL INSTITUTE CURRICULUM

One of the primary objectives of the Appraisal Institute at its founding was the advancement of the science of appraising through the establishment of educational standards for the profession of real estate appraising. These would encompass the general fields of knowledge with which an appraiser of real property should be acquainted to understand and perform the function of evaluating interests in real property.[12] The original idea was to accomplish this by using the Appraisal Institute as a forum for discussion and self-education among the leading appraisers from various parts of the country. In this way, appraisers would be able to achieve a "greater unanimity of thought and procedure than now exists."[13]

Continuing education seminars in which appraisers can meet and discuss important issues are still an important component of the Appraisal Institute's education program. However, a serious attempt at establishing a uniform body of knowledge for appraisers was shelved for nearly half a century in favor of providing facilities for basic training in appraisal technique. The success of its first "Case Study Course," held in 1935 on the University of Chicago campus, convinced members of the demand, as well as profitability, of such instruction. Since then, the Appraisal Institute has expanded its efforts in this area. Courses are offered on the campuses of various colleges and universities across the country. (Many appraisers list in their professional qualifications the university's name in describing the courses they have taken. Because the university has no control over the course content and assumes no responsibility for the program or its instructors, this is misleading and unethical.)

The number of courses offered by the Appraisal Institute has also expanded. With the implementation of examination requirements for the

12. Harry Grant Atkinson, "Recollections of the Founding of AIREA," *The Appraisal Journal* (October 1972):291.
13. Kniskern, p.2.

Member, Appraisal Institute (MAI) and Residental Member (RM) designations, enrollment in certain Appraisal Institute courses became practically mandatory for candidates. By the early 1960s, a basic curriculum of required and elective courses in real estate appraisal had been developed. Further changes have generally been forthcoming in response to new developments and problems faced by the appraiser. For example, initiation of a course on "Condemnation Appraising and Court Testimony" was an obvious reaction to the increased volume of condemnation activity and subsequent litigation in connection with the federal highway and urban renewal programs of the 1950s and 1960s. A more recent emphasis on capitalization theory and quantitative methods reflects the importance of these new developments in appraisal technique in the 1970s and 1980s. The recent expansion of the Appraisal Institute's curriculum is also an indicator of the widening of the scope of activities considered appropriate for a real estate appraiser, as reflected by new courses in valuation, investment, and market analyses. Indicative of a current emphasis on uniform standards in the appraisal field are new courses on report writing and standards of professional practice. The curriculum is continually updated. The Appraisal Institute now offers a "hands-on" computer course in connection with investment analysis.

OTHER CURRICULUM DEVELOPMENTS

In 1979, the appraisal program of seminars offered by the national organization and its regions and chapters began to expand. The Appraisal Institute has sponsored seminars and conferences since its early days in an effort to provide an "open forum" for qualified appraisers. The current list covers a wide range of subjects, such as Applied Sales Comparison Approach, Appraising Conservation or Preservation Easements, Electronic Spreadsheet in the Appraisal Office, and Hotel/Motel Valuation.

In another major restructuring of its educational curriculum, begun in 1980, the Appraisal Institute expanded its introductory courses, added new courses, and updated established courses. Annual updates ensure that the curriculum is abreast of changes in real estate economics. In addition, course designations have been coordinated with the Appraisal Institute's examination requirements.

PROBLEMS IN APPRAISAL EDUCATION

Given the Appraisal Institute's efforts in the area of education, it is somewhat surprising that the major criticism leveled at appraisers in their attempt to gain professional recognition is deficiency in educational standards. In the late 1950s, real estate education in general was criticized as being too heavily oriented toward licensing and examination requirements.[14] Along with a new emphasis on professionalism in the business world, writers of the 1960s

called for an expansion of the appraiser's role, which in turn necessitated an expansion of the appraiser's educational background. Although it was generally accepted that appraisers were "specialists" in their field, in 1960 Robert K. Brown pointed out that "the specialist's understanding of particular concepts and techniques must depend, in the first instance, on a thorough grounding in the general principles which condition and to a large degree determine the more specialized variables.[15] Although Brown turned to the Appraisal Institute to initiate such "generalist" educational requirements for its candidates, it rapidly became clear that the Appraisal Institute could do little more than offer its own specialized courses in basic appraisal techniques. Dr. William N. Kinnard, Jr., MAI, stated in 1968 that "most 'educational' opportunities represent training for specific applications rather than basic education," while Dr. Richard U. Ratcliff pointed out that "absorbed in procedure the appraiser has neglected the systematic development and study of the basic science—the economics of real estate production and the real estate market."[16] In the late 1960s, Dr. Paul Wendt criticized the Appraisal Institute's curriculum as being too rigid, resulting in the institutionalization of various techniques and practices and the stifling of innovations.

As early as 1954, Ernest M. Fisher pointed out that real estate is an economic and social resource deserving to be in the collegiate curricula.[17] Ten years later, Boyd T. Barnard, MAI, was still complaining about the lack of response from the academic community. "Appraisal groups should not be relied upon as the source of education for this specialty in the real estate field. Colleges and universities must recognize that it is their responsibility for basic education in any profession. [18] The problem is that real estate appraisal has, as yet, failed to achieve general recognition as a professional discipline. This is somewhat of a "Catch 22" situation. While academic institutions may refuse to offer courses for the real estate appraiser until he has achieved professional status, Dr. Ratcliff pointed out that "no group has attained this blessed state without complementary facilities for education and research in our institutions of higher learning."[19] As a result, universities offering the kind of real estate curriculum designed to give the appraiser the desired generalist background are few and far between. Some notable examples are the undergraduate and graduate programs of the Department of Real Estate,

14. Jerome Dasso and Lynn Woodward, "Real Estate Education: Past, Present, and Future—The Search for a Discipline," *AREUEA Journal* (Winter 1980): 404–416.
15. Robert K. Brown, "The Need for Generalists in the Appraisal Profession," *The Appraisal Journal* (April 1960): 219–220.
16. William N. Kinnard, Jr., "The Approaching Crisis in Appraisal Education," *The Appraisal Journal* (April 1968): 167; Richard U. Ratcliff, "A Restatement of Appraisal Theory," *The Appraisal Journal* (January 1964): 53.
17. Ernest M. Fisher, "What Should Be Included in a Real Estate Curriculum?" *The Appraisal Journal* (July 1954): 359.
18. Boyd T. Barnard, "The Future of Appraising," *The Appraisal Journal* (April 1965): 187.
19. Ratcliff, p. 52.

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School of Business Administration at the University of Georgia, Athens, Georgia; the Department of Real Estate and Urban Economics, School of Buisness at the University of Wisconsin, Madison; and the Department of Real Estate at the University of Connecticut, Storrs.

THE APPRAISAL BODY OF KNOWLEDGE

In part, the difficulties encountered by real estate appraisal in relation to academic institutions stem from a general problem with the appraiser's public image as a professional. More particularly, appraisal has been denied the status of a professional discipline because of the lack of a generally accepted uniform body of knowledge. Two decades ago it was pointed out that "there are critical inadequacies and divergencies between theory and application in the present state of appraisal education," and that "there remains a considerable and long-term task of formalizing existing knowledge, expanding it and providing the facilities through which it may be transmitted to the practitioner."[20] Little has been accomplished in the meantime. A 1985 study of real estate appraiser education, cosponsored by the Appraisal Institute and the Homer Hoyt Institute, concluded that one of the major reasons why real estate appraisal has failed to become a profession within the past two decades is "the incoherent effort to articulate an educational curriculum either within universities or among the disjointed and feuding appraisal groups."[21]

In an effort to remedy this situation, in April 1985, the Appraisal Institute set up a Task Force on The Common Body of Knowledge. The stated purpose of the task force's proposed research project was twofold:

1. To identify and outline the component parts of the appraisal body of knowledge that define the current minimum requirements for the MAI and RM designations
2. To utilize the derived body of knowledge to initiate a process of developing continuity in the presentation of appraisal concepts, methods, and techniques

OTHER EDUCATIONAL ACTIVITIES

Since its inception 35 years ago, The Appraisal Institute's Research and Educational Trust Fund has awarded nearly half a million dollars in scholarships, research grants, and awards to individual appraisers whose work has helped to advance the profession of real estate appraising. The fund also promotes the advancement of appraisal education through the development of educational seminars and appraisal publications, such as *The Dictionary of Real Estate* published in 1984. The Appraisal Institute also is the foremost publisher of real estate appraisal literature in the United States.

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20. Kinnard, p. 166; Barnard, p. 184.
21. Boykin, n.11

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At its November 1985 meeting in New Orleans, the Appraisal Institute's Governing Council approved the establishment of a research department to provide direction and continuity for theoretical and applied research in real estate appraisal. The department's first two projects are a membership profile survey and an update of the Appraisal Institute's *Real Estate Appraisal Bibliography*.

GENERAL MEMBERSHIP REQUIREMENTS

Changes in the Appraisal Institute's curriculum, as well as criticisms of its shortcomings reflect a widening of the real estate appraiser's expected areas of competence. As a result, requirements for membership in the Appraisal Institute have expanded. Initially, membership was based on a review of no less than 10 appraisal reports and two recommendations from independent credit agencies. No written examination was required. Although the reports did not have to be perfect, the standards adopted were so high that less than 25% of those who applied were able to qualify. In an effort to expand membership, first the "junior" appraiser, then the "candidate" designations were established to distinguish these persons from full MAIs. Through the formulation of the candidate program, achieving the MAI title was made similar to the receipt of a college degree. Candidates are required to secure a sufficient number of credits through completion of a designated number of courses, the passing of specified examinations, and the preparation of a qualified demonstration report. In 1968, the RM designation was added for individuals who had demonstrated ability in the valuation of single-family dwellings and in two-, three-, and four-unit residential properties.

Although candidates are still required to provide recommendations as to their good moral character, integrity, and general fitness for the designation applied for, the requirement for 10 appraisal reports has been simplified to receiving a passing grade on a single, highly specialized demonstration appraisal report. The RM's report must relate to a one- to four-family residential property, while the MAI's must be on the valuation of an income-producing property. The report must satisfactorily demonstrate the candidate's ability to handle at least two forms of depreciation, and the proper analysis and development of net income.

Other requirements for the various Appraisal Institute designations have undergone some interesting changes in the last two decades. Age requirements—(21 for a candidate, 23 for the RM, and 28 for the MAI)—were dropped in the late 1970s. In the early 1970s, an attempt was made to expand the previous educational requirements for candidacy from a high school education to the equivalent of a four-year accredited college education. By 1975, this latter requirement had been restricted to those seeking MAI designation. However, as of January 1, 1987, individuals applying for either designation are required to have received an undergraduate

college degree from an educational institution approved by the National Admissions Committee. There are no provisions for equivalency.

EXAMINATION REQUIREMENTS

Before 1973, RM candidates were required to pass the Appraisal Institute's Examination No. 1 or IA, after Course I—basic principles, methods and techniques—was expanded into two sections. In 1973, this requirement was changed to passing the new Examination No. 8, taken in conjunction with the course on residential properties. In 1980, this examination was split into three parts: 8-1, Real Estate Appraisal Principles; 8-2, Residential Valuation; and 8-3, Standards of Professional Practice.

MAI candidates are also required to pass the Appraisal Institute's Examination No. 1. When this was expanded into two sections, both Examination 1A on the fundamentals of real estate appraisal and Examination 1B on the income capitalization approach were required, whereas the RM had only been held responsible for 1A. In addition, MAI candidates are required to pass Examination No. 2 on urban properties, one "special" or elective examination, and a Comprehensive Examination. As with Examination No. 8 on residential properties, the course exams required for MAI designation were split into several sections after 1979. Examination 1A became 1A-1, Real Estate Appraisal Principles; and 1A-2, Basic Valuation Procedures.

Between 1980 and 1983, Examination 1B was split into three parts; in 1984, this was simplified to Examinations 1B-A and 1B-B, Capitalization Theory and Techniques, parts A and B.

Examination No. 2 became 2-1, Case Studies in Real Estate Valuation; 2-2, Valuation Analysis and Report Writing; and 2-3, Standards of Professional Practice.

Once again, new concerns of the Appraisal Institute are indicated by the inclusion of examinations on report writing for MAI candidates, and on professional standards for both MAIs and RMs.

PROFESSIONAL EDUCATION/CERTIFICATION PROGRAM

In November 1979, the Appraisal Institute's Governing Council approved the development and operation of a Professional Education Program designed to enhance the professional competency of all MAIs and RMs through continuing education. Certification, lasting for three years, is part of the program and is acquired after completion of 60 hours of approved educational activities over a three-year period. Appraisal Institute seminars and courses are approved for certification credit. The program is solely for MAIs and RMs, not candidates or non-Appraisal Institute members. According to the education director of the Appraisal Institute, the program is highly successful. About 50% of the members participate in the program by taking

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courses or seminars offered by the Appraisal Institute; another 30% receive certification through other means. The remaining 20% is generally made up of retired members, or members presently holding nonappraisal jobs.

EXPERIENCE REQUIREMENTS

In addition to a basic training in appraisal methodology, candidates for professional designation are required to have a certain amount of previous experience in the real estate business. In recent years these requirements have been simplified to focus more on experience connected with the valuation of real estate. Although the required number of years of field appraisal experience has remained the same for both MAI and RM candidates, the total number of years of experience required, which would include general real estate business, was reduced in the early 1970s from five to three for RMs, and from seven to five for MAIs.[22]

At the same time, the scope of acceptable appraisal experience has been significantly widened for MAI candidates. Requirements for the RM designation have remained stable since the early 1970s with three years of real estate experience, including at least two years of residential appraisal experience. At present, the MAI is required to have five years of creditable appraisal experience, three of which must be specialized appraisal experience. In addition to experience as a field appraiser, such specialized experience can now include three years as a review appraiser, a real estate analyst-consultant, or teacher of appraisal. These developments not only demonstrate the growing importance of appraisal within the real estate business, but are also indications of the expansion of the appraiser's role in recent decades.

ANALYSIS OF EDUCATIONAL PROGRAMS

The Appraisal Institute has an impressive record of performance in diversifying and strengthening its educational courses and seminars over the years. It has also been responsive to the political and economic times in its ability to organize and offer courses of contemporary meaning and interest. I can offer only two constructive suggestions for course improvement. First, there is still a very obvious deficiency in report writing because of the natural tendency to concentrate on the so-called boilerplate, at the expense of sentence structure, vocabulary, and semantics. More must be accomplished in this respect. The Appraisal Institute has recently taken a step in the right direction through its experimentation with team teaching for its report writing course, in which instruction is shared by a practitioner in real estate appraisal and an expert in writing skills.

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22. Field appraisal experience is defined as personal investigation, estimation, and field appraising of real estate value, including the written reports, some of which must bear his or her signature as a professional appraiser.

Another suggestion for course improvement concerns the degree of emphasis on market analysis. These courses are few compared to the vast array of specialized appraisal courses. Perhaps some expansion would be appropriate here, especially in feasibility, which has its own unique meaning and is an extension of marketability and market analysis. Overall, however, the Appraisal Institute is to be commended for its educational programs. The Appraisal Institute's principal need is to recognize the distinction between college-oriented courses that should stress theory, market structure, and the role of real estate in relation to the economy and the GNP; and the more mechanically oriented "how to do it" courses that it must teach. The colleges are attempting to address both these needs, and usually at the expense of what Dr. Ratcliff referred to as the "basic science."

ETHICS AND STANDARDS OF PRACTICE IN APPRAISING

In 1982, the Appraisal Institute celebrated its 50th anniversary. In his "Message from the President," John D. Dorchester, Jr., MAI, stated that "it is fascinating to observe that the economic and professional conditions leading to the formation of the Appraisal Institute in 1932 bear a striking resemblance to those of recent time."[23] There is a striking difference as well, however, in that the years between 1932 and 1982 provided appraisers with a half century of experience in modern appraisal problems. Particularly through the efforts of the Appraisal Institute and with recent technological advances, appraisal methodology has been advanced and refined to a level of sophistication undreamed of during the depression years of the 1930s. As a result, there has been a shift of emphasis within the Appraisal Institute, and although there are many similarities between the current crisis in real estate and that of 50 years ago, the response of appraisers has shown marked differences.

REASONS FOR CREATION OF THE APPRAISAL INSTITUTE

During the real estate boom of the 1920s, appraisal work was carried on largely by persons who lacked any special competence in the field of valuation. By the end of the decade, the amount of overfinancing based on misleading or inaccurate appraisals had reached alarming proportions. The 1930s' economic recession brought about a collapse of values. Real estate owners defaulted on their mortgages, real estate bond issues stopped paying interest, and real estate corporations went into bankruptcy and receivership. In 1932, the Appraisal Institute was established to help remedy this situation. Stated simply, the primary purpose of the Appraisal Institute is threefold:

23. John D Dorchester, Jr., "A Message From the President of the Institute," *The Appraisal Journal* (October 1982): 492.

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1. The advancement of the "science" of appraising
2. The selection and identification of competent individuals for membership
3. The control of its members through disciplinary powers

In the 1930s, the emphasis was clearly on following the order of these objectives.

During the Depression, the standards of market value seemed to have disappeared. Sales were few, limiting the number of comparables from which an appraiser could choose, while erratic economic conditions meant that current prices were unreliable for comparison. Any prediction of the future was extremely risky. The public saw appraisers as close to, if not, charlatans. At best, appraisers were simply considered inefficient. Among appraisers themselves, there was no consensus on how their problems should be dealt with. As a result, one of the major tasks set before the Appraisal Institute in its early years was to rethink the basic concepts of valuation; and, in the words of the founding president, Philip W. Kniskern, "to develop an agreement, which does not now exist, as to sound, proper, and reasonably uniform procedures for each of the varied appraisal problems."[24]

The Appraisal Institute's emphasis on functioning as a forum for arriving at useful standards by which to measure value, implies that the major problem is faulty, rather than fraudulent appraisals. Abuses do exist, but until proper appraisal procedures are established there are obvious difficulties in classifying any appraisal as "improper." Even the Appraisal Institute's original set of Rules of Professional Ethics seemed as concerned with appraisers' methodology as with their honesty, and included much that would now be classified as Standards of Professional Practice.[25] Discussions of ethical problems in *The Appraisal Journal* have tended to revolve around relations between members of the Appraisal Institute and proper use of the MAI designation, rather than the abuse of the appraisal procedure.

As the decades passed, the Appraisal Institute proceeded with its work and the established body of knowledge for real estate appraising continued to grow. At the same time, however, economic conditions were changing, and with them the role of the appraiser. World War II stimulated the American economy and the real estate market. Appraisers were able to report higher valuations, and because these were borne out by the market, the image of appraisers improved. The main fear was that government regulation would interfere with the profits of the American businessman. Whatever its effect on the economy as a whole, government regulation in the postwar period resulted in a significant volume of business for appraisers without any regulatory shackles.

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24. Kniskern, "A Message From the President", p.2.
25. For the Institute's original "Rules of Professional Ethics," see *The Appraisal Journal* (July 1933): 368–370.

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LEGISLATIVE ENACTMENTS SPUR APPRAISING VOLUME

Two basic legislative enactments were primarily responsible for the high level of appraisal activity in the 1950s and 1960s. As discussed previously, both the federal highway program and urban renewal legislation stimulated a great demand for real estate appraisers in condemnation proceedings and reuse appraisals. Appraisers became the experts to whom the government, courts, and the public turned for accurate valuations of real property. As a result, there was general consternation when condemnation proceedings began to reveal wide divergencies between the valuations of individual appraisers. Despite the efforts of authors in the *The Appraisal Journal* to convince the public of the possibility of honest divergencies, the public was not easily convinced. The Appraisal Institute had accomplished one of its tasks all too well—the public assumed that appraisers were competent; therefore, divergencies were the result of fraud. *The Appraisal Journal* began to carry discussions concerning the ethical extent to which an appraiser can act as an "advocate" of the client. Helpful hints were given as to how an appraiser should act when called as an expert witness in court, in order to avoid personal liability.

