APPRAISAL REVIEWS AND THEIR IMPORTANCE

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Introduction

Many articles and textbooks emphasize destroying the opponent's expert witnesses' appraisal reports and testimony. Aren't we as professionals trying to protect the public's interest and achieve justice? Ethical attorneys and other professionals should want the truth to come out from an expert's appraisal report. This is where an appraisal review can help. Appraisal reviews may uncover many problems or errors in appraisal reports and reduce the risk of making bad decisions based on inaccurate and biased appraisal reports.

The recent FBI report on mortgage fraud[1] indicated that fraud occurs because the participants omitted certain facts or misstated or misrepresented material facts in the submission of loan documents. These same issues addressed by the FBI report can occur in appraisal reports prepared for all types of clients other than financial institutions. Appraisal reviews may uncover errors that are deliberate, as well as unintentional errors that may mislead users of appraisal reports including attorneys, judges and accountants. Reviews can also spot evidence that an appraiser was pressured by a client to present a biased value opinion. While the average person may not read FBI reports, appraisers should take note—they do read Money Magazine, which recently implicated appraisers for bowing to pressure from mortgage brokers to increase property value estimates.[2]

The Center for Law and Renewal, based in Kalamazoo, Michigan, in their program, The New Professionalism and the Lawyer's Identity, cited "the identity crisis [in the legal profession], which conventional, case-oriented quandary ethics do not address."[3] For lawyers, appraisers and other professionals alike, it is not just their own habits but the habits of their clients that must change, "…so that they transcend the ruthless pursuit of personal gain."[4]

Indeed, every profession faces these problems today. All feel pressure to make money, increase output and retain clients. As a result, many cut corners by doing their "client's bidding" rather than follow the Code of Ethics or Standards of Professional Practice established by the various professional organizations.

It is important to understand the biases and weaknesses that may exist in an appraisal report prepared for litigation, condemnation, divorce, tax certiorari, estate tax, etc., especially in cases where the parties are particularly adversarial. Appraisal reviews can be utilized by third parties,

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[1] U. S. Department of Justice - Federal Bureau of Investigation, "Financial Crimes Report To The Public Fiscal Year 2006," http://www.fbi.gov/publications/financial/fcs_report2006/financial_crime_2006.htm.

[2] "Scenes from a Bubble," Money Magazine, May 2007, p. 114.

[3] The Center for Law and Renewal, "What is The Center for Law and Renewal?," http://www.healingandthelaw.org/Centre_Overview.html, July 4, 2007. {(Kronman, Anthony T. The Lost Lawyer: Failing Ideals of the Legal Profession (Belknap Harvard 1993); Glendon, Mary Ann. A Nation Under Lawyers (Farrar, Straus & Giroux 1st ed. 1994); Linowitz, Sol M. The Betrayed Profession: Lawyering at the End of the Twentieth Century (Johns Hopkins University Press 1994); Rhode Deborah L. In the Interests of Justice: Reforming the Legal Profession (Oxford University Press 2000); Sells, Benjamin. The Soul of the Law (Element Books 1994).}

[4] Ibid. http://www.healingandthelaw.org/Centre_Overview.html, July 4, 2007, quoted from William F. May, founding director of the Maguire Center for Ethics and Public Responsibility at Southern Methodist University.

such as government agencies, attorneys and judges, to uncover fraud, incompetency, and human errors in appraisal reports or lapses in ethical behavior by real estate appraisers and their clients which result in wide differences of opinions in value for the same property. "A distinction must be made between a divergence which is valid and one which is so wide that something other than fair market value is obviously the intent and purpose of the testimony."[5]

WHAT IS AN APPRAISAL REVIEW?

Black's Law Dictionary defines an appraisal as "a valuation or an estimation of value of property by disinterested persons of suitable qualifications" and "the process of ascertaining a value of an asset or liability that involves expert opinion rather than explicit market transactions." Appraisals are ordered for a number of reasons, including financial reporting purposes, federal & state tax related issues, compliance with the Financial Institutions Reform Recovery and Enforcement Act (FIRREA), transfer of ownership/occupancy, investment decisions (lease, buy, contract terms), mediation/arbitration, and litigation support.

An appraisal is considered to be an opinion or estimate of value which should be justified and supported by market information. An appraisal is considered valid as long as the assumptions and methodologies that are applied are reasonable. One must also remember that an appraisal is an opinion of value based on the analysis of relevant data. Two professionals may arrive at divergent conclusions.

