

Appraisal Review Ethics

Appraisal reviews have undergone modifications in content and function since government directives such as R41b, R41c, in addition to the American Institute of Real Estate Appraisers' Standards of Professional Practice, were implemented. Litigation by attorneys using appraisal reviews against appraisers has also added a new dimension to review practice. In this article, the author examines issues in appraisal review education and ethics, taking the position that new standards will contribute to objectivity in the appraisal review function.

Qualified appraisers are often asked to review the work of other appraisers. If appraisal reviews are factually inaccurate, blatantly subjective, or assert reviewers' unsupported judgments, they may violate basic standards of professional ethics. Such reviews can produce serious consequences for the original appraiser.

Are some real estate appraisal reviews biased, and therefore not objective? A critical look at current appraisal review practices may shed some light on this problem.

This article addresses the question of what is acceptable and unacceptable professional practice in connection with written or verbal criticism of the work of other appraisers. Acceptable professional practice is nothing more than common-sense ethical behavior, the

same behavior that is expected in all aspects of professional appraisers' conduct.

PURPOSE OF APPRAISAL REVIEWS

Until recently, the purpose of the appraisal review was to determine the validity of the appraisal report prior to use in the consideration of mortgage loans, condemnation value, or other purposes. But with the recent crisis in financial entities and the propensity of regulatory agencies to shift the blame for their losses to real estate appraisers, a more ominous use of appraisal reviews has arisen; that is, as a basis for damage suits against appraisers. For example, syndicators whose projects have failed have been sued by investors, with

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the attorneys for the plaintiffs casting a net wide enough to include appraisers.

The battle of wits between reviewers and appraisers is no longer a game in which the participants compete intellectually with nothing more at stake than personal pride. The personal wealth of appraisers, and more important, professional reputations, are at stake when appraisal reviews are used as a basis for lawsuits against appraisers.

BASIC REVIEW FUNCTIONS

An appraisal review is an analysis of all aspects of the appraisal report of another appraiser. The review's purpose is to:

- Ascertain whether the appraisal report contains the pertinent data available;
- Determine whether the factual information logically relates to the conclusions made by the appraiser;
- Determine whether the appraisal conforms with acceptable appraisal practices and techniques; and
- Decide whether the reasoning and logic applied to the data in the appraisal process result in a logical conclusion.

There is a significant difference between an appraisal review and an appraisal. The function of the review appraiser is not to conduct an appraisal of the property; rather it is to analyze the contents of the appraisal report itself. There is often a fine line between objectively judging the reasoning and logic of an appraiser and instead substituting one's subjective judgment as a reviewer.

An appraisal review must be an impartial analysis of the total work of another appraiser; anything short of a review of the entire work can-

not qualify as an appraisal review. When only certain parts of an appraisal report are analyzed, the reviewer should note that no other sections have been reviewed. In the case of such a limited review, the total report should not be judged on the basis of only a few parts.

IMPACT OF REGULATIONS AND UNIFORM STANDARDS

The failure to precisely define the role of the review appraiser has contributed to a lack of clarity regarding standards for appraisal review. Reviews have undergone an evolution that originated in two sources: government regulatory agencies (particularly those involved in the interstate highway program) and mortgage lending agencies. Both of these groups were interested primarily in resolving mathematical errors and ensuring conformity with a checklist of basic report requirements.

Originally there were no Uniform Standards of Professional Appraisal Practice (uniform standards), although there were report requirements that tended to increase with time. Conformity with the report requirements, which were less stringent than uniform standards, was required by the Federal Home Loan Bank Board (FHLBB) regulations R41b and R41c.

The FHLBB regulations introduced the idea of "adequate support" to the older checklist regulations. Although R41b and R41c have now been discarded, their impact on the definition of the functions of an appraisal review continues, in particular since the Standards of Professional Practice of the American Institute of Real Estate Appraisers were expanded and became more specific. According to these standards, the reviewer should determine the adequacy of support based on the data, logic, and reasoning of the report.

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The standards increased demands on appraisers by inserting such criteria as cash equivalency standards and valuation of the land as if vacant.

CHANGES IN THE CODE OF ETHICS

Previously, the Code of Ethics of the Appraisal Institute merely stated general rules of conduct. The founders of the Appraisal Institute and of the other appraisal organizations predicted difficulties not only with defining standards of appraisal reports, but with solving the problems created by subjective interpretation of such standards. The entire concept of appraisal reviews changed after the Appraisal Institute added to its Code of Ethics the provision that the appraiser must also conform to the Standards of Professional Practice.

The old checklist method of appraisal reviewing lent itself to a system of "grades" in which the reviewer marked a positive check if the appraiser did conform with the report requirements. The positive grade system disappeared with the advent of the "fault-finding" review system encouraged by regulations such as R41b and R41c and the Standards of Professional Practice.