The Appraisal Institute was determined to police its own ranks. At a meeting on May 6, 1961, its Governing Council adopted a new resolution designated as Regulation No. 12, to become effective July 1, 1961. The Appraisal Review Committee (ARC) was established, "empowered to review and take appropriate prescribed action in cases where two or more MAIs and/or candidates representing opposing litigants testify to value, damages, or benefits in a judicial proceeding or any other public hearing."[26] The volume of business that came before the committee was overwhelming. An early report on ARC's progress stated that between May 1961 and the end of 1965, the committee reviewed 2,123 files, 638 of which were still being processed; 1,424 had been closed; and 61 referred to the Ethics Committee, which can admonish, reprimand, suspend, or expel the appraiser. It was stated that "there are a great many cases where the deficiencies are not matters of ethical violations as such, but are shortcomings which ARC feels can be materially lessened by corrective action and continuing education."[27] In 1971, however, the Appraisal Institute's Committee for Special Research Project on Divergencies in Right-of-Way Valuations recognized the importance of ethical considerations as well:

> The AIREA Appraisal Review Committee has acted as a major deterrent to advocacy among its Members and Candidates, as indicated by its findings. This encouraging trend has resulted in the refusal of appraisal assignments from clients with pre-conceived ideas of market value and damages, and to some

26. Laurence Sando, "Appraisal Review Committee: Its Purpose and Function," *The Appraisal Journal* (April 1966): 229.
27. Ibid., 231.

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extent has impressed upon the legal profession that the professional services of a Member or Candidate are not for hire as an advocate.[28]

It was added that the success of ARC was indicated by the decreasing number of files to be reviewed.

This decrease in ARC's activities may also have been a reflection of the changing economic climate. The inflation of the 1970s offered lucrative opportunities to the appraiser outside of government condemnation proceedings, and once again, the business community became more respectful of those appraisers whose high valuations could be realized in the market. At the same time, the advent of computer technology added to the sophistication of the appraiser's product. More than an expert, the real estate appraiser was moving closer to the status of an advisor, if not a true professional.

In the late 1970s and early 1980s, the economic climate became much less certain, and appraisers were accused of reacting slowly to the new environment. On December 24, 1980, an article entitled, "Critics Contend Chaotic Economy Makes Appraisal Worthless" appeared in *The Wall Street Journal*, criticizing the current applicability of the traditional three approaches to real estate valuation. Appraisers had responded to a similar crisis in the 1930s, by admitting their technical deficiencies and forming the Appraisal Institute to arrive at common solutions to current problems. By the 1980s, appraisers could claim in response to their critics that appraisal methodology had indeed reached a level of sophistication that allowed it to contend with the problems confronting appraisers in an erratic economy. In a series of replies to *The Wall Street Journal* article, several appraisers affirmed that they indeed possessed the tools to make accurate appraisals in a changing market.[29] The major problem apparently, was a general misunderstanding on the part of the client as to the appraiser's proper role, the methodology to be used, and the definition of market value. As a result, in recent years the Appraisal Institute has placed a great deal of emphasis on insuring proper communication between the appraiser and the client, from the statement of the assignment to the writing of the final report.

The responses to *The Wall Street Journal* article also pointed out another, perhaps more serious problem. Although appraisal methodology has developed along with the economy, not all professional appraisers keep current; a poor appraisal can be the fault of the appraiser. The issue becomes that of insuring that appraisers use the most modern and effective methods in arriving at a valuation.

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28. "Divergencies in Right-of-Way Valuations," *The Appraisal Journal* (October 1971): 492.
29. "Can Appraisers Appraise Today?" *The Appraisal Journal* (April 1981): 271–278.

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PROCEDURAL CHANGE IN ETHICS AND STANDARDS ENFORCEMENT

On January 1, 1982, The Appraisal Institute implemented a new procedural system for the enforcement of its Code of Professional Ethics and Standards of Professional Practice, as provided in Regulation No. 6. An important change from the old regulation was that the new system's enforcement procedure was to be based on eight regions rather than the organization's individual chapters. Not only had many inconsistencies been discovered from chapter to chapter, but it also had been difficult to find enough people at the local level who could be sufficiently detached and uninvolved with any individual member to be impartial.

More significant, however, was the separation of the Appraisal Institute's Standards of Professional Practice from its Code of Professional Ethics. First, the previous code, found in Regulation No. 10, was amended so that what was formerly simply referred to as "disciplinary rules" were now divided into "Ethical Rules" and "Standards Rules." On January 1, 1983, the Standards Rules were taken out of Regulation No. 10 and made into a separate document known as "Standards of Professional Practice," leaving Regulation No. 10 simply as a "Code of Professional Ethics."

In effect, the new enforcement system recognizes that ethical and standards violations are quite different matters and have to be treated differently. Thus, the first step taken when a complaint reaches the Director of Screening is to determine whether it involves a possible violation of the Standards of Professional Practice or of the Code of Professional Ethics. Standards violations are generally seen as being the result of ignorance rather than dishonesty, so such complaints are sent to a Review and Counseling Committee with disciplinary competence extending primarily to counseling of the offending member or candidate in writing.

FAULTY APPRAISAL TECHNIQUES

The Appraisal Institute's enforcement system reflects its belief that many faulty appraisals are the result of appraisers who fail to stay abreast of modern techniques, a problem that presumably can be corrected by counseling appraisers on proper procedure. For this to work, however, the Standards themselves must be updated as new techniques are introduced. Unfortunately, as the real estate industry becomes more complex, it also becomes more difficult to agree on uniform standards of professional practice. In the early 1980s, record high interest rates led to the widespread use of creative financing, that is, seller financing at below-market interest rates in sales to syndicators and others. This added to the prices of properties, although it was questionable whether the accrued interest and other costs could be recaptured over a reasonable period. As a result, there was considerable overextension of loan portfolios, particularly among the savings and loan associations that were taking advantage of the 1982 deregulation of

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the banking industry. The number of savings institutions forced to close in the final months of 1985 was the highest since the Depression. The problem of unique financing was also a concern to appraisers of syndicated property. Recently such properties have been in default because of inability to pay the heavy current or deferred interest charge. In May 1985, the Appraisal Institute adopted a new set of Standards of Professional Practice that require that the effect on market value of "atypical" financing be estimated and included in the appraisal report. At the same time, it was determined that a continuing series of Guide Notes for applying the Standards to hypothetical appraisal assignments was to be added to the Standards of Professional Practice to aid appraisers in dealing with specific problems.

As much as the Appraisal Institute might avow that faulty appraisals are usually the result of honest mistakes, it does recognize that this is not necessarily the case. In August 1984, the president of the Appraisal Institute, Reaves C. Lukens, Jr., MAI, met with members of the FHLBB to discuss the problems facing savings and loan institutions. According to Lukens, "The FHLBB has accumulated a substantial number of appraisal reports of such atrocious quality they would be an embarrassment to most of us. Some of the work reflects a lack of skill, but the majority of it seems to indicate advocacy on the part of the appraisers involved.[30] Such ethical violations are dealt with by the second branch of the new enforcement system, Ethics Administration. Recognizing that ethics violations can also result from ignorance, the disciplinary actions available range from 1) admonishment, 2) censure with publication, 3) suspension of member, and 4) explusion of member, to 5) termination of candidacy, with educational alternatives offered for 1 through 3.

It is difficult to judge the success of this new system. A look at the number of disciplinary actions taken suggests that the aim of uncovering guilty parties takes precedence over the task of lessening their number. The statistics, however, do show that the committees have not been lacking in business.

WHEN IS AN APPRAISAL SOMETHING ELSE?

When is an appraisal not an appraisal, but something else? The Appraisal Institute has experienced considerable confusion over this question. Its 1985 publication of the Code of Professional Ethics and Standards of Professional Practice tried to clarify the issue. Standards Rule 2-7 states that an appraiser is permitted to make an "appraisal report" that is "something less, or different from, the complete appraisal report that would otherwise be required... ."In the accompanying explanatory comment regarding Rule 2-7, the Appraisal Institute states that it would prohibit any report that would mislead or confuse the client, the user of the report, or the public. Incorpora-

30. Reaves C. Lukens. Jr., "Professionalism," *The Appraiser* (October 1984): 2.

tion of revelant material by file references is suggested as one means of relieving the situation. The rule as stated accomplishes little, and lacks the definitions necessary to provide any insight into what is permitted in a nonappraisal report.

However, in the "Explanatory Comments Relating to the Code of Professional Ethics," a distinction is made between *an appraisal* and *an appraisal assignment*. The latter covers the formal, documented report rendered by the appraiser as a disinterested third party, and calls for "an unbiased report of the nature, quality, value, or utility of interest in or aspects of real property." Presumably, an appraisal or appraisal report, as the terms are variously employed, permits all other activity, such as marketability and feasibility studies, investment analyses, consultative work, and arbitration. Any report containing material relating to the foregoing is considered for ethical purposes as an appraisal report, regardless of other titles employed. When taken in conjunction with the newly recognized right to charge contingent fees, it is evident that the Appraisal Institute has yielded to its general membership in liberalizing the basis on which ethical conduct is to be judged. All of this is logical and practical. The confusion could be avoided by labeling all work for a client other than an appraisal assignment as an "evaluation," or "investment analysis."

The Appraisal Institute's insistence on having the MAIs under its total ethical control for all their business activities appears to have created the uncertainty over what constitutes an appraisal assignment as opposed to any other activity. This has been further complicated by the Appraisal Institute's leniency, as set forth in Comment E.R., 3-3, which allows an appraiser to accept what amounts to a preliminary and indirect contingent fee to investigate market value on an unbiased basis. If the client agrees with the valuation result, he or she presumably would then engage the appraiser to prepare a formal appraisal as part of an appraisal assignment. The obvious intent of this provision is to satisfy the needs of appraisers engaged in condemnation and tax abatement assignments. It apparently enables these specialists to be paid for their "unbiased" opinion of market value, while the client decides whether to engage them to perform the full, formal documented report.

This procedure makes good sense for all types of appraisal assignments, not only those in which condemnation and tax abatement are involved. Simply stated, clients pay to determine whether the appraiser agrees with them or not. However, this has placed many appraisers in an awkward position when a noncontingent appraisal assignment is requested by another client. The client must expend a full service fee without knowing whether the appraiser's opinion will be in agreement with his or her own views. All of this puts pressure on the appraiser to estimate a value that is at least sympathetic to a client's position, and exposes the appraiser to bias pressures when he or she is supposed to be acting as a disinterested third party. Why not adopt a

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more practical policy of conceding that within the bounds of propriety, all appraisers are advocates for their clients? This would eliminate the present double standard. Obviously, full disclosure of the appraiser's position and role is essential to observance of the ethical requirements.

ENFORCEMENT OF THE APPRAISAL INSTITUTE'S CODE OF PROFESSIONAL ETHICS AND STANDARDS

At present, nearly 100 alleged violations of the Code of Professional Ethics and Standards of Professional Practice are referred to the Director of Screening each month.

There is no denying that the new system has its problems. The primary one is the length of time involved between receipt of the complaint and final determination of the case. In part, this is an unforeseen result of the general recognition of the importance of the MAI designation in real estate appraisal. The courts have ruled that if membership in a professional association has a substantial effect on the "relevant market," the association must adopt admission and disciplinary procedures that conform with "due process" requirements. The essential elements of due process of the law are "proper notice" and that everyone has the "opportunity to be heard." The Appraisal Institute admits the difficulties encountered in implementing what is still a new procedural system, but claims that these are being corrected. While formal hearings for only nine cases were held in 1985, the Appraisal Institute expected to hold 40 more in the next 12 months.

CERTIFICATION AND UNIFORM STANDARDS

The Appraisal Institute alone cannot solve the problems facing the appraisal industry, primarily because it has no jurisdiction over the majority of appraisers practicing today. As of April 1, 1987, the Appraisal Institute included 5,205 MAIs, 1,313 RMs, and 10,716 candidates. This total of 17,234 is quite small when compared with the alleged 200,000 to 250,000 people calling themselves appraisers. This number would be even smaller if one were to exclude those who are merely candidates for professional designation, as well as dues-paying MAIs and RMs who do not practice real estate appraisal on a regular basis. A recent estimate indicates that the Appraisal Institute currently represents only about 3% of practicing appraisers in this country.

Even if all accredited appraisal organizations were included, it has been estimated that their members would represent a mere one-quarter of the people in the marketplace calling themselves appraisers. Attempts to merge the various appraisal groups into a single all-encompassing organization have repeatedly proven unsuccessful. Most recently, in May 1985, a proposed plan for consolidation of the Appraisal Institute with the Society of Real Estate Appraisers did not receive the required two-thirds majority vote of the

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members of both organizations. Areas of concern expressed by members included the question of whether or not the new organization would be affiliated with the NATIONAL ASSOCIATION OF REALTORS,® (as is the Appraisal Institute), and the proposed altering of requirements for Appraisal Institute designations.

The failure of the Society to accept merger conditions in which it would fairly and reasonably have the opportunity to grant the MAI status over an agreed time period, and the provincialism of the Appraisal Institute in adopting an independent course of action have severely damaged the appraisal business and its members. The end product of the failure to merge has been the elimination of any current chance of either organization to claim professional status.

Given this situation, the Appraisal Institute and other appraisal organizations have advocated some form of state or national certification. At present there is no federal legislation concerning the licensing of appraisers. Only 12 states require licensing. All of these have widely varying requirements. In most of these states only a broker's license is required. Only Nebraska and Oregon have a separate licensing classification for appraisers. In November 1985, the Governing Council of the Appraisal Institute approved a resolution to permit the president or his designees to work with legislators and regulators to develop a national certification program for the appraisal profession, similar to the Certified Public Accountant Program for the accounting profession. Several states have already expressed an interest, and the Appraisal Institute has appointed a task force to draft model legislation for the certification of real estate appraisers.

The legislation is aimed at setting up a national Real Estate Appraisal Board that will consist of a combination of "public" members and real estate appraisers, all of the latter being members in good standing of a nationally recognized appraisal organization. This board will be responsible for establishing requirements and procedures for issuing certificates to state certified real estate appraisers. This will involve defining the levels of education and experience required of certified appraisers, and the requirements of periodic renewal of certification; reviewing the standards for the development and communication of real estate appraisals; and establishing disciplinary proceedings for those who fail to uphold such standards.

As a first step, in May 1986, an ad hoc group of representatives from the eight largest appraisal organizations in North America, including the Appraisal Institute and the Society, adopted a set of uniform professional standards for the entire real estate appraisal industry. These are the same as the revised Standards of Professional Practice adopted by the Appraisal

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Institute in May 1985. Organizations subscribing to these uniform standards are:

American Institute of Real Estate Appraisers (AIREA)
Society of Real Estate Appraisers (SREA)
American Society of Appraisers (ASA)
American Society of Farm Managers and Rural Appraisers (ASFMRA)
Appraisal Institute of Canada (AIC)
International Association of Assessing Officers (IAAO)
International Right of Way Association (IR/WA)
National Association of Independent Fee Appraisers (NAIFA)

While the effort to establish national certification through a board approved by the various states is both essential and commendable, it appears that appraisers have the cart before the horse. A critical precondition is the need for the Institute and the Society to merge and produce a plan for the ultimate merger or switch of individuals from the myriad other organizations. The full force of what the Appraisal Institute seeks will be lost until the two qualifying organizations present a unified front.

HOW SUCCESSFUL HAS ENFORCEMENT BEEN?

The Appraisal Institute has conscientiously exerted every effort to create and maintain high ethical and practice standards since its founding in 1932. The task has been made more difficult since the 1960s by a growing resort to the threat to use civil rights and due process as a basis for escaping any punishment for gross ineffectuality, deliberate violation of rules, or obvious advocacy. Increasing sensitivity to human rights, together with the nonhomogeneous nature of real estate, have enabled many appraisers to avoid admonishment, censure, or more.

There is no single arbitrary figure of value that can be relied on as "the truth," in appraisal. This makes it very difficult, if not occasionally impossible, for any committee of the Appraisal Institute to conclude with certainty the relative guilt of an appraiser, although in a nonlegal sense such guilt may be more apparent. Furthermore, the offending person may elect a court defense in which the issue may not be as clearly understood by a jury.

Nevertheless, the Appraisal Institute's very earnest enforcement of ethics and standards has had an extraordinarily salient effect. If nothing else, it has made members much more aware of their responsibilities to their clientele and to the general public. Conscientious adherence to high standards is, in the long run, a greater deterrent to the possible compromising of an answer to an appraisal problem. Occasional incidences of departure from Appraisal Institute standards will also diminish as better educated and more dedicated people are attracted to the field.

Vigilance in administrating the Code of Professional Ethics and Standards of Professional Practice is essential. Otherwise, a marginal few will

sense a letdown in enforcement, to the detriment of the Appraisal Institute and members who are willing to play by the rules. Thus, strong committee action on a continuing basis is critical to achieve success. The Appraisal Institute has been very impressive in its dedication to the maintenance of high professional standards. The administration of ethics and standards by staff and committee members has been efficient, conscientious, and analytical, while the rights and sensitivities of the members have been scrupulously protected. All in all, the Appraisal Institute can be proud of its achievements in a complex and difficult business environment.

PROGRESS IN APPRAISAL METHODOLOGY

In the period from 1960 to 1985, the cost and sales comparison approaches seemed to lag in terms of any significant improvements in methodology. The income capitalization approach, however, was the beneficiary of two extraordinarily substantive improvements that appear to have vaulted the appraiser from a rather pedestrian occupation into the possible ranks of a true professional, at least in a liberal interpretation of the definition. Events subsequently occurred, which, at the time were difficult to evaluate without a historical perspective, and the significance of which was not then fully appreciated. In the one instance, one man made a critical contribution to capitalization technology. In the other, the consequences of a raging inflation prompted several astute appraisers, computer software experts, and mathematicians to produce both separately and in combination the use and application of lease-by-lease analysis and discounted cash flow (DCF) on an annual basis.

THE NEW CAPITALIZATION ERA

The man who contributed to capitalization methodology was Leon W. Ellwood, MAI. At his retirement in 1973, Ellwood was senior vice president and chief appraiser of the New York Life Insurance Company. Ellwood had many disciples but his most faithful and infinitely patient one was James E. Gibbons. Gibbons, a scholarly man of deep intellectual capability and exceptional writing ability, in many instances sacrificed his own business time to teach the gospel of mortgage-equity capitalization by the Ellwood method.[31] The salient point of Leon Ellwood's method is the assumption that market value is specifically defined as "the present worth of all rights to future benefits arising from ownership."[32] The future, according to Ellwood's method is not "now," but truly ahead. He conceived the mathematics of his method and then published a book in 1959, in which he reflected on what future income expectations could reasonably be attained. Interestingly enough, Ellwood was perfecting his method in the early 1960s, a period of

31. Gibbons, Chap. 7, n.5.
32. Ellwood, p.1, n.4.

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economic tranquility, when most appraisers were not thinking beyond tomorrow in their property valuations. He pointed out that values could rise or fall, and that the property should be given credit, all other things being equal, for the equity appreciation resulting from reducing the actual or presumed mortgage debt on the property over a five- to ten-year projection period. He felt that appraisers had not recognized that the payment of amortization reduces liability on a property on an individual's balance sheet, and contributes to the increase in the property's net worth.

The original problem with Ellwood's method was the algebraic nature of the formulas. The typical practicing appraiser, especially the older ones without extensive educational backgrounds, did not fully understand, or reacted poorly to the need for solving algebraic equations. The resentment and confusion that followed was difficult to appease, despite the efforts of Gibbons and others. In 1969, a major step in the use of Ellwood's method was achieved with the publication in *The Appraisal Journal* of an article by Charles B. Akerson, MAI, entitled "Ellwood Without Algebra."[33] According to Akerson, the mortgage equity rate could be developed without special symbols and formulas. Familiar amortization schedules and compound interest tables could be used to develop the same capitalization rates as shown in the Ellwood Tables. While Akerson by no means simplified Ellwood's method to the level required by some older members, he did remove some of the mystique, fear, and misunderstanding held by many.

From 1960 to 1976, Ellwood's method gradually dominated capitalization. Its use surpassed the land and building residual techniques employing Hoskold or Inwood sinking fund factors. It made appraisers more conscious of the future and more aware of the effects of mortgage amortization on capital appreciation. Many lending institutions would not put an appraiser on its approval list for mortgage purposes without the appraiser having a demonstrated mastery of the Ellwood method. Teachers Insurance and Annuity Association was in the forefront in this respect.