An appraisal review is a process where an expert is called to evaluate an appraisal completed by another party. USPAP defines an appraisal review as "the act or process of developing and communicating an opinion about the quality of another appraiser's work that was performed as part of an appraisal, appraisal review, or appraisal consulting assignment."[6] While an appraiser develops an estimate or opinion of value, it is the reviewer's responsibility to evaluate the reasonableness of the report. The International Valuation Standards specifically state that the reviewer should focus on the following:

- Data used is adequate and relevant
- Appropriate methods and techniques are employed
- Analyses, opinions, and conclusions are appropriate and reasonable
- Overall product presented meets or exceeds standards.[7]

An appraisal review does not result in a new valuation conclusion. In fact, the reviewer should not substitute his/her own judgment for that of the appraiser when the original conclusion was one that a reasonable person might have drawn based on the market information as of the effective date of valuation. A review appraiser may disagree with the final valuation conclusion or the techniques that were applied in an appraisal report, but the reviewer should not offer an opinion of value unless the reviewer as complied with USPAP. A reviewer may suggest that another appraisal be ordered.

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[5] Y.T. Lum, MAI, CRE, "Illogical Divergencies of Opinion Values-Some Inconsistencies and Remedies," The Appraisal Journal, (April 1964), pages 192-202.
[6] The Appraisal Foundation, "Uniform Standards of Professional Appraisal Practice," July 4, 2007, http://commerce.appraisalfoundation.org/html/2006%20USPAP/DEFINITIONS.htm.
[7] International Valuation Standards (IVS), "International Valuation Guidance Note 11 – Reviewing Valuations," http://www.ivsc.org/standards/index.html.

APPRAISAL STANDARDS

Standards for appraisals and appraisal reviews are governed by the Appraisal Foundation under USPAP. USPAP established ten standards relating to developing and communicating real property appraisals, appraisal reviews, real estate consulting assignments, mass appraisals, personal property appraisals and business or intangible asset appraisals.

According to Standard 3, "Appraisal Review, Development and Reporting," an appraisal review should consider the quality, completeness, accuracy, relevance, appropriateness and reasonableness of all data, assumptions, procedures and conclusions provided in the report. Additional standards may be found from the Appraisal Institute, American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, as well as standards established by the courts and International Valuation Standards Committee.

Uniform Standards of Professional Appraisal Practice
Standard 3[8]

"In developing an appraisal review, the reviewer must:

(a) identify the reviewer's client and intended users, the intended use of the reviewer's opinions and conclusions, and the purpose of the assignment;
(b) identify the:
(i) subject of the appraisal review assignment,
(ii) effective date of the review,
(iii) property and ownership interest appraised (if any) in the work under review,
(iv) date of the work under review and the effective date of the opinion or conclusion in the work under review, and
(v) appraiser(s) who completed the work under review, unless the identity was withheld.
(c) determine the scope of work necessary to produce credible assignment results in accordance with the Scope of Work Rule;
(d) develop an opinion as to the completeness of the material under review, given the reviewers scope of work;
(e) develop an opinion as to the apparent adequacy and relevance of the data and the propriety of any adjustments to the data, given the reviewers scope of work;
(f) develop an opinion as to the appropriateness of the appraisal methods and techniques used, given the reviewers scope of work, and develop the reasons for any disagreement; and
(g) develop an opinion as to whether the analyses, opinions, and conclusions are appropriate and reasonable, given the reviewers scope of work, and develop the reasons for any disagreement."

The appraisal ethics and standards established by the professional organizations and the Foundation have been developed to promote and maintain public trust in the appraisal industry by establishing requirements for honesty, impartiality, and professional competency by the appraisal industry. The Appraisal Foundation does not enforce the standards. Each individual state's appraiser licensing/certification agencies are empowered to enforce USPAP standards, and some

[8] The Appraisal Foundation, "Uniform Standards of Professional Appraisal Practice," July 1, 2006, http://commerce.appraisalfoundation.org/html/2006%20USPAP/std3.htm.

governing bodies may require additional standards be met.[9] The minimal standards developed are very difficult to enforce because the government agencies responsible for oversight have insufficient resources to monitor the appraisal profession to protect the general public from intentional fraud and/or misrepresentations, incompetency, or human error.