The fundamental difference between the original review function and that which evolved from R41b, R41c, and the Standards of Professional Practice was that the review appraiser became more an auditor than a reviewer. Rather than objectively review the appraisal, the review appraisers began to point out areas in which the reviewer disagreed with the appraiser. As a result, the reviewer's purpose was no longer to indicate whether the report was satisfactory, or in fact, good. The function of the reviewer became to note every apparent discrepancy (such as an omission of

an item on the checklist). The reviewer began to determine subjectively what portions of the appraisal report did not satisfy the reviewer's concept of adequate support.

To illustrate, assume that the appraiser of a small commercial property includes in a report data from only two land sales, with the explanation that they were the only sales considered reliable. The reviewer analyzes this report and indicates that the appraiser should have included data obtained from other towns or researched sales in previous years to obtain more evidence than that provided by two sales to support the value conclusion. In other words, the reviewer implies the support for the land value conclusion is inadequate. And it is worth noting in this scenario that the review appraiser discredits the appraiser without presenting any evidence to prove that the appraiser disregarded pertinent data.

As an alternative, suppose the appraiser adds to the report a third sale of commercial land that occurred five years ago, which the appraiser indicates is not particularly relevant. The appraiser endeavors to adjust the third sale for quite different market conditions. In this scenario, the review appraiser is highly critical of the appraiser for using irrelevant data (an old sale) in order to support what the reviewer suggests is the appraiser's predetermined conclusion of the value of the land. It is clear that in these two hypothetical cases, the appraiser is in an impossible position.

SCHOOLING OF APPRAISAL REVIEWERS

Perhaps these subjective aspects of the appraisal review have been encouraged by the way review appraisers have been professionally educated. Any appraiser who has attended an appraisal review sem-

inar or course can attest to two basic facts inherent in the subject matter: 1) the appraisal reviewer is in some way more competent and knowledgeable than the appraiser; and 2) the job of the reviewer is to find fault with, rather than objectively review the report.

The most damaging of these two misconceptions is the first. Of course, there is no basis for the theory that the reviewer—by virtue of his or her position—has greater knowledge than the appraiser. In fact, many reviewers have neither the credentials nor the experience of the appraiser. Currently however, the reviewer is encouraged to assert his or her assumed superiority by finding mistaken conclusions in the report. The reviewer is trained to fulfill the requirement of the second misconception mentioned above; that is, to find fault with the report rather than review it objectively.

THE LEGAL PARADOX

It is sometimes the intention of those commissioning an appraisal review to explore the potential of a lawsuit against the appraiser. The type of appraisal review that has evolved from R41b, R41c, the Standards of Professional Practice, and current reviewer education is one in which the review appraiser is encouraged to find weaknesses and problems in the report. The resulting negative bias can cause the attorney seeking to file suit against an appraiser to draw erroneous conclusions about the appraiser's work. Often, appraisal reviews performed in anticipation of a lawsuit are done long after the original appraisal, thus giving the reviewer the not insignificant benefit of hindsight.

Because the review appraiser is not able to express an opinion regarding the market value of the property at the time of the ap-

praisal, the implication of the negative appraisal review is that the appraised value is incorrect. If their decisions are based on the negative citations in the review, the judge and jury are likely to arrive at the conclusion that the appraiser was negligent in his or her determination of the value of that property. This conclusion is in perfect accordance with the advocate attorney's goals.

Assume that the same review appraiser were to accomplish an objective review of the appraisal. Even if the reviewer does not agree with the value conclusion of the appraiser, the usefulness of the review for the advocate attorney in a litigation against the appraiser is reduced when the reviewer repeatedly states that the appraiser did this and that correctly and can find no fault with most of the report.

In addition to the use of negative reviews in suits against appraisers, consider the effect of a fault-finding review on the loan officer of a bank or savings institution. Ordinarily, the impression that the loan officer gets comes directly from the review rather than from his or her own analysis of the appraisal report. The exclusively fault-finding review, particularly if repeated often enough, would logically lead the loan officer to seek appraisal services elsewhere.

In a negative review, a dozen minor problems can become more significant to the reviewer than one major error that affects the value conclusion. When an appraisal review is conducted that points out only the negative aspects of the report, the reviewer often fails to indicate which, if any, of the deficiencies have a potential impact on the final value conclusion and which do not.

Another way to unfairly damage the original appraiser's reputation is to require each report to meet the demonstration report requirements

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of the Appraisal Institute or other professional organizations, even if this is not really necessary to support the conclusions of the report. For instance, if the appraiser reports that the ad valorem taxes on single-family houses in the area have been the same for a number of years and are not expected to increase in the near future, the review appraiser may be critical because the appraiser did not include in the report a complete tax expense study.

While the review appraiser has an obligation to his client to objectively analyze the appraisal report, the reviewer should not be oblivious of the consequences of the review for the appraiser, either in potential litigation or in ordinary business circumstances. The review function is no longer merely a frivolous exercise.