Through the years the Ellwood method was able to withstand the criticism made by those who resisted change or feared the unknown. One criticism deserving response is the use of pretax rates of return and yields. In actuality, this is the way in which the real estate market operates, that is, on a pretax basis. How would one appraise otherwise, in light of the various entities in which property ownership is held? The sole proprietorship, the partnership, the typical corporation, the life insurance company, the thrift institution, the pension fund, and the individual, all may have different investment objectives and tax liabilities. Pretax overall rates of return were and still are the accepted way to quote a property's success. As Gibbons pointed out, a few simple, further steps could take the appraiser to an

33. Akerson, n.6.

after-tax equivalency basis, as custom-crafted for the legal entity in which the property was held.[34] In no sense does the basic pretax nature of the Ellwood method invalidate it as a capitalization method.

A SEVERE INFLATION PROVOKES NEW COMPUTER-BASED METHODOLOGY

Many authors had warned and in some instances complained in the late 1960s about the increasing volatility in financial markets, the topsy-turvy nature of interest rates, and the increasing inflation since the first credit squeeze in 1966. Ellwood and Gibbons saw the necessity for forecasting the future, no matter how risky that prediction might be. In the immediate recovery period in 1977, following the full three-year real estate recession of 1974 through 1976, a group of professionals saw the computer as a means to combine new techniques of income and expense forecasting with a more advanced and computerized method for finding "net present value" (NPV). This group included computer experts from Decisionex, Inc., a Connecticut based computer software company; some professionals from the staff of Landauer Associates, Inc., Real Estate Counselors, in New York; several mathematically minded trust company bankers; and several developers. Computers had been in widespread use previously, but a major breakthrough did not occur until 1977.

At that same time, these real estate professionals had been puzzling over the increasingly more complex task of recording on a spreadsheet basis, the future course of rental income, especially for office buildings and shopping centers, cases in which lease terms tend to be of long duration and complex. The lack of uniformity in the leases created difficulty as appraisers were asked to value the more substantial buildings for various purposes. Computerized lease-by-lease analyses had previously been available, but the software lacked depth, breadth, and flexibility.

THE LXL/DCF METHOD

The new computer-based forecasting and capitalization techniques evolved from 1976 to 1980. There was no one author or creator, but many contributors; nor was there a name for the techniques. Because it did not burst on the scene like Ellwood's book, but simply developed over a period of time, the significance of the new methodology was initially not comprehended. For want of a name, it is referred to here as the LXL/DCF capitalization method because it combines a detailed forecast of future rents (lease-by-lease analysis) and expenses with computerized discounting of the estimated NOI or DCF.

The real estate recovery surged, in a breathtaking way, after January 1977. Inflation came back strongly after the mid-decade pause and became

34. Gibbons, n.5.

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ingrained almost as a way of life. Thus, market pressure intensified the need for a computerized method for valuations, to increase the efficiency and accuracy of the process. Decisionex, Inc., with the assistance of several real estate professionals from different New York appraisal offices, was able to upgrade significantly the entries, depth, and flexibility of its so-called Quick system, which was able to accomplish what previously was considered unachievable on a printout. On a mainframe computer on a time-sharing basis, this innovative and pioneering software program could accept innumerable entries about property leases and operating expenses, and thus created a maximum degree of flexibility. Effective analyses for clients with complex buildings could now be offered with accurate printouts. This marked the end of manual calculations for spreadsheets, with all the glaring inaccuracies. The entries in the Quick system included, but were not necessarily limited to the following:

Rents per square foot and per floor
Lease commencement and termination
Lease options and renewals
Real estate tax escalation
Percentage lease provisions, if any
Expense escalation, including any "stops" or ceilings
Miscellaneous revenue
Vacancies and contingencies
Rent increase on termination
Assumed percentage of tenant move-outs on lease expiration
New tenant work letter cost per square foot
Existing tenant work letter cost per square foot
Automatic substitution of new rents
Automatic substitution of new expenses
New tax and operating escalations terms
Compounding of future rent increases
Compounding of future expense increases
Sublet provisions
Assignment provisions
Vacancy provisions during relocations
Spinout of old rent and escalation terms
Spinout of any irrelevant data
Mortgage amount
Terms of interest and amortization
Balance of mortgage at any time
Self-liquidation time
Prepayment provisions
Ground lease terms
Deferred interest circumstances
Discount rates and capitalization rates

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The capacity to undertake a lease-by-lease analysis was a giant step forward for real estate appraisers. It made Ellwood's method almost completely obsolete for large scale buildings. Ellwood's system relies on a weighted mathematical average or, as the term was used, "stabilized equivalent level annuity," for forecasts. Later, the Ellwood method incorporated use of the "*J*-Factor," which adjusted for an equivalent increasing or decreasing annuity. Under the LXL/DCF method, the full effect of any and all individual lease changes on an annual basis are entered into the computer so that much more accurate data emerges about the property's leases, operating expenses, and forecast of NOI. The Ellwood method was and is capable of annual lease analysis and discounting of each year's NOI. It is still sufficient for smaller, simpler buildings with a smaller number of tenants. However, when the lease terms are varied and the number of tenants is large, it is essential to use a computer program.

The algebra required in the Ellwood system has been programmed into the LXL/DCF software, including application of a series of discount and capitalization rates, permitting a sensitivity analysis almost instantly. The basic Ellwood tenets of income capitalization have been retained, except that there is less stress on the components of value, namely debt and equity. The computer has been programmed to accept NOI on a pre- or after-debt basis, depending on the circumstances, or on a pre- or after-tax basis, or both.

Again, Ellwood's basic belief in a reversionary value has been largely faithfully observed. The general concept is to forecast NOI annually over a 10-year period and discount each year's income at the selected discount rate. Then, as in Ellwood's method, NOI is stabilized and then capitalized by using a capitalization rate as a divisor (I/R = V). Finally, the market value established 11 years hence is deferred by use of the same discount rate.

Being able to do an accurate lease-by-lease analysis in an almost unassailable way through the computer, while at the same time, converting the expected income into market value, had a very strong appeal to appraisers. The process of entering rent as predicted at a certain growth rate when tenants vacate, discarding prior escalation provisions, providing for the competitive capital cost of refurbishing the space at the owner's expense, creating a new basis for real estate tax and operating escalation, providing for a vacancy period until rerental, entering all the new assumed terms of the rerental—all of this was heady stuff to appraisers.

The new methodology caught on quickly, however, especially after all the publicity surrounding the sale of the Pan Am building for $4 million in late 1980. In that instance, Decisionex's Quick software was employed. The results were unbelievably revealing. The enhanced income prediction enabled Pan Am to realize more money than its appraiser advisor and itself thought possible. The Quick program was, of course, available to owners and brokers as well as appraisers. A number of very useful programs for

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lease-by-lease analysis, similar to Quick were thereafter devised. One such program is Office-2.[35] At the same time, generic spreadsheet programs like Lotus 1-2-3[36] and SuperCalc[37] could be used on personal computers, for those wanting to do the calculations themselves. Although the latter programs lack the flexibility and depth of Quick, they helped to popularize the so-called spreadsheet method of estimating market value.[38]

In late 1981, urban appraisers became alarmed at what they foresaw as possible abuses of the LXL/DCF methodology. For example, it was easy to overestimate rents and rent growth, while understating expenses and expense growth. It was simple to use a discount rate that was lower than the market consensus. All this added to professional concerns about the ever-present problem, in one form or another, of misrepresentations of property values. An article was published warning appraisers and others of the potential for abuse in the manipulation of revenue and expense estimates and discount rates.[39] The precise effect of this article on the investment public is unknown. What is apparent now, however, is that relatively few professional appraisers were accused of manipulating figures for their own purposes. A new maturity that surpassed any other part of their history had seemingly enveloped appraisers.

The LXL/DCF method received the same criticisms as the Ellwood method. The principal criticism is that it is not a means of income capitalization, primarily because it dares to peer into the future, and therefore is only a means of "investment analysis." Those rendering this criticism seem to reject the method because it is not based on the present. On examination, it does appear difficult to select an overall rate of return, free of mortgage debt, without a detailed consideration of what the future holds for the property. Another criticism states that the method is workable only in an inflationary era. This could hardly be the case. What would happen if we had a severe deflation and an accompanying depression? The equation (I/R = V) would become much more of a guess about the future than the estimate of the appraiser equipped with a considered perspective about the downward course of future rents.

THE FUROR OVER R 41b AND R 41c[40]

The recent abnormal number of thrift institution failures accompanied by deficient appraisals prompted the FHLBB to issue Memorandum R 41b on

35. Office-2. New York, N.Y.: H.B. Pascal.
36. Lotus 1-2-3. Cambridge, Mass.: Lotus Development Corporation.
37. SuperCalc. Garden City, N.Y.: Computer Associates.
38. By the early 1980s, Decisionex introduced the Q-2 software program, which was made available on a license basis and less cumbersome, but with all the flexibility of the Quick program.
39. Robert A. Steele and John R. White, "Beware the Abusers of Internal Rate of Return Methodology," *The Appraisal Journal* (April 1982):204-211.
40. See David C. Lennhoff, "Why All the Ruckus Over R 41b?" *The Appraisal Journal* (July 1984):443; and "Letters to the Editor," *The Appraisal Journal* (July 1985):472.

March 12, 1982. This was followed by Memorandum R 41c on September 11, 1986. No methodological significance can be found in these memos, except for a warning to discount future receivable revenue, after all appropriate expenses, and provide adequate documentation on all aspects of the market. The 1986 memorandum also provided a new, improved definition of market value and is more detailed. It includes interesting material on the topic of "appraisal management." For some reason, the memos have created an unusual stir in the appraisal business, although there is nothing in them to suggest a governmental directive to utilize methods not already fully and customarily employed.

The litany of common errors in either R 41b or R 41c includes failures to obtain relevant data and instructions from the client, follow the agreed definition of market value, and document market support for the property, as if vacant and improved.

There is considerable reference in both memoranda to the lack of proficiency in market and economic feasibility analysis. This is at the very least embarrassing to the Appraisal Institute, suggesting that its members have not uniformly been able to develop this facility. The creation of a regulatory memorandum illustrates the periodic difficulty that appraisers have encountered in meeting and coping with changing economic and financial times. It also indirectly reflects the narrow body of market data and methodology that appraisers appear willing to deal with. In short, although appraisers' futures compel them to widen their professional capabilities, in many cases they appear unwilling to accept the challenge.

VARIATIONS ON THE COST APPROACH

Some appraisers have been using a revised cost approach that assumes that the valuation result is a definite ceiling of market value based on an overall consideration of market value through reconciliation of the three approaches. This group holds that the cost approach has not been properly calculated in previous years. It also holds that appraisers have minimized or ignored the significance of those periods in the market when, for example, the income capitalization approach will yield a much higher value. When this occurs, it may signal one or more of many circumstances. It may indicate an undersupplied market. It most certainly may be indicative of an overheated and perhaps inflationary market in which compounding of rent increases provokes higher market values by income capitalization. It certainly would imply that the market has achieved a peak at which caution must be exercised about future conditions.

Most appraisers are not qualified quantity survey cost estimators. In estimating market value, they almost universally use unit cost figures pre-

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pared by such firms as Marshall Stevens and the Dow Calculator. These basic unit costs are then adjusted by a local cost modifier that reflects local building and labor costs. One problem has been the appraiser's failure to add a sufficient amount to the basic cost for architectural, engineering, general and overhead costs, property taxes, marketing, and mortgage loan interest. These so-called soft costs add from 15% to 35% to the basic field (labor and material) cost. Traditionally, the market value of the land, presumably as if vacant, is added to this.

The above considerations on soft costs do not represent a new technique. What is represented is a modification of the cost approach based on the need to add the full range of soft costs to the hard field costs, depending on the type of building, the extent of the marketing effort, the period of time for construction, and construction interest charges at the time. Some appraisers believe that the developer, as an entrepreneur, is also entitled to a fee as much as 5% of basic costs for supervision and management of the construction process. There is also some merit in considering adding a presumed developer's profit, say in the 10% to 15% range, after all other basic building soft costs have been totaled.

A second modification of the traditional cost approach involves deciding whether or not the historic record of sales provides the correct estimate of land value. All other things being equal, the value of land under construction may be worth more or less, depending on the relative demand-supply balance, the price paid, or the apparent market value by past or current sales. The new way of thinking holds that the land may be entitled to some appreciation, if for no other reason than that it is actually being developed at the time of the appraisal, subject again to market circumstances.

> The analysis of the difference in value between the new, optimal property and the property being appraised leads to an understanding of the economics of real estate not obtainable from the other approaches.... Properly done, the cost approach tells significant things about the property: the value of the land, the reproduction cost in case of casualty loss, and why the (subject) property is not worth as much as similar new property or the optimal property.[41]

The net effect of this modification of the cost approach is to provide a more realistic market value without the embarrassment of an improperly calculated estimate that in a balanced market may only be 75% of the value obtained through income capitalization. When the value estimate derived from each of the three approaches varies significantly, the appraiser can now provide an explanation for the disparity.

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41. Max J. Derbes, Jr., "Is the Cost Approach Obsolete?" *The Appraisal Journal* (October 1982) :589-90.

DYNAMIC CAPITALIZATION[42]

Early in 1984, C. Gordon Blackadar, a senior appraiser with the Metropolitan Life Insurance Company, published a paper on dynamic capitalization. Blackadar is an outstanding mathematician whose grandfather and father had preceded him as actuaries with Metropolitan Life. While not an actuary himself, Blackadar applied his knowledge of math and actuarial principles in the formulation of his methodology. Blackadar's theory had its genesis in the extraordinary inflation that engulfed the country from 1977 through 1981, the effect of which was to erode the value of money equal to the inflation rate. Dynamic capitalization applies the actuarial theory of interest to the problem of capitalizing net income from real estate investments, as a means of precisely calculating the present value (PV) of an income stream in an inflationary environment. The method appeared as the nation was rapidly cooling off from a hyperinflationary period. Consequently, its acceptance and recognition has been slow because, at the time, appraisers were preoccupied with mundane matters such as analyzing the meaning of the current serious oversupply in many types of real estate, and of evaluating the significance of a possible long-term period of low inflation and interest rates, as was characteristic of the 1950 to 1965 era.

One of the major contributions of the dynamic capitalization formula is its quantification of the forces acting on real estate investments. For example, dynamic capitalization differentiates between cash flows fixed in nominal dollars, those fixed in nominal dollars but with periodic lease stipulated recoveries, and those determined by free market forces on a continual basis. In addition, the dynamic capitalization equation allows present value to be used to its best advantage because the actual timing of cash flows can be taken into account—that is, continuous increases in expenses, monthly rent collections, quarterly debt service payments, annual Consumer Price Index (CPI) adjustments, etc.

One benefit of applying the dynamic capitalization formula is that the appraiser can determine the real, rather than the nominal rate of return on a real estate investment. The real rate of return, the amount actually earned on invested capital after allowing for the erosion of purchasing power, is sometimes overlooked in the wake of double-digit internal rates of return (IRRs) pumped up by inflation. Blackadar's formula enables appraisers to break an IRR into its components—real yield and inflationary expectations. In doing so, it is often discovered that an income stream marketable under one set of inflation assumptions becomes unmarketable under another.

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42. We are indebted to C. Gordon Blackadar and to Charles E. Snoddy, Jr., Vice President of Metropolitan Life and member of the Real Estate Investment Committee, for their summarization of an extremely complex mathematical formula and explanation of the methodology. See Mr. Blackadar's article, "Dynamic Capitalization: An Income Approach in Real Dollars at Real Interest," *The Appraisal Journal* (October 1984):565-94.

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The dynamic capitalization formula can be relatively easily applied manually in appraising new and proposed properties. In situations where there are large numbers of existing leases, however, the formula requires too many individual calculations. To accommodate such cases, Blackadar has written a real estate investment computer software program employing the dynamic capitalization methodology. This program enables the user to complete calculations that would have taken hours or days, in minutes. It is particularly valuable for testing a variety of assumptions relating to yield requirements, inflation, depreciation, market rents, and other parameters without having to recalculate numerous spreadsheets. The program is especially useful when the appraisal involves proposed development.

It is too early to assess the degree to which appraisers will ultimately accept dynamic capitalization. Surely it is to be commended for its capability to increase accuracy in distinguishing between a real and an inflationary yield. However, real yields can readily be computed now with existing methodology. This is done by comparing projections and values without assumed inflation, with projections currently employing compound growth rates for revenue and expenses, together with higher discount and capitalization rates presumably in economic consonance with inflationary or noninflationary expectations. Many sophisticated developers will project NOI on a nongrowth basis, but employ an IRR more consistent with nongrowth to establish the downside potential of the real estate. Another question raised by the dynamic capitalization method is whether real estate lends itself, or requires the degree of accuracy and precision implied, when the answer tends to preclude a strictly mathematical solution.

QUESTIONNAIRE SURVEY RESULTS

Whatever the specific criteria required to qualify as a profession, an important precondition is that no field is accepted as a profession without some reasonable degree of public recognition. It is true that the general public has little idea of what appraisers are, and therefore is in no position to judge their professional status. Appraisers, however, have a public of their own—private and public clients and fellow appraisers, groups that could have very different perspectives on the matter. Therefore, it was important for this study to provide both an introspective and a public view of the professional status of appraisers, and objectively assess the progress appraisers have made in this regard in recent decades.

QUESTIONNAIRE RATIONALE

A special questionnaire with 20 questions was designed to elicit from a carefully selected sample of MAIs, their reaction to and opinion of the progress of the appraisal business since each one had begun practicing under his or her own signature on reports. Because of the subjectivity of the matters

being discussed, the questions were designed to give the appraisers a wide latitude in their responses. In addition, the respondents were encouraged to talk with others to gain additional insights from business acquaintances. As a result, the survey revealed a wide range of opinions, often expressed at great length and with such nuances as to make quantification of responses practically impossible. An attempt to tabulate statistically the results of the survey was discarded. Instead it was decided that a narrative description of the responses, along with some rudimentary estimates of their relative weight, would give the reader a feel for the various opinions expressed. For this reason, rather than aiming at a statistically accurate cross section of practicing appraisers, the bulk of the respondents were chosen from among the top practitioners of commercial real estate appraisal. Random selections were made as well. As a result, even opinions expressed by a single individual have been given due consideration. It should also be kept in mind that a single question might receive several different answers that are not necessarily mutually exclusive. Finally, more weight was given to survey responses that were detailed, thoughtful, and obviously well prepared. All responses will be kept on file for use as requested by the National Council of Real Estate Investment Fiduciaries.

A detailed presentation of instructions and explanations accompanied the questionnaire. A careful geographic dispersion was arranged. Some RMs were included, but the vast majority of questionnaires went to MAIs. Replies were received from MAIs all over the United States, representing excellent cooperation. Virtually all responses were forthright and very carefully reasoned, indicating that considerable time and effort were spent in answering the questions. The quality of the replies was very impressive. A similar, but not identical questionnaire was also sent to 100 users of appraisal services. The response for these was only 15%, indicating less interest or perhaps preoccupation with other matters.

APPRAISERS' VIEWS ON APPRAISAL

Basic Appraisal Methodology

The appraisers were asked to discuss recent improvements in the income capitalization, sales comparison, and cost approaches to commercial real estate valuation. Certain areas of change were mentioned with respect to all three approaches: 1) better collection and availability of data, 2)increased use of computers, and 3) recognition of outside factors (unusual financing, tax shelter, indirect costs, etc.) affecting value.

Many appraisers were quick to point out, however, that improvements in methodology can be undermined by individual appraisers who either fail to understand, ignore, or deliberately misuse such improvements. For example, three of the respondents stated that many appraisers have no idea how to analyze the vast amount of data that they now accumulate.

The majority of respondents felt that the use of computers in real estate appraisal is now taken for granted, but opinion on the extent of the benefits of such use varied widely. Two respondents acknowledged that computers make work easier for the appraiser, but denied that their use is necessary. Many others felt that the use of computers is limited, with seven respondents stating that they are only as good as the information entered. Many went even further and pointed out the dangers involved in improper use, particularly in cases in which they are used to improve the appearance of the appraisal report as a cover-up for shoddy work. As one appraiser put it. "The computer is making the good guys better and unfortunately making some of the bad guys look like good guys." Some respondents felt that computers can be positively harmful and pointed out that the computer may make reports faster, more detailed, and longer, "but the end result will most likely be the dehumanization of the appraiser."