USPAP permits an appraiser to invoke a **Jurisdictional Exception** if a condition of the appraisal or if any part of USPAP is contrary to law or public policy applicable to the assignment. In that instance, the appraisal report may no longer comply with the USPAP requirements. Appraisers must perform their services in a manner that complies with the regulations of the state licensing/certification agencies in the jurisdiction where the property is located. A well prepared and documented appraisal report should fully disclose any parts of the appraisal that do not conform to USPAP. Professional appraisers should disclose the effect that such non-compliance has on the final valuation conclusion.

WHAT CAUSES PROBLEMS IN APPRAISAL REPORTS?

Client Pressure

Recently, there have been well-documented cases that indicate that the appraiser's clients (such as mortgage brokers and lenders) apply pressure on the appraiser to produce a specific conclusion. Colorado, Ohio and New York are currently investigating the tactics that are used by mortgage brokers and lenders in the sub-prime market.[10] The previously cited Money Magazine article laments that appraisers are increasingly unable to act as independent gatekeepers when many of their clients tie a desired value result to current and future jobs.

Client pressure is not just limited to mortgage brokers and lenders, however. Pressure may come from any of the following:

- Lawyers
- Accountants
- Government
- Individuals
- Mortgage brokers & bankers
- Real estate brokers
- Loan officers

For example, lawyers may order an appraisal report, similar to a mortgage broker or lender, but for litigation purposes. Regulations do not prevent property owners, accountants, lawyers, and other potential appraisal clients from shopping for appraisers who will provide the answers that they seek. Since, lawyers are allowed to be advocates for their client's interest and do their "client's bidding," very often the appraisals are biased, leaning toward the lawyer's client's position, right or wrong. Many accounting firms follow a similar practice for their clients. This bias may be accomplished in several different ways by any of the parties listed above that may not be as obvious as paying to "hit the right number."

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[9] United States Department of Justice, "Legal Documents - Uniform Appraisal Standards for Federal Land Acquisitions," July 4, 2007

[10] Bloomberg.com, "Ohio Sues Real Estate Firms for Pressuring Appraisers," June 7, 2007, http://www.bloomberg.com/apps/news?pid=20601087&sid=aqbaAscsJavI&refer=home.

Insufficient Information

The 12th edition of **The Appraisal of Real Estate**, published by the Appraisal Institute, indicates the documents that are required to complete a thorough appraisal of real property. Lawyers or their clients may withhold important information that is critical to the appraisal, limiting the appraisers ability to do a thorough analysis. For example, the title policy may indicate certain deed restrictions that affect the valuation of the property. If this information is not provided to an appraiser, the valuation conclusion may be inaccurate.

Some of the information that is required by an appraiser to do a thorough analysis includes the following:

- Signed agreement or contract
- Contact name and phone number of property manager, leasing agent, and appropriate person to arrange for the property inspection.
- Plot plans or survey for the property.
- Legal descriptions.
- Copy of current title insurance policy, if available.
- Deed restrictions, covenants, easements, that are applicable
- Five-year ownership history.
- Five year history of assessments and taxes, including Assessor's real estate tax id.
- Access to building plans and specifications.
- Engineering reports (i.e., hazardous materials, soils, assessments and physical condition survey).
- Detailed scope and cost of recent and prospective capital improvements or repairs.
- Detailed annual income and expense statements for the last five years.
- Access to copies of all leases & Current rent roll by tenant.
- Copies of all ground leases, if applicable (abstracts/summaries acceptable, if in sufficient detail).
- Three year occupancy history by month, if available.
- Current rent and or sale concessions specials or concessions.
- Information on current staff; including title, salary level, and all benefits.
- Year-to-date operating statements and similar time periods for three years.
- Annual budget for current year and proposed budget, if available.
- Copy of management or leasing agreements (abstracts/summaries acceptable, if in sufficient detail).
- Summary of recent offers to purchase or current listings, if any.
- Any "unusual" conditions that should be consider in analysis.
- Copies of any market and feasibility studies, appraisal reports within last five years.

Scope of Work

Often appraisal clients limit the scope of work which may lead to improper conclusions. USPAP specifically states that the scope of work must include “the research and analyses that are necessary to develop credible assignment results.”[11] If the scope of work specified by the client does not allow the development of credible assignment results, the appraiser must discuss this with their client and

[11] The Appraisal Foundation, “Uniform Standards of Professional Appraisal Practice,” July 1, 2006, http://commerce.appraisalfoundation.org/html/2006%20USPAP/std1.htm.

modify the scope or withdraw from the engagement. This doesn't always happen. Occasionally, the appraiser is not qualified to determine the scope of work that is necessary to complete the engagement. The client may also limit the amount of research and analysis the appraiser can do or request alternative methods which are less time-consuming as a way to save on fees. Either way, the results may be misleading or erroneous.

Appraisers are required to disclose the research and analyses performed, but are not necessarily required to disclose the research and analyses *not* performed nor the potential risks inherent in the report because the scope was limited. A good appraisal should include this information so the reader understands the scope of work and the limitations that were agreed to. A qualified review appraiser should be able to undercover the potential risks and explain these risks to a user of an appraisal report. For example, in cities such as New York where comparable land sales are difficult to obtain, an appraiser should perform a land residual technique to estimate the site's value.

In any case, appraisers must provide support for their client's decisions to limit investigation, data collection, analysis or techniques employed to estimate value. Moreover, the scope of work should not be so limited that the report does not satisfy the requirements of the intended user. The appraiser may prepare a restricted report in accordance with the client's request and include hypothetical or extraordinary assumptions that would impact the valuation conclusion. This appraisal report may find its way into the court room in a divorce proceeding, but the conclusions may be irrelevant for splitting marital assets.

The scope of work may change during the engagement based on new facts that are uncovered during the investigation or data collection phase. There may be inadequate time to revise the scope based on the new facts and maintain the delivery deadline. In addition, additional fees and resources may be required to accomplish this objective, but are unavailable. If an appraiser uncovers new facts and circumstances which should alter the scope of the engagement this should be discussed with the client and additional funds and resources should be made available in order to produce an appraisal report with credible results.

Qualifications of the Appraiser

A review appraiser is an unbiased, independent professional who passes judgment on another's appraisal report. He/she is not an advocate and therefore, does not embrace the appraisal's value estimate.[12] While he/she may form his or her own opinion of value during the course of the review, that opinion must not be provided, since it essentially constitutes an appraisal, which is beyond the scope of an appraisal review, and the review appraiser must comply with Standards 1 and 2, which govern developing and reporting a credible appraisal report

USPAP requires that reviewers be qualified in terms of their level of education, training and experience. They must be accountable for their decisions which should be based on the rules of fairness and objectivity. To be competent, the reviewer must be familiar with the type of property, the subject market, the geographic area and the appropriate analytical methods for determining value for that type of property. Beyond this simple definition of competence, regulations for appraiser qualifications may vary from state to state.

If the appraiser does not have the prerequisites, USPAP requires that he/she must disclose the lack of knowledge and/or experience to the client before accepting the assignment. The appraiser

[12] Jack P. Friedman, MAI, PhD, CPA, and Nicholas Ordway, PhD, JD, "Appraisal Review in a Litigation Support Role," The Appraisal Journal (January 2000): 20-31.

must take all steps necessary or appropriate to complete the assignment competently, and state the steps that have been taken to complete the assignment competently in the report.

Many appraisers do not disclose that they may not have the experience or expertise to value a particular type of property, such as a multi-tenanted office building, nursing home, hospital, or limited partnership interests. Many times clients hire their friends or acquaintances who are not licensed or designated members of professional organizations to appraise real property interests. Government agencies often approve appraisers just because they have made political contributions. Licensing sets the minimum standards which in many instances are inadequate to properly educate real estate appraisers on how to deal with complex related real property issues. As a result, many appraisers are not prepared to correctly employ those recognized methods and techniques that are required to produce a credible appraisal.

Review appraisers can evaluate the appraiser's qualifications who prepared the report based on the following criteria:

1. Professional designations from professional organizations
2. Appraiser state licensing or certification
3. Years of experience
4. General reputation of appraiser
5. Appraiser's level of education
6. Continuing education
7. Experience in appraising the property type
8. Experience in the local market area
9. Access to the appropriate data sources.

The professional organizations, such as the American Society of Appraisers and the Appraisal Institute, set higher standards and educational requirements for their members. The Code of Ethics and the additional standards that they impose on their members provide one more level of protection in comparison to state licensing laws which set minimal standards. Many professional organizations, such as the Appraisal Institute, have developed a sophisticated peer review system through which it enforces their Code of Professional Ethics and Standards of Professional Appraisal Practice. Violations of the Code of Ethics or Standards can result in remedial or disciplinary actions. The professional organizations often have more resources available to discipline members in comparison to the state licensing or certifying agencies.