> The computer is a fabulous tool, but its use involves some dangers. Programs introduce an element of mechanization which may take away from application of reasoning to individual items in the appraisal process. In mass appraisal, it is, of course, an absolute necessity.
>
> James E. Gibbons, MAI

> It has accomplished no special recognition for the appraiser, and it has generated no enhancement for appraisers over other professions. It is needed when considering alternatives and variables within a project, but the key element is still the appraiser's judgment.
>
> Peter D. Bowes, MAI

Opinions varied widely on the relative standing of the three basic approaches in contemporary appraisal technique. In general, it was felt that the income capitalization approach has progressed the most. Ten respondents mentioned the development of the Ellwood method of mortgage equity capitalization as a major improvement in recent decades. Several respondents felt that appraisal technique has already progressed beyond Ellwood, but only one went so far as to say that "the Ellwood method, useful at one time, now seems laughable to sophisticated critics." Nearly half of the respondents pointed to DCF analysis as the most important step taken forward in the income capitalization approach. Yet even DCF had its critics who emphasized the dangers involved when the technique is misused or abused. One appraiser pointed out that the technique is "too subject to input variations to be useful in valuation."

A minority of the respondents felt that proper use of the income capitalization approach has deteriorated in recent years, with three stating that the margin of error has increased as the technique has become more sophisticated. One respondent stated that DCF is not an appraisal tool at all: "The new income capitalization technology has addressed counseling more than appraising, but has been used as an 'easy' appraisal tool." One has to

question whether this type of response belies a lack of understanding of the LXL/DCF methodology.

The sales comparison approach appears to be the least controversial and aroused few comments. Only one appraiser felt enthusiastic enough to say that this approach has shown more improvement than any other area of real estate valuation. Another felt that it has actually lost ground, having been ignored in favor of income capitalization. One more appraiser simply stated that the approach is "vastly overrated."

There seems to be general agreement that the cost approach is presently the least important of the three. Opinion was fairly equally divided over whether or not this approach has progressed in recent decades, and no one felt that the progress has been substantial. Six stated that the approach has been neglected and its proper use has actually deteriorated, but they did not say that this is necessarily a bad trend. Five others stated that the cost approach is usually not relevant to the valuation task at hand. Only one appraiser felt that the approach deserves more consideration than it has been receiving.

Although there was no direct question to the following effect, it was interesting to observe that not one appraiser felt it necessary to support the thesis that there is only one overall approach to market value, the comparison approach, the three traditional approaches being comparative components.

One general comment on the subject of developments in appraisal methodology was made by several appraisers: "Changes" are not necessarily improvements. Rather, these developments should be looked on simply as adaptions to the way the market evaluates income property.

Dealing with Specific Problems

The responses to questions on appraisal methodology seem to reflect a general feeling that problems are not due to lack of progress in this area, but are the result of misuse, abuse, and lack of use of new methods by individual appraisers. This became particularly clear when the appraisers were asked about specific problems in modern appraisal technique. On the whole, they seemed to have a relatively low opinion of their fellows' success in responding to such problems and felt that there is a general lack of agreement on solutions.

Forecasting—Nearly half, 20, of the respondents stated that appraisers are inadequate when it comes to forecasting future value, as opposed to three who implied that despite their limitations, appraisers' abilities in this area are sufficient. Of the latter, one respondent stated that the problem lies with clients who ask too much, while the other two felt that it is possible to make accurate appraisals on the basis of predictions that later turn out to be faulty.

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Eight respondents felt that appraisers should avoid the problem of forecasting entirely by contenting themselves with looking at the past. Because all data are historical, accurate forecasting is impossible in any case. Twice this number, 19 respondents stated that appraisers should train themselves to become adequate forecasters as well as historians, but five of these also pointed out that the appropriate techniques have yet to be developed. Despite a generally low opinion of their abilities as forecasters, many respondents pointed out that appraisers are no worse than economists or any others who profess an ability to predict future economic events. It was somewhat discouraging to find that some appraisers generally do not appear to comprehend fully that forecasting, with all its obvious frailties, has not seriously been challenged; and that the present discounted worth of the future remains our most reliable value indicator.

> Unfortunately the generalization concerning most appraisers functioning in a historical reference is partly accurate. There is greater emphasis on detail rather than being a "generalist" trying to grasp a sense or feeling as to the direction of the market governed by the traditional forces of supply and demand. Appraisers are by temperment somewhat disinclined to predict future trends due to their generally conservative outlook. It is in the nature of our work to look back at what happened (sales data) rather than to look ahead at what most likely will happen. The truly professional appraisers will compensate for this by making a special effort to keep up-to-date by obtaining data not only on past transactions but current escrows, offers, listings, etc. Predictions concerning future values are fraught with pitfalls as evidenced by assumptions concerning future inflation rates and rental growth made just a few years ago in our cash flow assumptions. Nevertheless, it is in the nature of our business to make future projections. Quoting Justice Oliver Wendell Holmes, "All values are anticipations of the future."
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> Ronald L. Buss, MAI

> My years in evaluation have caused me to develop certain strong convictions:
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> 1. All investments in real estate are money.
> 2. The usual investment is a combination of debt and venture capital, what we appraisers call the mortgage-equity combination.
> 3. Any change in the value of money, in the absence of offsetting factors, will change the worth of its assets, whose values are expressed in terms of money. This is the big inflation problem.
> 4. Notwithstanding changes in the mechanics of appraisal, its essence is that the real estate interest to be valued must be clearly identified and described. A forecast must be made of future benefits, usually cash flows that will flow to the interest. An appropriate discount rate must be selected, reflecting the investment's risk qualities and maturity structure. And finally, valuation is accomplished through the arithmetic of compound interest discount.
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> There is no doubt in my mind that there are many instances where there is a lack of mutual understanding between appraiser and client about the nature of the interest being appraised. Beyond that, there are the many problems that are

being highlighted in today's debate about proper definitions of value. Obviously, the great need is for education of clients and appraisers and ample communication between them. An appraisal is the answer to a question about some real estate interest, and the question need not always be what is fair market value of the fee simple title.

James E. Gibbons, MAI

Market feasibility studies—This appears to be one of the more controversial areas of modern real estate appraisal, with five respondents stating that this is the greatest weakness in appraising today. While a sizable majority of the respondents felt that no progress whatsoever has been made in the market feasibility analyses, only four voiced a need for improvement. Five appraisers criticized the whole idea of such studies, saying that they lead to overbuilding. The most negative view was expressed by one appraiser who felt that they merely serve as a smoke screen to disguise inadequate appraisals: "'Feasibility Analyses' and 'Market Demand Studies' are the biggest joke in our business. There is a real reluctance to take a stand and render an opinion, rather than manipulating statistics." Only five respondents felt that any progress at all has been made in this area. Opinion on the value of courses offered by the Appraisal Institute was evenly divided between those who felt that such courses are deficient and those who believed that younger MAIs are learning how to deal with this kind of market analysis.

Overbuilding in many facets of the construction industry has resulted in numerous entrepreneurs going down the proverbial drain. In my opinion these occurences are largely attributable to the inability of appraisers to interpret market absorption. A case in point—35,000 motel rooms constructed in Orlando oriented to Disney World in the early 1970s. Developers and lenders were shocked when for several years occupancy hovered in the area of 50% to 55%. Subsequent improvements in the economy and inflation resurrected many projects destined for failure.

Richard M. Hamilton, MAI

Determining Cash Equivalency—Responses were relatively divided on this, with somewhat less than half of the respondents admitting that they have problems with this technique. In general, there seems to be the conviction that urban appraisers who deal with this problem regularly are able to overcome any difficulties. Two respondents stated that they felt that the Appraisal Institute's new Standards of Professional Practice will help, but another pointed out that the 8th edition of *The Appraisal of Real Estate* ignores the problem entirely.

Relations with Clients

A recurring complaint of appraisers is the attitude of the client, who generally is characterized as failing to understand, or sometimes even care about, the processes involved in the valuation of a particular piece of property. With respect to forecasting, respondents stated that clients expect too much from

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Report Writing

A great deal of attention has been focused on the appraisal report as the most important element in appraiser-client communications. Once again, appraisers' assessment of progress in this area is mixed. Although the majority of respondents felt that they have seen some improvement over the last few decades, most stated that this progress has been inadequate. Two respondents felt that appraisal reports are the most serious problem in appraisal today. While there is general agreement that the average appraiser's use of the English language is poor, there seems to be a difference of opinion as to the exact problem with current report writing. Five respondents stated that reports need expanded explanations for the benefit of the client, and expressed disapproval over a current trend toward shortened reports. On the other hand, 18 respondents felt that appraisal reports already have too much detail—referred to as "boilerplate," "Chamber of Commerce Data," or simply "selling by the pound"—four of these noting with satisfaction the trend toward shorter reports.

> Unfortunately, we overreacted to the old inadequate reports that stated, in effect, that the property was worth so much "because I say so." We became so preoccupied with documentation and attempts to "prove" value that we began selling our reports by the pound. The inclusion of unnecessary, and even irrelevant, information became commonplace. I hope that the pendulum is swinging back but none of us would want it to swing back too far.
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> Charles B. Akerson, MAI

As a cure for poor report writing, five respondents recommended that new courses and Standards of Professional Practice be offered by the Appraisal Institute. A few appraisers expressed disapproval over such regimentation of report writing. One felt that the Appraisal Institute encourages appraisers to include more material than is really necessary in their reports, while another went so far as to state that the suggested Appraisal Institute format for an appraisal report "borders on being ridiculous."

With the advent of computer graphics, appraisers have become more concerned with the appearance of their reports, though many point out that sometimes this has been to the detriment of content. Nevertheless, very few appraisers denied the importance of good graphics in today's appraisal reports.

A final element in report writing with regard to the client is the appraiser's liability for his or her actions. One-half of the respondents stated that this growing problem has resulted in taking greater caution in the preparation of reports. Although the other half denied that they have ever made any changes in their reports, a few of these pointed out that doing so implies that proper care has not been taken in the past. A few expressed the fear that higher insurance rates would lead to increased appraisal fees. One appraiser proudly announced that he is still uninsured.

the appraiser; with respect to cash equivalency, that while appraisers understand the concept, clients do not.

An understanding with clients is crucial if appraisers are to perform their tasks adequately. The one question on which the appraisers showed most agreement was whether it is possible for a property to have more than one value. The vast majority, 43, said yes, as opposed to one "no" and one "maybe." This being the case, it is not surprising to find that several of the respondents went on to emphasize the importance of a clear definition of the particular kind of value being obtained for the client. Although there seems to be general agreement that there is a communication problem between appraisers and their clients, there is a great difference of opinion as to the source of the problem and the individual appraiser's success in handling it.

Opinion was fairly evenly divided on the question of whether communications between appraisers and their clients have improved in recent decades. Fourteen respondents felt that there has been no progress whatsoever. Of the 16 who disagreed, nine stated that they have seen "some signs" of progress, while seven respondents felt that there has been great improvement.

There seems to be general acceptance of the appraiser's responsibility in ensuring proper communication. When seeking a cause for misunderstandings, eight respondents put the blame on appraisers for not properly educating their clients. The client did not escape censure entirely, however. Four others accused clients of not going beyond "I need an appraisal" when giving out an assignment. Only one respondent stated that the appraiser was at fault for failing to understand an assignment, while two more felt that appraisers step outside the bounds of their knowledge when they try to act as consultants, as well as appraisers. Thus, appraisers get it from both ends—either they are communicating too little or too much to their clients.

> Financing techniques have tended to blend a variety of capital forms with a variety of property interests. These complexities of the last 10 years have tended to make the appraisal purpose more difficult to define. I believe in a good number of cases that the appraiser is not sufficiently educated to the precise nature of the assignment.
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> Glenn J. Rufrano, MAI

> There has been no progress made in defining the appraisal purpose. In fact, I would say that there has been a regression in this area. The narrowing of the scope of the definition of market value by the FHLBB's so-called R 41b appraisals is a good example of this perceived regression. More attention needs to be addressed to the definition of the appraisal purpose. The enlightened appraiser interviews the client prior to undertaking the assignment in order to define more fully the purpose of the appraisal. The purpose of the appraisal should be as perceived by the client. The appraiser must be aware that sometimes even the client does not know what he wants; it is the appraiser's responsibility in these instances to counsel the client to the problem definition.
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> Joseph Farber, MAI

> It is my opinion that the more sophisticated the clients, the more likely they are to be capable of making quality distinctions, and the less likely they are to be fee conscious; they become aware of the fallacy of the statement that "an appraiser is an appraiser." Too many appraisers (perhaps due to "competition") do not charge enough for quality work.
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> Joseph Farber, MAI

> I feel that the private client in this area is in a transition from looking at an appraiser as a house specialist. Many of them are still shocked at the amount of information, time, and work that goes into an income property analysis. Most of these clients are impressed by the AIREA educational requirements when they are informed. As to the professional standards, private clients generally accept them and understand our position. The same can be said of governmental agencies. However, many governmental agencies are trying to buy brains by the pound and are trying to obtain appraisals at the lowest possible cost. Unless there is a very large and difficult problem, most of them go with the lowest priced quote regardless of the quality of the work. There are still a large number of financial institutions that say all we want is a letter in our files to justify the loan we want to make. They appear to be looking for a scapegoat to point a finger at if the loan goes bad. They are attempting to reduce the amount of the fee and their loan cost. The recent financial crunch has made some institutions more sensitive to the quality of their reports. It has been my observation that many people apply their own ethical standards to the expectations that they have of others. In other words, a person who is extremely suspicious of being cheated is one who, given the opportunity, will cheat you.
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> Wilbert L. White, MAI

A slight majority of the respondents felt that appraisers have made some progress relative to other professions such as law, accounting, architecture, engineering, with 16 stating that they have made "major strides." Seven stated that appraisers' status has remained relatively unchanged. Only one respondent felt that appraisers have actually lost ground as a result of the field being demeaned by some of its members. Opposed to this view, however, one appraiser stated that recent troubles in the business have had the beneficial result of showing the importance of good appraisals.

> Having started in the real estate business in Boston in 1925, I was in an era in which real estate salesmen and brokers were not rated very highly... .I was constantly irritated at the lack of esteem held for the professionals. The constant upgrading of the profession by the National Association of Real Estate Brokers (NAREB) and later by the Appraisal Institute have certainly improved the opinion of the public regarding the status of appraisers in recent years. It is my opinion that at this time, financial institutions and government agencies have considerable respect for our profession. I feel that the general public is still not well acquainted with our industry.
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> Theodore W. Slack, MAI

Only a quarter of the respondents felt that appraisers are now on a level with the other professions, and a nearly equal number stated that the general public does not agree. Only three appraisers stated that the general public places appraisers on a level with other professionals, as opposed to six

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Professionalism

> Given various definitions of a profession and given the current educational standards of the AIREA, strictly or technically speaking, MAIs may be deemed "professionals" practicing a "profession." However, as stated in Black's Law Dictionary, a vocation must "receive the name" profession; which raises the question of from whom or what does one "receive the name"? It is my opinion that it is the layperson, "John or Mary Q. Public," who grants the name profession to a particular vocation. Furthermore, the layperson has yet to make said grant to the vocation of real estate appraising, not even to the top group of the vocation, namely the MAIs. The late Dr. Robert O. Harvey made this point in a paper addressed to the NATIONAL ASSOCIATION OF REALTORS® by saying "simply wishing will not make it so." In other words, MAI appraising meets the literal definition of a profession but not the common perception of a profession. It is the latter that really counts. With nearly 50 professional designations in real estate, 21 of which are in real estate appraisal, the public is confused to the point that, for many, the designations remain as merit badges to show accomplishment to others in their own field.
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> Joseph Farber, MAI

The respondents were asked several questions concerning the professional standing of appraisers, beginning with whether or not, according to the dictionary definition, real estate appraisal qualifies as a profession. To this question approximately one-half, 26, appraisers answered in the affirmative, as opposed to seven negative responses. An additional 17, however, qualified their responses in such a way as to imply a lack of professional recognition for appraisers as a group. For example, four respondents felt that appraisers are professionals in a general sense, but not according to the strict dictionary definition. Perhaps even more negative, one said that while appraisers qualify as professionals according to the strict dictionary definition, it is unlikely that they can be considered professionals in the general sense. Five respondents felt that the level of professionalism depends on the individual appraiser, and four more stated that there is too much unprofessional activity even among MAIs. One appraiser felt that younger appraisers have lost the sense of professionalism found among their elders, and one more simply stated that appraisers would *like* to be considered professionals. Even among the 26 who stated that they felt appraisers are professionals, five admitted that the general public feels differently.

> The public perception of the AIREA educational and ethical requirements and standards is currently nebulous at best. This is primarily a dual function between the recent negative press on "appraisers" and the confusion surrounding MAI designation and the average non-MAI practitioner. The many other appraisal organizations and designations tend to cloud the distinction between standards and requirements of the Appraisal Institute. The Institute needs to continue its advertising and create a clearer awareness by the public of the quality and ethics behind the MAI designation.
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> Donald M. Blake, Jr., MAI

their thoughts more towards what is happening in the world around them. From this information may come additional vital information relating to the future of the properties they are now appraising and a better understanding of the factors that are currently and may, in the future, influence real estate values.

John R. Garvin, MAI

I believe the public perceives the requirements as being difficult (to become an MAI, not just to be an appraiser). In my opinion, my education only *started* when I became designated. Course work was too oriented to number-crunching; not enough to understanding economic forces, real estate markets, how to research, using good judgement, ethics, etc.

Kathleen W. Price, MAI

There was much more agreement over the Appraisal Institute's ethical standards, although ultimately the response was anything but positive. Over half of the respondents felt that the ethical standards set down in the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice are good. Once again, however, there were about 10 others who had various reservations such as "too strict," "too loose," "too verbose and complex," and "too much emphasis on due process." The weight of these opinions was nearly reversed in regard to the enforcement of these standards. Thirty-one respondents stated that the Appraisal Institute's ethical standards have been poorly observed and administered, although a few of these noted that ethical matters are difficult to enforce in any case. Only nine expressed satisfaction with curent enforcement of ethical and professional standards.

Concerning administration of the Code of Professional Ethics and Standards of Professional Practice, I have two major complaints. First, not nearly enough people report violations to the Director of Screening; and second, the morass of data that has created a log jam. I feel as though complaints must be processed most expeditiously in order to create incentive for other violations to be reported. I know this is repetitious, but many, many appraisers I have talked to, who have taken the time and trouble to issue a complaint, are most discouraged because they have never heard or seen any results of those complaints, and state quite candidly they'll never do it again. This is a very bad situation in my opinion, and must be corrected if we are to achieve the status of a profession.

Warren Hunnicutt, Jr., MAI

These are admirable standards, generally endorsed by all MAIs but interpreted differently by individual MAIs when the pressure is on to satisfy the needs of a client. *Most* appraisers probably adhere to *most* of these standards *most* of the time. However, we deviate often enough to question our commitment to our "professional" integrity. It is also impossible to administer the necessary "police action" to keep the standards pure, because it is done by volunteers at the local level who find it difficult to sit in judgment of a fellow appraiser accused of something that they may also be guilty of—at least to some degree.

W. Reynolds Couch, MAI

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appraisers who agreed with the negative assessment of their own standing. In terms of educational requirements, the general feeling is that appraisers are lagging behind other professionals. Nearly half of the respondents felt that the educational standards of appraisers are less demanding than those of related professions like architecture or engineering, although six of these stated that the standards are more rigorous than those required of planners. Opposed to these, seven respondents felt that appraisers' standards are on a level with those of the related professions.

A key question in discussing the professional status of appraisers seems to be whether one is looking at appraisers as individuals or as a group. With regard to professionalism in general, only three appraisers specifically stated that they are gaining as a group. Ten appraisers stated that they are personally respected as professionals, but that others are not. In all, 17 respondents made the point that respect for the appraiser as a professional depends entirely on the individual appraiser. In addition to differences in the natural talents individuals possess, we have already seen that while most of the appraisers seemed generally satisfied with progress in appraisal technique, many pointed out that not all appraisers take advantage of new developments.