Different Legal or Accounting Instructions

In 1966, the Appraisal Review Committee of the American Institute of Real Estate Appraisers (now, the Appraisal Institute) stated that: "One of the most frequent causes of major divergencies that have become evident stems from different legal instructions. An appraiser for a property owner is given an interpretation by counsel telling him he is to treat a certain matter in a particular way; the attorney for the condemnation body gives his appraiser an entirely different interpretation." This has not changed. Each side in a dispute may interpret legal or accounting concepts differently. In fact it is quite common for the appraisers' clients to provide different legal or accounting instructions concerning hypothetical or extraordinary assumptions that may impact the final valuation conclusions.

An extraordinary assumption is defined as "an assumption, directly related to a specific assignment, which, if found to be false, could alter the appraiser's opinions or conclusions."[13] The appraiser is making an assumption about the physical, legal, or economic characteristics of the subject property or about conditions that are external to the property that might impact the final valuation conclusions. Under USPAP, the appraisal report must provide full disclosure. In many instances an appraiser may not gain access to the improvements, such as real property assessors who are not provided access by the property owner. The appraisal report should include an extraordinary assumption regarding the interior finish and condition which if found false would impact the final valuation conclusion.

A hypothetical condition is defined as "that which is contrary to what exists but is supposed for the purpose of analysis."[14] The appraiser is making an assumption about the physical, legal, or economic characteristics of the subject property or about conditions that are external to the property that might impact the final valuation conclusions and are known to be false at the time of the appraisal. Under USPAP, the appraisal report must provide full disclosure.

For example, an appraisal utilizes the hypothetical condition in preparing the subject's site valuation, that the existing improvements have been demolished and that the site is ready for re-development. The appraisal should have included a statement that states that this hypothetical assumption might have affected the assignment results. In addition, it would have been prudent to indicate the cost required to buy out any leases and the cost to demolish the existing improvements. The site is not vacant and is leased and the final valuation conclusion was overstated.

An extraordinary assumption or a hypothetical condition should only be used if the resulting analysis is credible. The appraiser must have a reasonable basis for making an extraordinary assumption or a legal reason for using a hypothetical condition. It is prudent for the parties to agree in writing as to the assumptions that will be utilized in the appraisal prior to ordering the appraisal. This would reduce the cost of litigation because these types of issues should be resolved prior to ordering an appraisal.

Additional assumptions may also be added that some appraisers refer to as special conditions or limiting assumptions. These must be read carefully, as well as any extraordinary assumptions or hypothetical conditions, to ensure that owners and their agents do not make false representations.

Date of Valuation

Very often some clients, such as attorneys, do not agree on the valuation date. Richard Sorenson, MAI, CRE stated four examples that might be requested by a client:

- As-is property value at the current appraisal date, in its current physical condition, and subject to the zoning currently in effect;
- The value as if complete and operational on the appraisal date;
- The prospective future value upon completion of construction;

[13] The Appraisal Foundation, "Uniform Standards of Professional Appraisal Practice," July 1, 2006, http://commerce.appraisalfoundation.org/html/2006%20USPAP/DEFINITIONS.htm.
[14] The Appraisal Foundation, "Uniform Standards of Professional Appraisal Practice," July 1, 2006, http://commerce.appraisalfoundation.org/html/2006%20USPAP/DEFINITIONS.htm.

- The prospective future value upon reaching stabilized occupancy or upon income stabilization; that is, when leased and all tenants are actually paying rent.[15]

In addition, in divorce cases, the effective date of valuation may result in a retrospective valuation. In one particular instance, a Judge ruled the assets should be valued as of 1992 and 1994. The real estate markets changed during that period of time. The attorneys could have saved the litigants time and money if the Judge had heard arguments concerning the date of value prior to ordering appraisals on numerous properties.

In each of the five situations referred to above, the final estimate of value would probably differ substantially.

Market Data and Comparable Sales

The basic elements of comparison between the subject property and the comparables are (1) real property rights conveyed, (2) financing terms, (3) conditions of sale, and (4) expenditures immediately after purchase, (5) market conditions, (6) location, (7) physical characteristics, (8) economic characteristics, (9) use/zoning, and (10) non-realty components. Fannie Mae lists several basic rules regarding Adjustments to Comparable Sales.[16]

Using the Sales Comparison Approach, the appraisal will compare the transfer price of each comparable property to the subject property, reviewing each feature and evaluating its relation to the subject property. The objective is to adjust for any differences between the subject property and the comparable property to arrive at a reasonable estimate of value for the subject. If the feature is superior to the subject property, a negative adjustment is made to the value of the comparable. If the feature is inferior, a positive adjustment is made. Failure to adjust for obvious differences would be a red flag, easily spotted by a review appraiser. The market data available in the subject neighborhood and competing locations at the time of sale, provides the basis for adjustments. Predetermined or assumed dollar adjustments are not valid.