One possible means of distinguishing the professional from the nonprofessional appraiser is designation by a reputable appraisal organization, the most prestigious of which is the MAI designation offered by the Appraisal Institute. From the responses to the survey, it is difficult to judge the relative standing of MAIs among appraisers. Only six respondents stated that one must be an MAI in order to be respected as a professional appraiser. This seems to have resulted partly from the fact that many seem to have taken it for granted that when one says "appraiser," what is meant is "MAI."

Leaving aside the question of undesignated appraisers, however, it is clear that many respondents felt that even the MAI designation does not necessarily guarantee professionalism. To begin with, there was a certain amount of dissatisfaction with the Appraisal Institute's educational requirements. A slight majority of the respondents felt that the Appraisal Institute's educational programs are good, and respected by the general public. Ten, however, had doubts about the standards, with assessments ranging from "mediocre" to "bad."

> Current educational requirements for the valuation business are not as demanding as the requirements for the other professions. The requirement for just a college education does not specifically address general areas of knowledge related to the valuation field where some knowledge and background should exist. Examples of these are economics; general planning; economic geography; finance accounting; marketing; and other factors that influence regional, area, and community development patterns. There are many forces that drive and impact upon the real estate community and property ownership beyond just the neighborhood in which it is located. I believe our members should be directing

Once again, as with appraisal methodology, the problem with ethics and professionalism is not that the appraiser lacks the proper tools to be successful. New developments in appraisal technique, along with the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice would seem to provide adequate guidelines for any appraiser desiring to be respected as a professional. In the opinion of the appraisers themselves, however, there are simply too many appraisers who fail to take advantage of the opportunities that exist for advancing themselves as individuals or as a group.

CLIENTS' VIEWS ON APPRAISAL

Basic Appraisal Methodology

With respect to the three basic approaches to valuation, clients tended to focus on income capitalization as most accurately reflecting the thinking of buyers, lenders, and sellers. Not only do techniques such as DCF analysis help clients understand the approach, but the use of long-range projections, as opposed to values at a single point in time, actually reflect what the investing public demands. Clients appear to understand more clearly than appraisers that value must reflect future expectations for the property.

Except for the better accumulation of data through the use of computers, clients had little to say about the sales comparison or cost approaches to valuation. The appraisers themselves stated that they have little use for the cost approach. Although one client seemed to imply that this is really not the case ("Appraisers act *as if* clients no longer consider the cost approach useful"), others confirmed that the approach holds no interest for clients, and that the diminishing emphasis on costs is appropriate.

Most clients recognized the benefits that the computer can offer and noted that its absence would reflect poorly on the appraiser. None, however, felt that its use results in any enhancement of the appraisal field as a whole. "The computer is only a better pencil, calculator, typewriter, not a better appraiser!" I tend to disagree sharply with this consensus. The use of the LXL/DCF method has had far reaching beneficial consequences for appraisers that both they and their clients appear unwilling to appreciate. Granted that the appraisers' judgement is paramount, the computer has enabled more precise and accurate appraisals to be made and has significantly increased the utility of appraisal services. In the process, appraisers' status has been materially enhanced, despite their unawareness.

Dealing with Specific Problems

Forecasting—Practically all of the clients felt that appraisers are inadequate as forecasters, although one stated that this is not necessarily a bad thing. Eight respondents felt that it is important for appraisers to improve their skills in this direction, with two pointing out that new developments

such as DCF analysis have made forecasting necessary. One client added that appraisers already have the necessary tools to become reliable forecasters. A new slant on the problem was offered by one client who stated that appraisers do not always have access to current data, and blames brokers and owners who are "very reluctant to share the specific nature of 'the deal'; I don't blame them, considering many of the deals are zero cash flow!"

Market Feasibility Studies—Opinion was somewhat more divided on appraisers' skills in market analysis, but was still weighted on the negative side. Only three clients felt that there has been sufficient progress in this area. Ten disagreed, with one stating that this is the biggest deficiency in appraisal today. One client stated that there has been some progress in manipulating data, but there is a continued weakness in interpretation. Another felt that even the data are inadequate. One client complained that appraisers do not know the difference between "absorption" and "activity."

Determining Cash Equivalency—Responses were much more varied on this, perhaps reflecting some confusion over exactly what "cash equivalency" means. One client apparently did not even understand the question. Four clients stated that they did not think that appraisers have trouble with cash equivalency, although two of these did not sound very positive. Five stated that appraisers definitely have difficulties in this area. Three clients stated that it depends on the individual appraiser. One appraiser stated that his clients feel that "the person who has not had difficulty is extraordinary."

Relations With the Client

Report Writing—Opinions on progress in this area varied widely, from "notable improvement" and "getting better every year," to complaints that too many reports are "wordy, unclear and poorly organized," or "bare bones, standardized, and boilerplate." One client stated that "I am still painfully aware that New York City is on the eastern coast of North America in the United States of America, on the planet Earth." On the whole, all clients seemed to agree that there is still room for improvement in this area.

Defining the Appraisal Purpose—Once again, there was a wide range of opinion. Two clients stated that they have noted some progress in this area, while two others stated that it has never been a problem, one of these pointed to their "clear engagement letter" as the reason. Two clients blamed the appraiser for failing to understand or ascertain the purpose of assignments, but four others blamed the clients themselves. Two of the latter claimed that it is clients' misconceptions, rather than appraisers', that are at fault. The other two stated that the problem is often the result of the client not clearly articulating in writing what the appraisal assignment entails.

One respondent had some very strong words concerning the appraiser-client relationship: "Appraiser's greatest problem. At mercy of client's needs. Leads to complete compromise. Source of 90% of industry's problem."

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Professionalism

Only two clients denied that appraisers qualify for professional status. The remainder seemed to feel that, while the term "professional" can be applied to appraisers in general, there are many who act in an unprofessional manner. Three clients pointed specifically to MAIs, although one of these felt that MAIs are "specialists/consultants" rather than true professionals.

Most of the clients had little idea of the educational requirements for the MAI designation, but on the whole seemed to feel that they are highly respected. Nevertheless, not a single client felt that the educational requirements for the valuation business are as professionally demanding as those for architects or engineers. One client, however, stated that this is an apples and oranges comparison. In appraisal education, "the subject matter is not as scientific, and involves a more subjective application of the basic principles. The field is still more of an art than a science."

Although there seemed to be some feeling that the Appraisal Institute's ethical standards are of high caliber, the clients were practically unanimous in stating that these standards have not been well observed by individual appraisers. Two clients felt that in their experience the standards have been fairly well observed. One pointed out that this was the result of careful selection of appraisers for individual assignments. Two clients repeated the by now stale joke that "MAI = Made As Instructed."

On the whole, clients do not seem to rate appraisers on a level with other professionals. Some pointed out that there are appraisers who rise above the general level of professionalism of their fellows, while another stated that appraisers have reached the level of professionals, but that their current public image belies the definition.

Profile of the Modern Real Estate Appraiser

by John R. White, MAI

Unquestionably appraisers' status, especially those accredited by the American Institute of Real Estate Appraisers, has grown perceptibly over the past seven to 10 years. As I pointed out previously, however, in the public's eyes, appraisers made relatively little progress in the era from 1950 to approximately 1970.[1] There were few, if any, improvements in income methodology until the theories of Leon W. Ellwood. Prior to 1970, the use of direct capitalization in the income approach was widespread; the various residual techniques were used when a report needed "dressing up." The use of William Inwood's tables as a basis for depreciation or return of capital was reserved for instances in which the outlook for the property was favorable. Generally, H.E. Hoskold's tables were used to obtain more conservative answers when the outlook was fair. The use of a straight-line depreciation allowance in the

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Part one of this article, "The Real Estate Appraiser—The Elusive Goal of Professionalism," appeared in the July 1987 issue of *The Appraisal Journal*.

1. John R. White, "The Real Estate Appraiser—The Elusive Goal of Professionalism," *The Appraisal Journal* (July 1987):325–377.

residual techniques produced the lowest possible value. Little or no thought was given to predicting future income.

Similarly, the 1950 to 1970 period did not witness any real advance in market comparison techniques, but significant progress was made in improving the accuracy of market data. More effort was exerted to "get in back of the sales price" by interviewing the buyer or seller, or both, to obtain the details of the transaction. The use of computerized central data banks did not occur until 1982 or later. The accuracy of data slowly became better appreciated as data became more critical, but the simplest comparative techniques —principally time, location, zoning, and property size adjustments—were basically unchanged. Regression analysis was rarely used in the sales comparison approach. The cost approach had sunk into disuse, while income capitalization and sales comparison dominated. Recently, but on a very limited basis, and presumably provoked by four years of moderate inflation and a nonoverheated economy, some re-examining of the cost approach as having real meaning as a ceiling of value has occurred.

A series of apparent failures beset the appraisal business from 1950 to 1970. They were the result of a lack of experience and competence on the part of some appraisers, and unethical conduct on the part of others. All these failures were expressed in diminished credibility in the public's eyes. Problems arose as highway condemnation, urban renewal, and Real Estate Investment Trusts (REITs) created new demands on appraisers' imagination and ingenuity in meeting entirely new situations. The earnest growth in ethics, standards, and education tended to be obscured by the times.

PROGESS SINCE THE LATE 1970s

The period from approximately 1977 through 1985 produced a dizzying series of events that contributed significantly to an elevation of appraisers' status and brought enhanced respect. These events included:

- The development of excellent software to permit extensive and detailed analyses and valuations of income properties
- The perfecting of lease-by-lease analysis in the major software programs so that the most complex changes in revenue and expense escalations could be made
- The emergence of the need for forecasting of revenue and expenses at a compound growth rate because of hyperinflation
- The utilization of discounting techniques in converting the anticipated net operating income (NOI) into value
- The steady decline in price and further development of microcomputers, making them affordable for most appraisers

Along with these refinements came the increasing use of appraisers as investment advisors. They were engaged because of their recognized skills and advanced knowledge for a wide variety of client needs, but primarily for their valuation skills. The combination was exhilarating.

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SHOULD APPRAISAL OFFICES REMAIN SMALL?

A surprising revelation of the questionnaire survey on which this article is based is the persistence of the cottage industry concept. Many appraisers still work out of their homes. Others occupy very small office suites, frequently as small as 500 square feet. Appraisers tend to believe that they must stay small to be recognized, as well as to keep overhead down. Many outstanding appraisers choose to remain small. When they require additional staff they are usually able to obtain competent temporary help. This same type of appraiser is also generally able to keep up with the changing technology because of his or her innate intelligence. The freedom of action and independence of others dominate their business philosophy. However, there is a tendency to grow in company size and have specialists in property types. The obvious drawback to the self-sufficient, single-proprietor concept, however, is the difficutly of keeping up with the market. This presupposes that the sole proprietor is constantly alert to and current with evolving methodology, that is, the use of word processors, advanced calculators, and microcomputers. Lack of peers to discuss problems with is also a disadvantage. Another drawback is the inability of the proprietor of a small appraisal office to leverage his or her time effectively by employing younger associates to do the research work. And finally, the larger the company, the greater the tendency to have specialists in a wide range of fields on the staff, thus providing a basis for the enlargement of the practice and the enhancement of the appraiser's status.

The questionnaire returns disclosed that 60% of the appraisal companies had no more than 10 professional associates. One company, a distinct exception, reported having 60 market-value appraisers on its staff. Otherwise, 20 professionals or more was a very large aggregation, with only six companies in this category. What has recently emerged is the growth of the larger, say 10 professionals or more, urban appraisal operation as an independent entity or part of a real estate agency or consulting company in which group action permits acquisition of the most advanced word processing and computer equipment. These appraisal operations have become completely "state-of-the art" and offer a variety of services that the small shop or sole proprietor finds difficult to match. Such operations are likely to be found in the heart of the 50 largest metropolitan areas. However, as Robert E. Hickman, MAI, has sagely observed on the subject, "In analyzing appraisal services, one must distinguish between the small office and the small mind. It's the person that counts."[2]

HOW EXTENSIVE SHOULD AN APPRAISAL PRACTICE BE?

There are few practicing appraisers who can successfully accomplish an

2. Robert E. Hickman, letter to the author, 1986.

economic base analysis. The most common basic factors included in a mastery of demographics—disposable household income, employment and its distribution, transportation and its effect, climatic conditions, and more—are not necessarily part of an appraiser's arsenal. Nor does an appraiser always have the insights required to relate the meaning of the economic base factors to the market value of a particular property. A few appraisers even lack a sufficient comprehensive knowledge of physical geography, including factors of climate—soil and subsoil, terrain, vegetation, temperature changes, prevailing winds, and so forth—the essential backdrop for many real estate conditions. An applied form of economic geography is required to make corporate industrial and office relocation studies. This is a potentially very profitable field for appraisers that has been pre-empted by economists and city planners. Some appraisers have successfully entered this field as in the recent study of industrial location sites for the proposed Saturn automobile plant. Over a quarter century ago, Robert K. Brown voiced the need for "generalists" in the appraisal business stating:

> Professionalization of appraising will require a broadening of the appraiser's body of knowledge in two vital areas. One area is that of urban land economics, embracing site utilization and the planning and zoning of land uses. The second area is that of market analysis, or the understanding of basic economic forces which contribute to an area's economic vitality and which find expression in the local, regional, and national real estate markets.[3]

More appraisers should represent themselves outright as advisors to their clientele rather than merely as appraisers. The use of the sophisticated techniques of investment analysis in assisting a client in the financial structuring of a deal or in making a basic decision to hold, sell, or finance, are ways appraisers can very effectively serve their clients in a long-term relationship. To impress clients with their professionalism, appraisers must, where the opportunity presents itself, abandon their traditional passive image in favor of an activist role in which they may not only be advisors, but also effectuators on behalf of their clients.

SHOULD FEE APPRAISERS BE OBJECTIVE AND DETACHED?

A continuing inclination at distinct cross-purposes with the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice is the disposition of appraisers to reflect to some extent their client's viewpoint; rather than to insist on an independent, objective, and detached view. The vast majority of appraisers are honest and would not intentionally falsify a value. However, the notion persists that formal appraisals "made as instructed" can still be purchased, if not from the top rung of appraisers, at least close to it. In practice, it is the appraiser's natural or sometimes subconscious

3. Robert K. Brown, "The Need for Generalists in the Appraisal Profession," *The Appraisal Journal* (April 1960):222.

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disposition to see the market through his or her client's eyes. The resultant appraisal may then be described as being in either the upper or lower range of value, depending on the client's circumstances. Chances are that any client using the appraisal will not be hurt by relying on the value estimate because the deviations from the considered norm are not at all significant, and, in fact, are difficult, if not impossible, to detect with any certainty. In more instances than not, the appraiser will go no further than perhaps reflecting a slightly more optimistic view of things, or the reverse, as the case may be.

A minority of appraisers has forcefully argued that within reasonable bounds, it is not an incorrect or unethical procedure to find a formal market value that is supportive of a client's position. A few believe that it is unrealistic to expect their peers to be any less an advocate for his or her client than an attorney or accountant. Why should the burden of steadfast independence, professional detachment, and objectivity fall on appraisers to a greater extent than other professionals? There appears to be a certain "holier than thou" attitude in the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice that is generally not found in other professional disciplines. The Appraisal Institute has begged the question by advising its members that they may act as advocates in instances in which a formal documented appraisal is not required, presumably such as an investment analysis or in described advocacy services. My comments are confined to the Standards surrounding the formal appraisal assignment. The Appraisal Institute's position is that the appraiser is never released from its ethical constraints and Standards in accomplishing either an appraisal assignment or an evaluation study of any type. More broadly based individuals may question the wisdom of becoming an MAI because the Appraisal Institute has placed a Standards blanket over them that may prove chafing and inhibiting at the least. A logical case may be made for the Appraisal Institute's having jurisdiction only when an "appraisal assignment" is being carried out. A merger with the American Society of Real Estate Counselors (ASREC) (which permits advocacy) may be one way to solve a perplexing dilemma.

This ambivalence as to appraiser's actual position in regard to advocacy seemingly causes confusion and has tended to detract from their professional status. The assumption that appraisers owe nothing more essential to their clients than objectivity may some day be challenged by top-flight appraisers. The stock response that opponents of this radical veiwpoint of advocacy cite is the prospect of mass confusion and loss of credibility in the event that every appraisal has a bias of one type or another. However, the appraisal public, that is, those who either engage appraisers or rely on appraisal results, can readily distinguish incredible reports from those that make sense. Why not consider elimination of the very thin veneer of objectivity and professional detachment in favor of recognizing appraisers as advocates for their client's cause? It appears that as a matter of practice, this is happening every day.

Surely this is occurring in appraisals for ground lease renewals. It happens to a sometimes ridiculous extent in tax abatement and condemnation appraisals. The extremists would soon be spotlighted under a reasonable advocacy standard and the market would expose them for incredibility. On the other hand, the best appraisers would operate in this new environment within a very narrow band of market value because of the credible nature of their opinions. Appraisers need to engage in a full-scale open debate over this issue.

Nowhere in the codes of ethics or standards of professional practice of attorneys, accountants, architects, planners, and some of the other professionals is there a prohibition against advocacy under some or all circumstances when acting on behalf of a client. Surely the most comparable organization to the Appraisal Institute, ASREC, has no such requirement. In practice there is scarcely any appraiser who would not privately agree that he or she has at a minimum been sympathetic to a client's position at least within the bounds of what every appraiser presumably decides represents decent business propriety. These appraisers do not provoke any problems nor is their work product apt to be misleading or inadequate. Conscience rules as to the limits the appraiser believes he or she may stretch in representing clients.

Appraisers who demean the Appraisal Institute's Standards and ignore the most elementary rules of business conduct tend to be extreme advocates for their clients or are simply incompetent or careless. The issue is whether removing the restrictions against advocacy would fundamentally sully appraisers' efforts at professionalism. The majority of thoughtful decent appraisers would not be affected by this radical change in the concept of ethical conduct. Their innate sense of propriety probably existed long before their first reading of the Code of Professional Ethics or Standards of Professional Practice. The outright extremists would continue to practice their deceit as before. Markets, like voters, are more discerning and more capable of grading individuals than can be imagined. Over a period of time, the "made as instructed" appraisers and the incompetent and habitually careless would be readily sorted out. The quality of their clientele would also decline from mediocre to poor because such appraisers lack credibility and hence, respectability. On the other hand, those appraisers acting within reasonable bounds of advocacy (normally defined as the upper or lower range of value as the case may be) will be recognized and respected for their professional judgment.

Through their trade organizations, appraisers must confront the assets and liabilities of a major departure from an established policy that has been part of their efforts since the Appraisal Institute's founding in 1932. Unfortunately in many cases, the maintenance of a postion of independence and complete impartiality may prove to be a deceit rather than a frank and open

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attitude. I take no stand on the issue. I believe it must come "out of the closet" and be aired before an open forum. As stated by Boyd T. Barnard, MAI:

> Are our pesent rules and rigidities (which seem to be increasing) inspiring or encouraging to our most experienced and able practitioners? I think of some of the "greats" of the past, and even now, as being men who used a freedom of thought, actions and writing which now is difficult or impossible without violating some rules of procedure or ethics as prescribed by the Institute or by some departments of government.[4]

INVESTMENT ANALYSIS ENHANCES APPRAISERS' STATUS

Investment analysis has been adopted by many outstanding appraisers as the occasional replacement for a formal estimate of market value. Appraisers recognize the formal appraisal as an estimate of market value being fully supported and documented at all levels of the market; setting forth all valuation rationale; and containing all the facts about a region, city, and neighborhood that have a bearing on the market value of a specific property. The problem in many instances is the arbitrary quality of the appraised value itself. Once made, the appraiser and his or her client are "stuck" with it. Another problem is the vast documentation and lengthy report the client frequently demands. An investment analysis is much more flexible; provides a range of possible market values, usually set forth in a grid or matrix; and demonstrates the sensitivity of the market value to different discount and capitalization rates and sometimes to other operating assumptions. Investment analysis does not normally require heavy market or city documentation, nor does it purport to represent any process other than an investment approach. The appraiser is prequalified and does not have to prove him- or herself by documentation. The client retains discretionary authority as to what figure he or she might employ from the valuation matrix and is not circumscribed by a formal valuation number.

Investment analysis is increasingly prevalent in instances of anticipated purchase or sale, or for the purpose of establishing a basis for action such as alteration, modernization, addition, or financing. In cases involving expected purchase or sale, it enables the appraiser to be involved in the ensuing implementation without the spectre of ethical considerations or standards violations that accompanies a formal appraisal and can be construed as self-serving.

In any event, appraisers' status as advisors and confidants to their clients has been significantly enhanced since 1977 by this new use of investment analysis. In formulating investment analyses, appraisers work closely and continuously with their clients and consequently, may be retained when any action is taken on the basis of their studies. In some instances, MAIs have

4. Boyd T. Barnard, "Artist or Mechanic?" *The Appraisal Journal* (October 1970):587.

recently been able to obtain investment analysis business in the face of competition from investment banking companies and real estate agencies. They were also able to obtain the ensuing assignments that led to the sale, for example, of the Pan Am Building and the financing of the General Motors Building in New York.

In the top 50 metropolitan areas of the United States, appraisers are increasingly being used as confidential advisors and not in the conventional view as some hide-bound numbers cruncher intent on his or her "slipstick" ways. The advisory role now being played in increasing numbers by appraisers to such clients as banks, savings and loan associations, insurance and investment companies, development companies, and pension funds is the most significant personal and professional advancement since the foundation of the Appraisal Institute in 1932. The role of advisor removes the appraiser from a passive and somewhat clerical position to one whose importance to the development process, financing, purchase, and sale is widely recognized. As Charles F. Seymour has stated:

> The sooner we come to a realization that value is always incidental to the solution of some other problem, and train ourselves in the solution of these larger problems, the more service we can give to our clients.[5]

PROFICIENCY LAGS IN MARKET ANALYSIS AND FEASIBILITY

Appraisers have also been slow in accomplishing more expert market analysis and feasibility studies that, among other requirements, compel them to decide by an inferential reasoning process what share of a defined market area can reasonably be allocated to the specific site or tract, the absorption per month or year, the size and general character of the buildings, and the rent or sale levels the public is willing to pay.

Feasibility studies have been even more taxing to appraisers because in addition to the basic ingredients for a marketability study, there are added requirements to estimate precise development costs, operating and overhead costs, and the ultimate return on a presumed or derived equity investment. The questionnaire survey did not satisfactorily explain why this type of business has been shunned by appraisers and instead has been awarded by default to planners, architects, and economists. Apparently, for those attracted to the appraisal profession, there is something inherently elusive about the economic base as it relates to the total competitive market and real estate development. Appraisers instead, appear more comfortable dealing with easily ascertainable known facts. They tend to shy away from the admittedly difficult vagaries of a tract's absorption capabilities. In this

5. Charles F. Seymour, "More and More of My Reports are Valueless," *The Appraisal Journal* (October 1967): 65.

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regard, appraisers' progress has not been uniform. Well over a decade ago, Dr. James A. Graaskamp pointed out that:

> An appraisal is a very narrow-minded form of a feasibility study because market value presently requires a fictional client and limiting conditions which exist only in the deductive logic of appraisal theory. Appraisal methodology must be revised to reflect current competition and be in accord with behavior of the economic enterprise or actor. Only then will the theory of appraisal be compatible with the reality of feasibility analysis.[6]

CONSISTENCY OF APPRAISERS' RESULTS

Some lingering doubt and cynicism about the consistency of appraisers' results remain. Much of this can be traced to the imprecise nature of valuation as an art that employs certain disciplines to achieve the best judgmental result, rather than to deliberate alterations or misjudgments in market value. Among the doubters are members of the New York Society of Securities Analysts and its real estate arm who in private conversations have expressed reservations about the consistency of appraisals made for open-end realty funds or current value balance sheet purposes. Other doubters are the large-scale real estate investment and development companies that have elected to ignore appraised value balance sheets in their annual reports, despite the possible loss of share value by so doing.

Difficulties with consistency are unique to real estate as a product. When the properties included in a portfolio are scattered all over the country and the assignment is carried out by a selected group of local appraisers, consistency becomes a problem despite efforts by fund managers to adopt a detailed common format and uniform capitalization techniques; subject, of course, to local conditions. The problem intensifies if the appraiser feels under pressure to support upward movements in share values, yet is slow to recognize the down movements in his or her appraisals. Dealing with the human factor seems almost beyond the fund manager's capacity.

In my prior article, "The Real Estate Appraiser—The Elusive Goal of Professionalism," I presented what the Appraisal Institute is doing through the enforcement of its Code of Professional Ethics and Standards of Professional Practice, and intensified educational activities to reduce the incidence of errors.[7] All these measures are helping. The counseling activities of the Appraisal Institute are very constructive ways to assist appraisers who somehow are deficient in their appraisals. Above all, it is appraiser's mental attitude and business philosophy concerning the proprieties of his or her practice that make the real difference. Attracting persons of high moral and personal character and, hence, quality to the business does not provide complete assurance, as the medical and legal professions have learned from

6. James A. Graaskamp, "A Rational Approach to Feasibility Analysis," *The Appraisal Journal* (October 1972): 516.
7. White, pp. 351–354.

bitter lessons, but the opportunity for enhancing the consistency of valuation results as a direct consequence of the quality of those persons involved.

ALIENATING NATURE OF APPRAISERS' LANGUAGE

For no discernable reasons other than perhaps insecurity, it is puzzling as to why appraisers have seemingly deliberately embarked on a course of choosing words and expressions alien to the very fields of associated disciplines with which they should nurture a relationship.[8] Appraisers tend to deal frequently with finance officers and accountants. Appraisers' clients also generally have investment backgrounds to some extent and deal constantly with investment people.

Despite this interaction, appraisers have insisted on inventing phrases or using words that are essentially nondescriptive and must confuse, if not irritate, the readers of appraisal reports. An example is the constant reference to NOI after mortgage interest as an "equity dividend." The words "equity income" would be far more accurate. Frequently, gross revenue is referred to as gross income. Appraisers call depreciation and amortization "capital recapture" rather than labelling them as they are. They also "process" rather than convert NOI into its value. I will not dwell on other illustrations of inappropriate word use except to observe that appraisers appear to be weakening their status in spite of themselves and their peers who insist on going their own way in the lexicon world.

COMPENSATION AS A MEASURE OF STATUS

Appraisal has been a very lucrative occupation in the past 25 years. Although fees for individual values may seem modest to moderate, appraisers have learned to economize their operations through the inclusion of standard phraseology in many sections of the appraisal report. They tend to utilize a generalized presentation of national, regional, and local events that affect market value. The custom is to update this data once a year or as required. Similarly, comparable sales, once they are presented in a standard format, can be used for analyses in different reports over an extended time frame. Thus, in some instances, the report represents a major use of prior material that is relevant to the appraisal at hand. The computer has had less effect in cutting operating expenses than one would imagine. As one appraiser has put it, "We installed both microcomputers and a minicomputer primarily in our anxiety to remain state of the art and hence competitive. I doubt very much that they will be cost effective. Their chief advantage is the increased capacity to make more accurate professional judgments."

Compensation today is more skillfully computed than in the days when appraisers secretly (because fees ethically were not supposed to be related to

8. See John R. White and Peter Spies, "Towards Universally Accepted Semantics," *The Appraisal Journal* (January 1978): 67-78.

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the appraised value) used one-tenth of 1% of the appraised value as a norm. They would then charge more, say one-fifth to one-half of 1% for smaller assignments and less than one-tenth for the largest assignments. Today, appraisers estimate total hours at varying rates, depending on the level of skills and experience of associates to be assigned to the work. To this subtotal they add overhead and profit, frequently including their own time. In many cases, appraisers maintain computerized estimates for as many as 12 different categories of time, quite aside from client time. Expense reimbursement is subject to negotiation with the client. Responses to the questionnaire survey indicated that although firm fees for an appraisal are quoted, appraisers do not generally reveal their own hourly rates unless asked. In many smaller metropolitan areas, the hourly rates appear somewhat low for the extent of the responsibilities. In the 20 largest cities, hourly rates tend to be directly competitive with the city's leading law and accounting firms.

The responsibilities inherent in the appraisal process greatly influence the compensation appraisers charge and clients accept. For the select few involved in due diligence appraisals in connection with public issues of securities, the creation of new entities, and mergers and acquisitions; appraisers must, in effect, become self-insurors by charging significantly higher fees because liability becomes so great. Clients generally understand this and are receptive to fees based on the nature of the responsibility, rather than strict reliance on the appraisal amount or the hours required to accomplish the appraisal.

Some appraisers attribute the improvement in fees to the growing complexity of their work. This does appear to be a substantial influencing factor. It seems that the principal negative influence on fees is the relative shortage of contemporary broad-based communicators of the appraisal story. Those who have minimized or partially eliminated the boilerplate, or placed it wherever possible in the addenda and concentrated instead on giving the client the appraisal answer in a penetrating and analytical way, demonstrate their broad background in the art of appraising and are eventually sifted out of the marketplace and recognized.

What is the range of appraisers' pretax net incomes (expressed here in salary terms because many appraisers are sole practitioners or operate small partnerships or corporations)? The answer is both difficult and elusive because charges vary significantly throughout the country. For example, in the Southeast—notably Georgia, Alabama, and Louisiana—appraisal hourly rates are lower and this is reflected in compensation. In the highly industrialized areas in the near Midwest and Atlantic coast regions, compensation is usually very high. Comparison also becomes difficult because some appraisers are self-employed and thus nonsalaried. The following yearly figures may provide some idea of how well appraisers are faring economically.

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Geographical Area	Trainee (College Only)	Career Midpoint	Proprietor, Sr. Partner, or Sr. VP-MAI
New York and Boston	$27,500	$65,000	$150,000-$200,000
Atlantic Coast	$25,000	$55,000	$125,000-$150,000
Deep South (GA, AL, LA, FL)	$20,000	$45,000	$ 80,000-$ 90,000
Southwest (TX, OK, AK, MO)	$22,000	$48,000	$115,000-$125,000
Midwest (IL, WI, MN, IN)	$23,000	$57,500	$125,000-$150,000
Far West (CA, WA, OR, AZ)	$23,000	$60,000	$135,000-$175,000

Source: Landauer Associates, Inc. Survey, 1986.

There are exceptions to these figures, of course. They must be treated with caution, but they do illustrate how well appraisers are doing. In many instances, the above figures are enhanced with annual cash bonuses and good fringe benefits that may include a 401(K) plan or its equivalent.

ECONOMIC EVENTS DEMAND ELEVATION OF THE APPRAISAL FUNCTION

Increased inflation in the late 1970s and the sharply more volatile financial conditions in the capital markets after President Carter's designation of Paul A. Volcker as Chairman of the Federal Reserve Bank forced appraisers to respond to extraordinary times not at all similar to events since the Appraisal Institute was founded in 1932. The effect was to make at least a fair proportion of appraisers aware of the powerful forces of erratically high interest and inflation rates, and a tightened money supply. Out of these demanding times a new and more respectful form of recognition for appraisers emerged. The times also created a link between appraisers and the broad financial community to a far greater extent than previously experienced. Appraisers began to earn respect and esteem for their mastery of techniques, which tended to resolve satisfactorily the problems of estimating value on a forecast basis.

The turbulent years between 1977 and 1986 were not without criticism of discounted cash flow (DCF) and lease-by-lease (LXL) analyses. Many appraisers adamantly believed that DCF was only an analysis tool that had no rightful place in income capitalization. Presumably the use of an overall rate of free and clear return was the only valid way to convert income into a present value (PV). These diehards simply never acknowledged that PV is the discounted worth of future expectations. Yet, there is a growing number of supporters of the LXL/DCF method. Peter F. Korparz, MAI, and Mark I. Roth have stated that:

> Appraisers, as a group, have tended to a) isolate themselves from the techniques utilized in the marketplace, and b) argue endlessly about appropriate

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> valuation technqiues....Almost every step of the appraisal process requires some subjective judgment; however, given existing market data, the DCF technique involves the least subjectivity. Furthermore, since in today's market most major office building sales are based on the application of this technique, the appraiser should place the greatest reliance on DCF.[9]

Critics of the LXL/DCF method also say that procedures involving forecasting are, in any event, unnecessary today as we face the possibility of temperate economic times and very low inflation rates over the foreseeable future. Persons in the forefront of appraisal theory and indeed those who engage appraisers feel that LXL/DCF is equally necessary in tranquil or declining times, as in turbulent and inflationary times. The findings of the questionnaire survey were entirely supportive of the latter view.

APPRAISERS' PERSPECTIVES ON THEMSELVES

The appraisers surveyed demonstrated a surprising degree of objectivity and detachment in their views on their relative status today. Virtually all were supportive of the Code of Professional Ethics and Standards of Professional Practice, while at the same time acknowledging the difficulty of enforcement in today's climate of heightened due process and civil rights. Many, but not all, acknowledged the problem of appraisal's recognition as a profession in view of nonuniform educational standards and lack of licensing in each state. A fair number of the appraisers surveyed felt that the successful passing of a reasonable number of MAI courses is equivalent to a master's degree and solidified the contention that appraisers are professionals. At the least, they thought of themselves as well-motivated business people with professional objectives.

The questionnaire survey, as well as a review of appraisal literature from *The Appraisal Journal,* revealed that the 1950 to 1970 period did not produce any really significant new methodology nor particularly enhance appraisers' status. The majority of the appraisers surveyed agreed that their status had been significantly elevated with the advent of inflation and financial volatility. They were generally quick to recognize the importance of the computer, while still cautioning that the quality of the entered data remains essential to the final value estimate.

Perhaps the most interesting aspect of the questionnaire survey was the indirectly expressed conviction that the respondents are more elite than general MAI accredited appraisers, and better qualified to be considered professionals. There is considerable merit to this thesis. If anything, the questionnaire survey was biased in the selection of the sample by inviting top practitioners, article writers, and those active in the Appraisal Institute's

9. Peter F. Korpacz and Mark I. Roth. "Changing Emphasis in Appraisal Techniques: The Transition to Discounted Cash Flow," *The Appraisal Journal* (January 1983): 44.

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affairs to respond to the 20 questions. It was therefore quite natural for the respondents to consider themselves outstanding in their field.

CLIENTS' VIEWS ON APPRAISERS

The clients surveyed were less enthusiastic about appraisers' professional status than, quite naturally, the appraisers themselves. About half of these respondents felt that appraisers are deserving of recognition as professionals, yet many other answers to the questionnaire survey seemed less enthusiastic. One client spoke very bluntly about "made as instructed" appraisals. Others questioned the sufficiency of the educational requirements to support professional status and mentioned the absence of licensing. In general, an acknowledgment of appraisers' more advanced knowledge over the past several years was evident. It appears that the clients were less concerned with professional labels than with the quality and independence of the appraisal report. In this respect, appraisers tended to be seen in an improved light. The noninstitutional clients surveyed use appraisal services on a consulting, investment advisory basis to a greater extent than institutional clients. Appraisers engaged for advisory purposes gained enhanced professional status and recognition from the clients surveyed, over those who were constricted by the dictates of the formal appraisal or never in a position to act in the implementation of a report's findings.

THE WINDS OF CHANGE

The continuing disposition to narrow, rather than broaden appraisal-related capabilities inhibits appraisal's recognition by the public as a professional occupation. The emphasis has been on the mechanics of valuation methodology with the market seemingly acting as an incidental background. The restrictive nature of the valuation exercise casts the appraiser in the role of "numbers cruncher," rather than the eminently more desirable role of advisor. While advancement in appraisal techniques is very evident, there is very little indication that the appraisal profession is making a determined effort to enlarge its narrow sphere of activity. MAIs who have expanded their activities, usually do so as counselor's, industrial Realtors®, or simply as Realtors.®

TOWARDS MORE BROADLY BASED REAL ESTATE EXPERIENCE

Ideally, the appraiser should have attained a specified educational level and broad work experience before he or she advanced to the role of appraiser. There appear to be too many appraisers who have gained employment in a real estate appraisal office without any prior exposure in the marketplace to ownership, construction, sales, leasing, or management of real estate. Absence of a practical background may make the market consider the appraiser as a theorist or a methodologically dominated person devoid of any firsthand

knowledge or "feel" for the market and its players. This does not mean that any appraiser inexperienced in direct participation in the marketplace is not qualified. It does mean that it is more difficult to apply one's judgment in the absence of a more broad and direct background. And certainly experience alone is no assurance of competence. As Leon W. Elwood, MAI, once stated:

> I believe experience can teach lessons which may lead to sound judgment. I believe sound judgment is vital in selecting the critical factors for appraisal. But, I also believe the bright 17 year old high school student in elementary astronomy can do a better job estimating the distance to the moon than the old man of the mountains who has looked at the moon for 80 years. So, I find it difficult to accept the notion that dependable valuation of real estate is nothing more than experience and judgment.
>
> I would not give a red cent for an appraisal by the "expert" who beats his breast and shouts; "I don't have to give reasons. I've had 40 years experience in this business. And this property is worth so much because I say so."
>
> After all, value is expressed as a number. And, no man lives who, through experience, has all numbers so filed in the convolutions of his brain that he can be relied upon to choose the right one without explicable analysis and calculation.[10]

It is certainly difficult for everyone to have the perfect apprenticeship. For example, most institutional and governmental appraisers rarely have had the opportunity to learn by doing. As the late Dr. H.B. Dorau, professor of real estate at New York University was prone to observe, "the *next* best thing to knowing is knowing how...." (italics added).[11] However, to the extent circumstances permit, an appraiser's career will be definitely enhanced if he or she is willing to serve as a generalist for as many as five years before venturing into the more specialized, more disciplined role of the appraiser of income-producing properties. This must be made more clear to our young aspirants.

EFFECTIVE COMMUNICATION, A MUST

The problem of effective communication is by no means a deficiency in real estate alone. The national educational emphasis on technology has left the country with a state of literacy lower than that necessary for us to understand each other effectively. Indeed, some appraisers feel that refinement of the vexatious boilerplate language in appraisal reports is the primary means required to advance effective communication! A far more serious problem than the multiple pages of boilerplate in the typical report is the failure to make clear to the reader the exact nature of the appraisal problem, the means used to solve it, the documentation utilized in the solution, and the rationale for the value estimate. Back in 1962, John P. Dolman added to experience,

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10. L.W. Ellwood, *Ellwood Tables for Real Estate Appraising and Financing*, 4th ed. (Chicago: American Institute of Real Estate Appraisers, 1977).
11. Herbert B. Dorau, "Is Rote Right in Valuation?" *The Appraisal Journal* (October 1960): 419.

knowledge, and judgment, a fourth basic quality necessary for a good real estate appraiser—the ability to communicate.

> In other words, if he has experience, knowledge, and judgment, but cannot express himself in a proper report, he may continue to lag behind in professional recognition.[12]

Appraisers seriously lack the capability of organizing and writing a lucid report that reflects both the market's and their thinking in descriptive English with decent sentence structure. Far too often, the reader of an appraisal report is smothered by a combination of boilerplate, economic base and market data without adequate analysis or understanding and establishment of integral relationships to the problem, and pages of computer printouts without required explanation. Some appraisers revel in the thickness of their reports rather than being concerned with a succinct presentation of the problem and solution and wisely consign the balance of the material to an addenda where it belongs. It is not surprising that there was virtual unanimity expressed by the appraisers surveyed in their responses to the questions on report writing. Appraiser's lack of ability to organize and write clear appraisal reports is regarded as one of the major road blocks to full professional recognition. No amount of graphics can substitute for the necessary writing.

CONFRONTING THE GROWING COMPETITION

The questionnaire survey did not cover the subject of increasing competition because prior to the date the research was conducted, it was not regarded as a significant factor. However, during the course of the inquiries, it became apparent that many persons outside the recognized appraisal organizations are making appraisals or investment analyses that traditionally have been made by Realtor® fee appraisers. The biggest inroads have been made by national accounting firms. While most have employed MAIs, they also use certified public accountants (CPAs) to accomplish valuation and related work. CPAs are especially aggressive in hotel market analysis in which two or three firms have dominated the market. Economists, accountants, and engineers have made major inroads into the marketability and feasibility fields. In the case of feasibility studies, economists, accountants, and engineers have come dangerously close to actually rendering appraisal reports because they utilize a spreadsheet approach over a presumed absorption period in which the pretax NOI after expenses on a cash flow basis is discounted annually and then aggregated. Engineers have also dominated the environmental impact field at both the state and federal levels to the almost total exclusion of appraisers. A recent study points out the bleak future facing the appraisal industry if changes are not made. According to James H. Boykin, MAI:

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12. John P. Dolman, "Responsibilities of the Appraiser," *The Appraisal Journal* (January 1962): 52.