Appraisal reviewers will be alert to any inappropriate time adjustments that overlook market events that may have an effect on the value of the property. Other red flags include appraisals that appear to be hiding or downplaying features of comparable properties that have a blatant or even subtle impact on the transaction price..

Reviewers will also be aware of two different ways that adjustments may be made: qualitative and quantitative adjustments. Quantitative adjustments may be made for differences that have a calculable dollar value reflecting the market's reaction to a specific difference. It should be noted that the adjustment is based on the market information, not on cost. For example, the market value of a new kitchen or a swimming pool may not be equal to the cost of the renovation or installation. The cost may be substantially higher than the value contributed by the item.

The reasonableness of an adjustment could be based on norms for a particular property class. For example, Fannie Mae's guidelines for single-family homes is that the dollar amount of the net adjustments for each comparable sale should not exceed 15 percent of the sales price of the comparable and gross adjustments may not exceed 25 percent. Adjustments that are outside these

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[15] Richard Sorenson, MAI, CRE, "The Art of Reviewing Appraisals," The Appraisal Journal (July 1991): 353-369.

[16] Fannie Mae, "Adjustments to Comparable Sales," Single Family Selling Guide,: Part XI, 406.03: (06/30/02)

guidelines should be explained thoroughly in the appraisal report, or else the comparable should not be used at all. It is extremely difficult to stay with this range when analyzing comparables sales in the luxury or high priced market, however, but an explanation should be included nonetheless.

In some cases a quantitative adjustment may not be appropriate. A qualitative sales comparison analysis allows the appraiser to indicate the market reaction to a particular feature as a positive (+) or negative (-) relationship. The final value estimate is calculated by giving greater weight to more similar properties and less weight to less similar properties. Qualitative analysis is appropriate when one or more elements of comparison are known to affect market value, but data is insufficient to estimate a specific lump sum or percentage adjustment.[17]

The complexity of the appraisal engagement determines the type of research and analysis that is required. In many instances, the appraiser does not thoroughly investigate trends in property values, supply and demand, current listings and offer which can impact the final estimate of value. While an appraiser should adequately research the market, they may rely only on multiple listing transactions because of time or fee constraints. All information from public records should be considered if appropriate. The appraiser must consider all relevant data, sources of information, and should not rely on incomplete information which may result in an inaccurate final estimate of value. If an appraiser excludes comparable sales and market data which are necessary to properly estimate market value, the resulting conclusion could be detrimental to their client's position.

Fannie Mae's Selling Guide for Single Family Homes lists a number of Unacceptable Appraisal Practices (below in italics),[18] which are areas where a reviewer may spot important divergencies in appraisals for any type of property. Some of these practices include the following:

Misrepresentation of the physical characteristics of the subject property, improvements, or comparable sales. If property characteristics are misrepresented, there is a risk that the comparables used to estimate value are inappropriate.

Failure to comment on negative factors with respect to the subject neighborhood, subject property, or proximity of the subject property to adverse influences. If a residential property is located near a dump or if a retail property has inadequate access, it should be revealed in the report.

Failure to adequately analyze and report any current contract of sale, option, offering, or listing of the subject property and the prior sales of the subject property and the comparable sales. All sales, contracts or listings that are available to the public at the time of the valuation should be considered.

Selection and use of inappropriate comparable sales or the failure to use comparable sales that are locationally and physically the most similar to the subject property. If a publicly available comparable sale is excluded, despite its greater similarity to the property, relative to other comparables used, its exclusion should be explained in the appraisal report.

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[17] Appraisal Institute, "Advanced Sales and Cost Approaches," Appraisal Institute (2002), page 2-51.

[18] Fannie Mae, "Single Family Selling Guide,: Part XI, 102.02: Unacceptable Appraisal Practices," (12/17/02)

Use of adjustments to the comparable sales that do not reflect the market's reaction to the differences between the subject property and the comparable sales, not supporting the adjustments in the sales comparison approach, or the failure to make adjustments when they are clearly indicated. While there are no standard dollar amount rules for adjustments, any adjustments that are made should be based on available market data, not on assumptions or personal opinion.