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> It is quite probable that much of the appraiser's business in future years will have been taken over by other professions or that the form of this business will have changed substantially.... Income property appraisals may succumb to the institutionalized, lengthy, unresponsive art form of today. The opportunity to provide market, feasibility, and highest and best use studies probably will be increasingly dominated by nonappraisers.[13]

What has become especially disturbing is the trend for large scale developers, brokers, investment bankers, and consultants to engage young persons with an MBA background and a foundation in mathematics to do all in-house investment analyses of properties to be bought, sold, or financed. Few of these companies place any significant importance on the MAI designation. Instead, they are intent on the analytical capability of the person and seemingly not concerned with the lack of a professional designation. This attitude is particularly evident in the largest metropolitan areas. It does not appear to be prevalent in the smaller metropolitan areas where among clients, the MAI designation has real significance and is respected. Nevertheless, appraisers must be alert to these competitive pressures. To the extent that appraisal is able to attract professionally qualified young people, an improved share of the total available appraisal business may result, and , competitors' invasion of the technical real estate services field may be reduced, if not eliminated.

PROBABLE STRUCTURAL CHANGES

The very small appraisal company, three professionals or less, must be alert to remaining "state of the art." The small company cannot handle as effectively large multiple location accounts and will have problems administering the normal "bunching up" of business because of limited human resources. The questionnaire survey responses indicated a real market for small appraisal office mergers or growth to accommodate expansion and handle the increasing number of national accounts with multiple properties. In the long run, fragmentation has been very limiting to the appraisal business. The appeal of remaining an independent business person with control of one's destiny is attractive to many; but the opportunities through adopting a deliberate policy of merger, acquisition, or growth, in which a wide variety of skills and experience can be offered to clientele appear greater. There will always be, however, an important place for the individualist who prefers to be small and control every phase of his or her professional destiny.

Appraisal organizations should also be less fragmented than they are now. Without taking sides on the relative merits of each association, the failure of the Appraisal Institute and the Society of Real Estate Appraisers (SREA) to merge has been a tragic event, one which again makes more

13. James H. Boykin, "Review and Prospects for Real Estate Appraisal Education," *The Appraisal Journal* (July 1985): 347-348.

difficult and postpones the day of professional recognition. Both organizations must regard future merger efforts as a "must win" objective by agreeing to a merger plan that obviously cannot be perfect for all. Personal pride, feelings of uncertainty, and emotional judgments must be put aside for the sake of future generations of appraisers and for the sake of ultimately achieving full professional recognition. This requirement should be a high priority in both organizations. As Reaves C. Lukens, Jr., MAI, has stated:

> How can real estate appraisers expect public recognition and acceptance as authorities when there are more than 40 organizations offering "designations" and purporting to speak for real estate appraisers around the United States? The answer is, it can't.[14]

ASREC is also an affiliate of the NATIONAL ASSOCIATION OF REALTORS® (NAR), as is the Appraisal Institute. This small group of 600 members has been struggling to establish an identity and maintain its economic viability in an era when size has become essential to the realization of an organization's individuality. ASREC is more fraternal than professional in the sense that there are no formal educational or examination requirements. About 50% of the members are also MAIs. They are an elite group because they must demonstrate that they have performed counseling services for agreed fees, before they can be invited to membership. They have a very professional mind set and are proud of their organization and achievements.

It is not inconceivable to foresee a merger of ASREC and the Appraisal Institute to provide an even stronger professional organization that would cover the various appraisal functions previously discussed. The combined organization could then be divided into fields of specialization. This would enable individuals to pursue their major interests, while having the benefits of a larger professionally dedicated organization to represent members in educational, ethical, and licensing matters. Both the Appraisal Institute and ASREC would gain enormously from a merger. Appraisers would be presented an opportunity to enlarge their horizons and expand their skills. Counselors would be permitted, in due course, to become licensed and enjoy a truly professional status rather than attempt to survive on a fraternal nonprofessional basis.

THE NEED FOR REGULATION

There appears to be no way to avoid the need for some type of regulation of appraisers. It is unfair for the Appraisal Institute to carry this entire burden through its MAI designation and triannual certification program. Yet, if regulation does not eventually occur, the goal of professionalism will continue to elude appraisers' grasp. Currently there are only 12 states that have licensing requirements, 10 of which require a broker's license, with only two states having a separate licensing classification for appraisers.

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14. Reaves C. Lukens, Jr., "It's Time" *The Appraiser* (February 1984): 3.

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Because of the number of states and the highly localized nature of real estate, a system of state-authorized and -approved uniform designation and certification criteria administered by a professional trade organization such as the Appraisal Institute and supervised by the states under simple enabling legislation seems the solution to the dilemma of persuading the various states to adopt regulatory laws. In my previous article, "The Real Estate Appraiser—The Elusive Goal of Professionalism," the Appraisal Institute's solution to certification was outlined, and is one that I believe is equally acceptable as a means of achieving the desired result.[15] A prior condition to regulation would be the merger of the Appraisal Institute and the Society, hopefully with ASREC as well. In the event that further efforts to merge the Appraisal Institute and the Society fail, the Appraisal Institute must nevertheless persist in its efforts to introduce a certification program that it would administer. The chances of the success of such a program are significantly lessened, however, without a successful merger.

Even at best, however, the Appraisal Institute alone cannot solve the problems facing the appraisal industry, primarily because it has no jurisdiction over the majority of appraisers practicing today, with only about 19,000 being members or candidates. This includes those holding the RM designation. This is not to say that the Appraisal Institute is the only reputable appraisal organization in this country, but that even if all the accredited appraisal organizations were included, their members would represent only about one quarter of all those people in the marketplace calling themselves appraisers. Given this situation, the Appraisal Institute and other appraisal organizations have advocated some form of state regulation, much like that practiced by CPAs, to insure a certain level of competence and awareness of current techniques. On November 3, 1985, the Appraisal Institute's Governing Council passed the following resolution:

> That the Appraisal Institute support legislation and regulations adopting the Institute's Standards of Professional Practice and/or programs for the certification of appraisers when the legislation or regulations lead to and support a national program for the appraisal profession, similar to the Certified Public Accountant program for the accounting profession, that is based upon a certifying board for appraisers and an appraisal standards board to set standards for the profession.

There is universal appeal in the concept of a state-supervised certification program administered by the leading appraisal group. Presumably the Appraisal Institute could devise an examination that its staff could correct. Whatever the cost of such a program, it would still be inexpensive in view of the benefits of establishing another basis for the public's perception of appraisers' professionalism. The Appraisal Institute's certification program

15. White, pp. 351-353.

could be maintained, but perhaps in a more rigorous way. The Appraisal Institute must take the initiative in establishing regulation. Candidates would not only have to pass the MAI examinations, but also those of the state-approved certification boards to obtain their licenses.

ELEVATION OF EDUCATIONAL STANDARDS

The question must be raised whether in the long run, not necessarily now, appraisers should first have a college degree, preferably in the liberal arts, in which English, history, and civics play a major role. In addition, should they have a master's degree in approved fields such as real estate, economics, mathematics, computer services, economic geography, accounting, finance, or city planning? Agreement must be reached to limit the number of fields in which a major could be chosen. This suggestion for advanced educational criteria may very well be dismissed as "overkill." The reasoning may be that a college degree in any one of the major fields is sufficient and the master's degree should not be required. Supporters of the college degree requirement maintain that the Appraisal Institute's course work, especially if strengthened with some of the subjects noted above, would be equivalent to a master's degree. Surely the Royal Institute of Chartered Surveyors (RICS) in Great Britain assumes that its general requirements are equivalent to a master's degree and sufficient to earn the coveted Fellow of the Royal Institute of Chartered Surveyors (FRICS) designation.

Stricter educational standards will inevitably evolve over time. It may be premature at this stage of the appraisal business's development to assume that it can attract persons willing to meet such demanding requirements. The problems with compromising the highest educational standards are the inevitable loss in the level of oral and written communication abilities and the possible reduction of the interpretive capacities by which to judge our actions as citizens possessing a substantial grounding in English, history, civics, and sociology. These otherwise essential courses are the most vulnerable to omission in the drive to complete course work more directly related to achieving one's career objectives.

DEFINITIVE ADVANCES IN THE PRACTICE OF REAL ESTATE APPRAISAL

All professions and near-professions have made significant strides in the past 25 years. The areas most directly competitive with appraisal—architecture, engineering, accounting, and city planning—have undoubtedly had increased recognition. In my opinion, architecture and accounting appear to have had more public recognition and increased perception as professions. Construction, civil engineering, and city planning, while no doubt moving forward, have enjoyed less public recognition.

Real estate appraisal has made particularly significant advances in the past 10 years for a wide variety of reasons. The major external reason was the increased volatility in the financial markets, which provoked significant changes in income capitalization methods. These changes were best accomplished by the LXL/DCF method. The second external reason was the continuing development of software programs, which provided a degree of accuracy and numerical flexibility never previously experienced. The interest in the use of computers was intensified by the continued decline in prices and the increasing utility of the personal computer. A third external reason for appraisers' increased prominence was the more complex nature of appraisal assignments and the purposes for which they were required. As more institutions became self-sufficient in appraising, the loss of mortgage appraisal business was easily compensated for by new types of business such as due diligence work in connection with new public securities issues, mergers, and consolidations, appraised value balance sheet assignments, sale or purchase needs, and so forth.

As mentioned earlier, one of the truly significant advances in appraisers' progress has been their evolving role as analysts and advisors. This is happening with increasing frequency in instances in which a formal appraisal is not required. Further, the ethical requirements of objectivity and professional detachment do not have to be observed by appraisers when they are providing services outside the usual appraisal format. Appraisers can then become much more valuable to their clients by acting as advisors, and, indeed, as advocates on the basis of their investment analyses. The importance of this enhancement in appraisers' status from a cog in a wheel to part of the motive power cannot be overemphasized. It will bring appraisers into the mainstream of development, finance, and investment activities; expand their horizons; and eventually broaden their knowledge and perception of the market.

"PURPOSE OF THE APPRAISAL" PRESENTS CONTINUING PROBLEMS

Too many statements of the purpose of the appraisal are couched in conventional language that fails to capture the reason for, as well as the special circumstances of, the appraisal assignment. The questionnaire survey revealed some deep concern or difficulty among appraisers with understanding or enunciating the purpose of the appraisal. Additional research through interviews with many appraisers indicated a continuing degree of confusion on the subject. The fundamental problem appears to be the conviction that physical real estate has an inherent asset value, that is, a bedrock figure, without regard to property interests. This conviction stems from a failure to grasp the bundle of rights theory that holds that market value consists of the valuation of defined property rights and interests, not necessarily the physi-

cal real estate alone. Many different interests may exist within the same realty. They include, but are not limited to:

- Type of entity in which ownership is held
- Type of property ownership such as fee simple, leasehold, or arrangements involving a master net lessee, subnet lessee, or gross lessee
- Liens and encumbrances against the property, evidencing some form of ownership interest, claim, or regulatory rights (such as rent control or zoning) that affect value, in addition to mortgages

The appraiser values the real estate subject to the rights, liens, claims, and interests of the parties involved in the real estate. If the purpose of the appraisal states that the client has requested an appraisal subject to some or all of those rights, interests, or claims, it is certainly conceivable that the market value may differ from the traditional definition of market value as all cash or its reasonable equivalent—the equivalent presumably being cash, plus a maximum of 75% mortgage at current interest rates.

The valuation problem became infinitely more complicated after the passage of the Economic Recovery Tax Act of 1981, which permitted deferred interest without current income tax liability. Such devices as subordinated ground leases, installment payments (usually without interest), equity participations of every imaginable type, deferred mortgage interest, and others were used to increase tax-sheltered returns. A recent article in *The Appraisal Journal* has drawn attention to the fact that many of the problems encountered in appraisal reports today are caused by the breakdown of communication resulting from the vagueness of terminology.

> Contrary to outward appearances, the crux of this problem is not the issue of what should or should not be included in the market value definition but what in each valuation situation the appraiser has or has not included....There is absolutely no possibility of a misunderstanding so long as the appraiser is careful to properly qualify what the estimate does in fact represent.[16]

The primary problem with the statements of purpose in appraisal reports is the occasional failure of the appraiser to state fully what the terms and conditions of the appraisal must be, since obviously radical differences in market value will result. Other appraisers refuse to recognize the financing on a property planned for tax shelter and adamantly hold that there can only be one value, that is, the free and clear value or its reasonable equivalent. Still others fail to see the distinction between a "wholesale" or institutionalized value and the property value at "retail," after subdividing the property interests into very small shares for the small investor. Profits to the syndicator (the wholesaler) and associated costs must be accounted for realistically.

Recognition of the foregoing, however, is no license for appraisers to support inflated values that cannot be justified over a reasonable time frame.

16. David C. Lennhoff, "Defining the Problem," *The Appraisal Journal* (April 1986): 203-204.

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Many of the post-1981 syndications will not be able to meet such a test—evidence to this effect is mounting daily. It is appraisers' responsibility to try to identify the deal structurings that will provoke future problems and to discount the market value accordingly.

A clear understanding of the appraiser's responsibilities in an appraisal assumes the prequalification of the appraiser by the client. It is to the client's distinct advantage to choose an appraiser who has the education, training, and experience in the type of property to be appraised. No amount of painstaking instructions to the appraiser concerning the purpose of the appraisal will suffice if the appraiser is unable to carry out the assignment effectively or does not comprehend the full meaning of the client's needs.

Prequalification requires investigating the appraiser's background, experience, and work product; and talking to his or her clients. A personal interview is indispensable. Recommendations by others are insufficient reasons for eliminating a personal meeting. The client and appraiser must be on the same personal wavelength. It is essential to choose the right person, not just the designation, and to fit the person to the task. Once the appraiser is chosen, a fee may be negotiated. If a highly selective choice is to be made, the appraiser should not be subjected to the demeaning need to make a competitive bid.

Appraisers have been unfairly criticized in hindsight because subsequent events have not always borne out their valuations or predictions. In some cases, the criticism might have been deserved, but the difficulties of accurately forecasting the future place appraisers in the same precarious position as economists or stock market analysts. James E. Gibbons, MAI has stated:

> I also believe there should be more emphasis on "date of appraisal." If value is present worth or perceived futures, the as of date is a key consideration. No one could argue successfully that the future looked the same in 1974 as it did in 1978, or as it did in 1980, or 1982. Securities analysts face the same problem as appraisers, but the public seems more willing to understand their difficulties in handling economic variability than in the case of appraisers. This situation stems, no doubt, from the bricks and mortar, concrete aspect of real estate, which wrongly conveys impressions of stability. Looking at many REIT appraisals of 1972-73, one might not find the news expressed to be at variance with the widely shared opinions of that time concerning "future benefits." The loan underwriting, however, was aggressive....The same conditions exist today in the savings and loan field; and I believe the FHLBB is trying to correct underwriting problems by tinkering with the appraisal function. Their concern and desire for a "way out" are understandable.[17]

PROFESSION OR PROFESSIONAL DISCIPLINE?

The Appraisal Institute and many individuals in the appraisal business have made significant advances towards achieving recognition of appraisal as a

17. James E. Gibbons, letter to the author, June 20, 1986.

profession. The college degree requirement of the Appraisal Institute is one. The sharply improved quality and diversity of the Appraisal Institute courses are further evidence of such advances. A nationwide certification system is yet to be achieved and appears essential to full recognition. Uniform state license examinations administered by the Appraisal Institute would be an effective alternative solution to accreditation. The consistently high quality of the Appraisal Institute's publications also provides evidence. The conscientious nature of the review process for alleged violations of ethical conduct or standards is added support for professional recognition. Last, the infinitely more complex nature of the appraisal process demonstrates the extent of advances towards recognition. One can only fault the previously discussed tendency to avoid a broadening of services such as market analysis, feasibility studies, economic base analysis, deal structuring, and corporate relocation.

One test of professionalism is a willingness to serve the public without charge. Doctors and lawyers must do this on occasion in their everyday practices. Accountants, architects, and engineers usually reduce their billings; many appraisers do so as well. However, appraisers are generally not recognized as providing gratuitous appraisal or advisory services to deserving clients. Willingness to serve the public without charge is the least important requirement in any quest for professional recognition. The problem of appraisers' reluctance to do so will tend to solve itself, however, as they near their goal, because more appraisers will be willing to give of themselves under certain circumstances as further evidence of their professionalism.

At this stage, I would characterize the appraisal field as an advanced business service with dedicated appraisers possessing a professional attitude. The most significant aspect to report is how appraisers feel about themselves. The questionnaire survey revealed that at least half of the responding appraisers felt that they were in a profession. Many of the respondents felt some degree of professional attainment. This represents a healthy situation in which a serious intent is very apparent.

THE APPRAISER OF THE FUTURE

Ideally the future MAI will have the following attributes:

- A liberal arts college degree
- An MBA or MS in real estate, accounting, finance, mathematics, economics, economic geography, city planning, or computer services
- Three years of real estate experience in sales, leasing, financing, management, or development
- Accreditation within three years thereafter, through obtaining the MAI designation and a state-certified license based on tests prepared by the ruling appraisal organization

- Improved writing ability and sharply improved communication skills in dealing with clients and the general public
- Membership in a consolidated professional organization consisting of the Appraisal Institute, the Society, and ASREC

The future MAI's practice will differ in the following ways:

- Companies will be larger, with more diversified groups of professionals possessing competence in fields directly related to valuation
- Fee structures will fully recognize the importance of appraisers' professional contributions
- Full professional recognition will have been attained
- Lenders, investment bankers, developers, and owners will fully accept appraisers and show increased respect for their role and standing
- The ambivalence caused by the ethical requirements for an unbiased detached appraisal result will have been resolved, or a stronger statement of how advocacy may be practiced when the appraiser is acting as an investment or market analyst or advisor will have been issued

THE PROFESSIONAL TRADE ORGANIZATION OF THE FUTURE

If real estate appraisers are to be perceived as professionals rather than as business people with professional objectives (a very important distinction), then the two qualifying organizations, the Appraisal Institute and the Society, must merge, together with ASREC. This will set the stage for obtaining state enabling legislation that will permit the surviving organization to be the agent of the 50 states in establishing regulation requirements and essential examinations to be monitored by each state.

The various professional functions, such as marketability and feasibility analyses, appraising, economic geography, marketing, and general counseling could be subdivided so that members could pursue their favored areas of specialization under one strong professional organization. Ideally, a name change to the American Society of Valuers and Counselors would be appropriate. The British have accomplished this organizational structure quite effectively through the RICS, which permits specialization in many different areas of the real estate business.

Brokers, agents, managers, and owners could continue to be represented by NAR through their affiliated organizations. The concept is not to compete with NAR, it is merely to form an organization equipped to meet certain high standards by, among other requirements, rigorous examinations and insistence on adherence to a strict code of ethics and standards of professional practice. The renamed and consolidated organization would be represented by NAR and referred to as the professional side of appraisal as distinguished from the business side.

HOW INVESTORS AND LENDERS CAN BEST UTILIZE APPRAISAL SERVICES

Investors and lenders can make the most of appraisal services by first understanding the appraiser's background and then by becoming adept in the selection process. Appraisal as a near science has only been practiced since 1932 when the Appraisal Institute was created. The Appraisal Institute deserves high marks for improving educational standards and conceiving, as well as enforcing, a Code of Professional Ethics and Standards of Professional Practice. Appraisal's progress toward public recognition as a profession has been hampered by the localized nature of real estate and the fractionalization of the trade associations serving appraisers. In analyzing these various organizations, the Appraisal Institute stands out as possessing the highest standards and being the most professionally dedicated. Thus, the selection process for choosing an appraiser will generally, but not necessarily always, demand that he or she have the MAI designation.

In selecting the appropriate person to perform an appraisal, it is critical that the appraiser have direct experience in the property type for the planned assignment. The chance of making a selection mistake is reduced by engaging someone with documented experience in a particular property category. The breadth of an appraiser's skills and practice is very important in the selection process. Ideally speaking, the most qualified appraiser, in addition to the usual valuation skills, should have some direct field experience in leasing, sales management, or development. Truly, "the next best thing to knowing is knowing how."[18] This is not always possible because many appraisers start as interns or trainees and do not get the opportunity of "hands on" experience. However desirable field experience may be, it should not necessarily be considered an absolute requisite in qualifying an appraiser for engagements.

It is desirable, but not absolutely essential, that the appraiser possess a master's degree in a business-related subject. Graduate school majors that are especially helpful in developing appraising and counseling skills are mathematics, economics, finance, economic geography, and computer services. An ability to communicate orally and in writing is paramount. In terms of personality, an appraiser should be imaginative and creative yet possess a sense of perspective about the cyclical nature of market activity. In general, one can anticipate that the larger the appraisal practice, the better deadlines will be met. Medium to large size companies have appraisers with diverse skills and backgrounds for a broad comprehensive service. There is, however, a natural disposition for the single-family appraiser to specialize, and many appraisers of income properties will exclude them from their practices. My references here, however, are solely to appraisers of income properties. The highly essential qualities of judgment and maturity in an

18. Dorau, p. 419.

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appraiser can only be determined over time. However, a reading of the appraiser's prior reports is helpful in forming conclusions about his or her ability and may help the lendor avoid making a selection error.

Much emphasis must be placed on ensuring that the purpose of the appraisal is carefully and thoroughly explained by the client and that the appraiser clearly grasps the objectives of the assignment. It is important that the appraiser understands the so-called bundle of rights theory in regard to identifying the property interest to be appraised under specific terms and conditions. To the extent that the appraiser can state the purpose with clarity and simplicity, devoid of boilerplate language that may not even fit the particular assignment, there will be less misunderstanding and confusion in dealing with the client.

Clients must also understand the difference between a formal appraisal assignment and its requirements, and an investment analysis. A formal appraisal under the Code of Professional Ethics requires a fixed arbitrary valuation result, arrived at objectively and based on substantiated market evidence, using standardized valuation approaches. In contrast, an investment analysis usually provides a range of possible market values and is devoid of heavy market substantiation because the appraiser has been prequalified to act in an advisory capacity to his or her client rather than only as a dispassionate and professionally detached observer of the market scene as required in the formal appraisal report. Fiduciaries, in particular, can take significant advantage of appraisers' skills and extensive market knowledge by using them in advisory capacities. For example, in screening a property for possible purchase, it is senseless to obtain a formal appraisal. Instead, the investor should consider engaging an appraiser to verify rents, taxes, expenses, capital costs, neighborhood quality, internal rates of return (IRR), and so forth, without constricting him or her to a formal valuation result. However, when it is necessary to have annual valuations in explanation of a portfolio's performance, the formal appraisal report must be ordered.

CONCLUSION

The post-1975 period witnessed a significant change in the way in which appraisers made appraisals. The frenzied inflation-ridden market, the growing complexity of leases, and the complicated structure of transactions forced the creation of the LXL/DCF method of income capitalization. In the late 1970s, a computer software program was created allowing every lease term and condition, and every subsequent change to be entered into the computer for reporting and analysis purposes. This was similarly achieved for expenses. Together with the established discounting techniques for capitalization purposes, this software program enabled a quick, efficient, and infinitely more accurate presentation of the probable net income at assumed compound growth rates for revenue and expenses over an extended time frame.

The new capitalization techniques solved a vexatious appraisal need and elevated some appraisers to a new standing with their clientele because their professional services became so much more effective. At the same time, appraisers obtained new clients. They were no longer completely reliant on the local savings and loans, commercial banks, attorneys, and investors for business. Pension funds, life insurance companies, realty trusts, publicly owned investment and development companies, and foreign entities constituted a stronger institutional linkage for appraisers. Mortgage loans, tax reduction, condemnation, and estate taxes were no longer the only reasons to engage appraisers. A new set of needs surfaced in the 1970s and thereafter, involving strange new concepts such as appraised value balance sheets, due diligence needs in public issues, and purchase or sale anticipations.

The vast bulk of routine appraisal work was not unduly influenced by either the more financially volatile economic times or the more advanced income capitalization methodology. The significant elevation in the perception of appraisers' standing has been mainly evident among a select few in major cities, with a concentration in financial markets such as New York, Boston, Chicago, Houston, Dallas, Los Angeles, and San Francisco. An elite class of appraisers has developed in the largest metropolitan areas over the past decade and, in a sense, has left the rest of the membership behind. It is this group that has heightened professional status and an improved institutional linkage with the financial services world. A new view of the quality of appraisers has emerged among investment managers, investment banking and stock brokerage companies, and other relatively new engagers of appraisal services. The more complex times and the more complex appraisal methodology have combined to elevate the standing of selected appraisers over many of their former peers.

Many appraisers have responded to these new opportunities by emerging from their provincial environment not only to become more technically proficient, but also to have more breadth of capability and to act in an advisory capacity to an increased extent. Those who have achieved these goals have developed enviable professional practices of the highest caliber. This is not unlike the degree of achievement in any other near-profession or profession. A certain number of appraisers will invariably rise above the multitude of practitioners. This elite corps possesses working artifacts, intelligence, mastery of technique, and a deep sense of perspective on the national and local economies and their effects.

This same distinctive group has experienced a significant evolution in market perception from essentially passive dispassionate observers of the market scene, to confidential allies and advisors to clients in both analysis and implementation. This new maturity has been especially identified by investment managers and bankers, and acquisition officers of trusts and other institutional entities. Insurance companies have not participated to the same

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extent in this evolutionary elevation of appraisers' status. They have preferred to seek their own counsel and, hence, have generally used only outside fee appraisers to make formal appraisals. Commercial banks and savings and loans have also not used appraisers wisely; their loan records over the past decade bear this out.

From the viewpoint of the typical investor or lendor, the most perplexing and annoying problem in dealing with appraisers is their tendency to be proficient in methodology at the expense of more broad capacities in marketability, feasibility, and implementation of valuation results. Appraisers have not been venturesome in acquiring skills in market and investment analysis. Their perspectives on the relationship of a particular real estate problem to the general economy need improvement. They have not proven to be particularly adept at market forecasting or allocating a reasonable portion of the total market to a project. Surprisingly, many appraisers still scoff at computer software and make obvious statements about the need for quality data. This points out the importance of selecting the right person or company to serve the client's needs.

Have appraisers achieved professional status? Unfortunately, the answer is no. A precedent need is for the three predominant professionally motivated organizations—the Appraisal Institute, ASREC, and the Society—to form a more powerful and effective umbrella organization that could then gain more widespread recognition for appraisers, analysts, and counselors.

This new organization under a new name (I prefer the American Society of Valuers and Counselors) could then press for the second precedent condition of professionalism, industry regulation, to be under its administration. Together with more stringent educational requirements, it is entirely possible that appraisers could gain almost universal acceptance as professionals by the end of this century. In the interim, appraisers should continue their dedication to professionalism in the manner in which they carry out their practices. As Charles F. Seymour, MAI, has stated:

> Although we like to tell each other that we have become a profession, I believe that it is much more accurate to describe real estate appraising today as a service business struggling to become a profession. That struggle will continue during the '80s. Progress will be made; there is even a chance that we will succeed![19]

19. Charles F. Seymour, "The Outlook for Real Estate Appraising in the '80s," *The Appraisal Journal* (April 1980):169.

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Dr. Kinnard has taught Finance and Real Estate, including valuation and investment analysis, since 1948. He retired from the University of Connecticut in 1981. While there, he was Professor of Finance and Real Estate, Director of the Center for Real Estate and Urban Economic Studies, Head of the Finance Department and Acting Dean of the School of Business Administration. Dr. Kinnard was twice included in Outstanding Educators of America and was a 1979-80 Beta Gamma Sigma Distinguished Scholar. He was also listed in Who's Who in the East and Who's Who in American Education. He is an Honorary Fellow in the Homer Hoyt Institute, and a member of Lambda Alpha.

Dr. Kinnard is past President of the American Real Estate and Urban Economics Association, and of the Connecticut Chapter of the Society of Real Estate Appraisers. He has been a visiting professor at major universities. He is a long-time faculty member for the Society of Real Estate Appraisers and the American Institute of Real Estate Appraisers, and has lectured for the Institute of Financial Education, the Mortgage Bankers Association of America, the American Society of Appraisers, the Institute of Property Taxation, and the International Association of Assessing Officers, among others.

Dr. Kinnard was Educational Consultant to SREA from 1965 to 1985. During that time, he authored or helped develop all the Society's courses and seminars. He has also been educational consultant to the Society of Industrial Realtors, the American Right of Way Association, and the National Institute of Real Estate Brokers.

Among Dr. Kinnard's more notable publications are Income Property Valuation, the text for SREA Course 201, and the first three editions of SIR's Industrial Real Estate. He has numerous articles in professional and academic journals, primarily on valuation and investment topics. He is a licensed real estate broker in Connecticut.

Within RECGC, Dr. Kinnard directs and reviews valuation, investment and market studies for both private and public clients. He testifies and consults nationally on the appropriate techniques applicable to valuation issues: including leased equipment, other tangible personal property, interests in real property, and going concerns. The nationwide practice is varied and wide-ranging, with emphasis on property tax appeals and expert testimony in litigation.

Dr. Kinnard is a Principal in the Real Estate Counseling Group of America, with which RECGC is affilicated. In 1985 he received the Alfred E. Reinman Award from the Society of Real Estate Appraisers, and the George F. Bloom Award from the American Real Estate and Urban Economics Association.

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CRITICAL IMPLICATIONS OF CONTROL AND THE CONCEPT OF AN APPRAISAL STANDARDS BOARD

William N. Kinnard, Jr.
Storrs, Connecticut

A Presentation at a Seminar on

Public and Private Control of Appraisal Procurement

The Real Estate Counseling Group of Connecticut, Inc.

I. Appraisal Procurement and Control: Why an Issue?

A. F, F & A A

1. Purported Role in Financial Institution Difficulties

2. Alleged Role in Federal Agency Losses

3. Misunderstood Role in Decision Making about Real Estate Investments

4. What is an "Accurate Appraisal"?

a. Whose Criteria (or Definition)?

b. Whose Decision (or Determination)?

c. Whose Interpretation?

B. "What Value?" vs. "Value of What?"

1. Confusion and inconsistency among:

a. Legislators

b. Regulators

c. Courts

d. Attorney/Advocates

e. Lenders

f. Developers

g. Real Estate Agents

2. Market Value

a. Specified Market Conditions
(1) Valuation Date
(2) Evanescence
(3) Asking the Wrong Question(s)

b. The Cash Equivalency Brouhaha
(1) "Cash in U.S. Dollars or the Equivalent Thereof"
(2) Cash Equivalency of What?
(3) "Money" vs. "Cash (or its equivalent)"

c. vs. Investment Value (or Investor Value)

d. vs. Use Value (or User Value)

e. Definitional Difficulties
   (1) The Humpty-Dumpty Syndrome
   (2) Redundancy can be an Evil as well as a Virtue
   (3) Linguistic Imprecision
      (a) Committee Efforts
      (b) Compromise

f. Asking the Wrong Questions (Revisited)
   (1) vs. Most Probable Selling Price

3. What Interest in Realty?

a. Fee Simple
   (1) What is it? To Whom? (Don't ask a lawyer)

b. "Unemcumbered Fee"
   (1) Often a Misnomer
   (2) Nonsensical for Investment Properties

4. Client Objectives

a. Perceived Wants and Needs vs. Knee-Jerk Tradition

b. "Value" at Sale
   (1) When? Today? Specified future date(s)? UNSPECIFIED FUTURE DATE?
   (2) What Conditions? Forced sale? Liquidation? Sale? "Normal" transaction?

      [Footnote: Is "Normal" normative or descriptive?]

   (3) Likely price or "needed" nominal price?
   (4) Terms of sale (especially financing)?

c. Likely cash flow(s)
   (1) Cover client/lender needs and requirements
   (2) If underwriting is done properly, never need to find out whether the appraisal is done properly

C. Procurers, Prostitutes and Johns

1. Deregulation: Greed and Avarice Unleashed

a. Points and Fee: "It's What's Up Front that Counts"

b. Underwriting vs. Booking Loans
   (1) Commissions, Fees, Bonuses for Volume (not Performance)
   (2) Participations and Secondary Market Sales
      (a) The Greater Fool Theory in Action
      (b) Due Diligence Ignored

2. The Appraisal/Appraiser as an (the?) Obstacle to the Deal

   a. "Doing Deals" vs. Making Loans

3. FDIC Non-Regulation

   a. Guideline Letters

   b. No Standards

   c. Rationale

4. FHLBB Retrogression

   a. The R41 Series of Memoranda: 1977-1986

   b. R41c
      (1) Nobody liked it (so it must have been close to the mark)
      (2) If it wasn't needed, why all the flurry of activity to build a substitute edifice?

   c. Current proposals on the table
      (1) Rescind R41c
      (2) Emulate Bank Regulators' Non-Standards (CEBA)
      (3) Have individual insured institutions adopt and enforce own standards: The fox in the hen house
         (a) Non-consistency: chaos
         (b) Non-enforceability: chaos in examinations
         (c) Delay in discovery: loss plus chaos
         (d) Non-preventice

II. An Appraisal Standards Board

A. Background and History

1. Professional Performance vs. Ethical Behavior

   a. Competence, Skills
      (1) Training
      (2) Experience

b. Conflict(s) of interest
   (1) Objectivity (non-bias, non-advocacy)
   (2) Measurement vs. advice

2. Inability of Individual Professional Appraisal Societies to Respond

   a. Diversity of Organizations
      (1) Proliferating plethora in profusion
      (2) Differing objectives, membership

   b. No Generally Accepted Appraisal Principles
      (1) Not necessarily all bad: See FASB 15, for example
      (2) No consensus
      (3) No authority(s) to cite
      (4) No standard yardstick for measurement

   c. Inability, unwillingness to join or unite in one position

   d. Inability to enforce ethical standards they have
      (1) Due process bars
      (2) Ponderous procedures
      (3) Fear of suit (based on actual experience)

   e. Inability, unwillingness to merge

3. 1979 Proposals

   a. CREUES and AREUEA
      (1) Appraisal Standards Board of North America
      (2) Academic base and orientation
      (3) Doomed: Mistrust and Jealousy

4. NACAO
   (Post hoc propter hoc?)
   a. Report Standards
   b. Regulator Meetings, Dialogue

5. Standards Boards, Committees, Statements within Individual Organizations

B. Uniform Standards of Professional Appraisal Practice

1. Joint committee (ad hoc) of 9 appraisal organizations

2. Threat from outside (Barnard Subcommittee)

3. Created in months

4. Adopted, accepted by all 8 in U.S.

5. Reasonable starting point

C. The Appraisal Foundation (Self-Regulatory Organization)

1. Threat from outside

2. NACAO Nucleus

3. Added Members:

4. In place 12/87

5. Advisory, trusteeship only

6. Two "operating" Arms (subsidiaries)
   a. Appraisal Standards Board
   b. Appraiser Certification Standards Board

D. Pending Federal Legislation: H.R. 3675

1. Federal Regulatory Structure: Federal Interagency Appraisal Council

   a. All appraisal work (and appraisers) in "federally covered transactions" [anything that involves a loan, a guarantee or federal insurance]

   b. Prescribe Uniform Standards for "covered appraisals"

   c. Establish requirements to certify "covered" appraisers

   d. Oversee state certification programs

   e. <u>May</u> accept advice and materials from Appraisal Standards Board

2. State Certification System

   a. Federal Certification if state has none, or not acceptable

   b. Balkanization of appraisal and appraising (Muhammed must go to the mountain; appraising is close to being unique.)

E. Appraisal Outside Lending or "Federally Covered Transactions"

1. Need for consistency in standards

2. Inherent bias of any regulator or administrator: constricted view of the world.

3. Possibilities for different:

a. Terminology

b. Difinitions

c. Tools and Procedures

d. Concepts

e. "Principles"

III. Implications for Appraisal, Appraisers and Real Estate Activity

A. Gresham's Law for "federally covered transactions"

B. Shotgun marriage(s) of major appraisal organizations, for survival

C. Possible consistency within scope of FIAC

D. Increase in "valuation consulting", "advising", "analysis" by major appraisal firms (and accounting, securities, architectural, engineering firms)

1. More "property economists"

2. Not all to the bad

E. Virtual demise of small, independent, non-volume firm <u>unless</u> highly specialized

1. Property tax work

2. Litigation

3. Market and feasibility studies

F. Restructuring and redirection of appraisal education and training

1. Collegiate level

2. Professional association

3. Proprietary school, agency sponsorhip

G. Whether HR 3675 passes (as is or amended) or not, the perception, structure, procedures and education of appraisers and appraising will be irrevocably changed markedly and measurably by 2000-or earlier.

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February 24, 1988

James A. Graaskamp
118 Commerce
Madison, WI 53700

Dear Chief,

As I have already written to the other participants, I thought our program was a smashing success and I really enjoyed doing it. Many thanks to you for creating the original program and your diligence in making it happen here in Atlanta. I enjoyed the chit chat between you and John R. White and, as you can see, added some of mine.

I assume your associates have started sending out refund checks. I hope the records we provided were clear and adequate. We've already sent the hotel bill under seperate cover. If any of the speakers submit expenses to me I'll rush them to you right away.

Many thanks again. I hope you had a good trip home.

Yours very truly,

Jim

James D. Vernor, Ph.D.
Chairman, Department of Real Estate

JDV/lp:K

March 9, 1988

William N. Kinnard, Jr., SREA, MAI, CRE
President
The Real Estate Counseling Group of
Connecticut, Inc.
Holiday Mall, Box 558
Storrs, CT 06268

Dear Bill:

Thanks again for being so supportive of Georgia State and Wisconsin Real Estate Programs. We are in your debt and here are a few blue chips which we will cash in:

1. We have reserved Thursday, October 6, for a keynote presentation, even though that means shortening our Wednesday evening class.

2. The address of Ahmed Karoos, Ph.D.:

   Home: 6796 S. Detroit Ct.
   Littleton, CO 80122

   (303) 694-2999

   Business: Council of Energy Resource Tribes
   1580 Logan St., Suite 400
   Denver, CO 80203

   (303) 832-6600

3. Relative to opportunity cost stuff, I have enclosed an excerpt from our AHTNA appraisal and the readings from the appendices.

The Portland Electric decision should be read in light of the Montana Power and Light decision. We are also looking to receive the AEUK case recently decided in Alaska.

Earlier I sent you a copy of comments proposed for the Barnard Committee. Actually things went better than the comments as the questions by Congressmen Craig and Barnard allowed me to pound at the inability of volunteers in a good-old-boy network to produce studies or reform them.

Crawford, the California savings and loan commissioner, came out after the hearing really excited about my comments. As usual, I talk better than I write--play a better game than I practice!

Really regret missing your comments in Atlanta. Maybe we can do something similar on the West Coast in early 1989. Thanks again for being so generous with your time.

Your check is churning through the University Process so, Lord knows when it will appear!

Best of everything,

Professor James A. Graaskamp
Chairman, Real Estate & Urban Land Economics

JAG:mjf

Enclosures

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February 24, 1988

Mr. John R. White
Landauer Associates, Inc.
Real Estate Counselors
335 Madison Ave.
New York, NY 10017-4683

Dear John,

Your kind letter and Jim Graaskamp's response to you reached my desk on the same day! The mailmen must all be Northerners! I agree with the "Chief's" sentiments entirely. While we would love to have you visit any time, you really shouldn't feel that you owe us anything for the Feb. 12 meeting. We realize the snowstorm must have been severe to keep you away but Jim Graaskamp was delighted to steal all the extra time anyway.

The program ran great. The participants were all sincerely appreciative, and David Haddow was a sincere stand by. I considered the program highly successful artistically as well as from the standpoint of support for our alumni groups. I was proud to be associated with the names on the program. Many thanks to you. We are in your debt.

Yours very truly,

Jim

James D. Vernor, Ph.D.
Chairman, Department of Real Estate

cc: Professor James A. Grasskamp

JDV/lp:K