Use of data—particularly comparable sales data—that was provided by parties who have a financial interest in the sale or financing of the subject property without the appraiser's verification of the information from a disinterested source. A broker who is paid on commission has a financial interest in the property in that he/she is paid a percentage of the purchase price. If the selling broker provides comparables to the appraiser, it behooves the appraiser to find additional comparables from another source. If the comparable sales that were provided by the broker were indeed the only data available, this fact should be reported.

Development of and/or reporting an appraisal in a manner or direction that favors either the cause of the client or any related party, the amount of the opinion of value, the attainment of a specific result, or the occurrence of a subsequent event in order to receive compensation and/or employment for performing the appraisal and/or in anticipation of receiving future assignments. This is fraud. An appraiser risks not only the loss of his credentials from the governing appraisal body, but also risks prosecution if he/she deliberately reports value that favors any party.

Development of and/or reporting an appraisal in a manner that is inconsistent with the requirements of the Uniform Standards of Professional Appraisal Practice that were in place as of the effective date of the appraisal. While not necessarily constituting fraud, any divergence from USPAP should be investigated.

Reviewers will ensure that the final value conclusion takes all adjustments into consideration. Were all adjustments thoroughly explained? Were quantitative adjustments based on relevant market data? If a qualitative adjustment was made, was the affect on value proportionate to the market reaction? Did the appraiser appear to rely solely on qualitative adjustments? If the value of the subject falls outside the range indicated by comparable sales, something may very well be wrong, but not always. When all appropriate adjustments have been made, a final value conclusion will be reasonable and valid.

Income Approach

Errors and biases can also be found in the income approach. The gross potential income should be supported by the existing contract rents and market rents for the vacant spaces. Rental concessions and tenant work letters can impact the effective rent collected by the owner of the property. A thorough market analysis is required to support the projected gross income.

Often one appraiser relies on the historical income and expense estimates submitted by the property owner. It is possible that this information does not reflect what a buyer would estimate. Maybe the property has not been properly managed. It is also possible that expenses are overstated because the current owner expensed non-property related items, such as personal automobile expenses and insurance, for example. The owner may also charge a management fee that is exorbitant. The reported historical property expenses should be compared to industry standards and competitive properties.

The projected income and expense pro-forma should reflect the actions of informed market participants. In the article, "The Art of Reviewing Appraisals," Richard Sorenson indicated the following items that might be observed in an appraisal report that may represent a bias or error:

- The rental income increases in an undeviating straight line over the projection period;
- The expense ratio (i.e., operating expenses as a percentage of total gross income) declines over the projection period;
- Percentage rent represents a significant source of total income disproportionate to the base income amount; All expenses are recovered from tenants without any net operating expense cost to the owner;
- A 5% vacancy factor is used for income stabilization;
- No capital expense or replacement reserve line items are included;
- There is no recognition of regional or local income or expense variations;
- The reversionary capitalization rate is lower or equal to a current capitalization rate;
- The discount, or internal rate of return (IRR), rate is out of balance with the capitalization rate and growth rate; or
- The pro forma cash flow was run on an in-house-created spreadsheet program.[19]

A review appraiser will quickly notice any of these potential items, as well as others that might be present in the Income Approach.

Cost Approach

The cost approach is based on the principle of substitution that states that a buyer will not pay more for a property than the cost to produce an equally desirable property. Buyers always have the option to acquire a site and build an improvement that offers similar utility to the property that is being appraised. They can also acquire an improved property that can be altered to meet the needs of the buyer. If the property is improved with an improper improvement the property can be acquired and the improvements demolished to create a vacant site that can be improved. The indicated value derived by the cost approach may provide a good indication of value for the property that is being appraised if properly applied.

In the cost approach the appraiser typically estimates the value of the site, if vacant, and adds the cost of construction of the improvements. The losses in value for age, wear and tear and due to functional deficiencies or external influences are deducted to provide an indication of value. The cost approach, while it has many weaknesses, if properly applied may produce a reasonable indication of value. Ratcliff points out that the cost approach is very useful in developing useful information in the following application:

- "The production cost of a reasonable and acceptable alternative property sets an upper limit to the amount anyone could be expected to pay for the subject property." (He did note that a buyer may pay more than cost when there is no acceptable alternative).
- "Production costs can be a useful evidence of value if, in fact, properties similar to the subject property are being developed."[20]

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[19] Richard Sorenson, MAI, CRE, "The Art of Reviewing Appraisals," The Appraisal Journal (July 1991), pages 353-369.
[20] Dr. Richard U. Ratcliff, "A Restatement of Appraisal Theory," The Appraisal Journal (April 1964), pages 258-291.

There are limitations to the cost approach and many common errors may be present that review appraisers can quickly uncover in a complete appraisal report. For example, the cost approach is difficult to apply when the improvements are older and outdated. The land value usually represents a large percentage of the overall value of the property in this instance. There may a lack of activity making it difficult to obtain recent land sale information and accurate construction costs. It is also quite common for appraisers to incorrectly estimate functional and external obsolescence. These two concepts are difficult for even the most seasoned appraiser.

Conclusion

Due to client pressure applied to real estate appraisers from all market partipants, it behooves attorneys to have real estate appraisals reviewed to insure that the appraisal reports have been prepared in conformance with the Uniform Standards of Professional Appraisal Practice. The review can determine if the scope of work included the research and analyses that were necessary to develop credible assignment results. In addition, the review appraiser will be able to understand the report to determine if the appraiser correctly employed the appropriate methods and techniques that are necessary to produce a credible appraisal. A thorough review will uncover errors, omissions, misrepresentations, and the improper application of valuation techniques that might produce misleading or fraudulent results.

A cover page with complete address, phone, fax, and e-mail of each author.

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An abstract of 75-100 words.

Many articles have been written on the art of reviewing appraisal reports by professional real estate appraisers for bank lending and litigation purposes. This article explains why attorneys, Judges, IRS, assessors and other individuals that obtain appraisal reports from third parties should have the reports reviewed by qualified individuals who are professional real estate appraisers. This article explains the review process, the guidelines that should be followed, and the conclusions that can be drawn from an appraisal review. Some of the reasons for divergencies between appraisal reports are discussed, such as fraud, incompetency, human error, and client pressure. The authors introduce some methods that might be employed in order to minimize conflicts, to promote justice and fairness in the appraisal and legal process.

Six key words for indexing, i.e., words that best describe the content of the manuscript. Also include a brief sentence describing how your article relates to each of those subjects.

Appraisal Review - the process and guidelines are discussed in detail based on USPAP and IVS standards.

Litigation Support – this article explains why appraisal reviews are needed, such as in divorce, condemnation, tax certiorari, and other litigation matters.

USPAP – the guidelines in USPAP are introduced and discussed.

Scope of Work – The concept of scope of work and how it may affect the outcome of the appraisal and make the report misleading.

Qualifications – The qualifications of the appraiser and review appraiser are discussed.

Mediation and Arbitration – the information presented in this article should assist in the mediation and arbitration of disputes.

A brief professional biography for each author, including present employment, title, degrees, designations, publishing accomplishments, and preferred method for reader contact.

Jim MacCrate, MAI, CRE, ASA has his own boutique real estate valuation and consulting company, MacCrate Associates LLC, located in the New York City Metropolitan area, concentrating on complex real estate valuation issues. Formerly, he was the Northeast Regional Practice Leader and Director of the Real Estate Valuation/Advisory Services Group at Price Waterhouse LLP and PricwaterhouseCoopers LLP. He received a B.S. Degree from Cornell University and M.B.A. from Long Island University, C. W. Post Center. He has written numerous articles for Price Waterhouse LLP, The Counselors of Real Estate, and has contributed to the Appraisal Journal in the past. He initiated the Land Investment Survey that has been incorporated into The PricewaterhouseCoopers Korpacz Real Estate Investor Survey. He is on the national faculty for the Appraisal Institute and Adjunct Professor at New York University.

Noreen Whysel has nineteen years of internet, research and database experience including operations manager for PricewaterhouseCoopers' global website and a researcher/librarian with Price Waterhouse's Real Estate Advisory Group. She is a long-standing coordinating member of GISMO, a NYC-based Geographic Information Systems users' group. Noreen has an undergraduate degree from Columbia University and has completed post graduate work. Noreen is currently serving as Operations Director for the Information Architecture Institute and as a consultant to the Municipal Art Society and the American Museum of Natural History on web design and usability projects. She has researched, written and edited numerous articles relating to real estate for various Partners and Directors at PricewaterhouseCoopers LLP and Price Waterhouse LLP.