GOALS OF AN APPRAISAL REVIEW

Because reviews can fulfill many functions, the goals of a review need to be clearly defined. The purposes of a review may be to correct mathematics, spelling, and grammatical structure or to review a demonstration report of a candidate for the MAI designation. The reviewer may simply ensure conformity using a checklist of basic requirements, or the reviewer may extend the scope of the review by using research and field inspections in order to attest to the validity of the value conclusion of the appraisal report. In the latter case, the goal of the reviewer would be to reach an independent value conclusion comparable to that of the appraiser.

PROFESSIONAL STANDARDS

Standard 3 of the uniform standards, which became effective on

January 1, 1989, states that "In reviewing an appraisal and reporting the results of that review, an appraiser must form an opinion as to the adequacy and appropriateness of the report being reviewed and must clearly disclose the nature of the review process undertaken."

In reviewing an appraisal, an appraiser must observe the following specific guidelines:

- a) Identify the report being reviewed, the real estate and real property interest being appraised, the effective date of the opinion in the report being reviewed, and the date of the review;
- b) Identify the scope of the review process to be conducted;
- c) Form an opinion as to the adequacy and relevance of the data and the propriety of any adjustments made to that data;
- d) Form an opinion as to the appropriateness of the appraisal methods and techniques used and develop the reasons for any disagreement; and
- e) Form an opinion as to the correctness and appropriateness of the analyses, opinions, and/or conclusions in the report being reviewed and develop the reasons for any disagreement.

One interpretation of the above standards is that the review appraiser may define the scope of the review process as merely to find weaknesses, and therefore to form only negative opinions regarding the adequacy and relevance of the data and the propriety of any adjustments to the data that the reviewer finds incorrect. By narrowing the scope in this way, the review appraiser apparently would be able to form opinions about violations of the appropriateness of the appraisal methods and techniques used, and develop the reasons for

any disagreement. Within the same limited scope, the review appraiser could report only the negative aspects of the analysis, opinions, and conclusions in the report being reviewed and develop the reasons for any disagreement.

A second interpretation would hold that the review appraiser, in order to be objective, must report both the positive and negative aspects of the report as the reviewer sees them. If there were sufficient relevant data with proper adjustments in any part of the report, the reviewer would be obligated to report this. If the reviewer found the appraisal methods and techniques appropriate in any part of the report, the reviewer would be obligated to report this. If the reviewer found the analyses, opinions, or conclusions in parts of the report correct and appropriate, the reviewer would be obligated to report this.

As long as there is ambiguity in the definition of the review appraiser's function, there will be enough latitude to allow for the possibility of subjective appraisal reviews. It is a paradox that the appraiser whose report is being reviewed is subject to a critique of his or her objectivity and professionalism, while the review appraiser can avoid such scrutiny by defining the scope of the review in a narrow, negative way.

CORRECTIONS TO THE SYSTEM

Changing review appraiser education is the most likely way to correct the current state of affairs. Currently, review appraisers are taught that they are, by virtue of their position, more knowledgeable than appraisers. We need new educational concepts that put the role of the review appraiser into perspective.

In addition to education, the Ap-

praisal Institute might consider the following suggested revisions in the Standards of Professional Practice:

- Appraisal reviews must render an objective judgment on all sections of the appraisal report; the sections that are found to be acceptable as well as those criticized by the review appraiser. The purpose of this standard would be to ensure that all appraisal reviews would be complete and therefore more objective.
- For each deficiency identified in the basic methodology or technique of the original report the reviewing appraiser must point out the deficiency, explain why it is incorrect and, if possible, cite a published reference to support that conclusion. It is not sufficient to fault the appraiser merely because some methodology or technique is preferred by the reviewer; rather, the criteria must be that the methodology or technique used leads to an erroneous conclusion. This eliminates the right of the reviewer to demand of the appraiser the reviewer's choice of methodology or technique.
- An appraisal review should be based on the same time period and market conditions as those on which the original appraisal is based. An impartial and objective review appraiser would not refer to any other time or compare the report to any other appraisal report, especially one done at a different time. Appraisal reviews should be completely devoid of hindsight. Subsequent events should not be used to refute projections made in the appraisal report unless the events were known in the market at the time of the original report. This places constraints on the

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reviewer similar to those on the original appraiser.

- Each appraisal report must be evaluated in terms of the definition of the problem and limiting conditions stated in the report. This is especially true for those cases in which the review appraiser does not agree with the original appraiser's definition of the problem. For instance, the reviewer may not agree with the opinion of highest and best use in an appraisal report, since this opinion was entirely based on a single given use of property (rather than considering all uses). Second, if the appraisal is of a proposed project consisting of 40 apartment units and only 32 units were actually constructed, the reviewer may not recognize that fact, and criticize the original appraiser for having too high a value in the income approach. Third, the original appraiser might be criticized if projected tenants are lost because of delays in the project, when the original appraiser based his or her value on completion of the construction at a certain time.
- When the reviewer questions the veracity of facts or data, he or she must ascertain the validity of the cited deficiency. It is not proper, for instance, for the reviewer to state there are comparables when the appraiser says there are none, unless the reviewer can prove their existence.
- Reviewers should be required to indicate the significance of each deficiency or error found in the appraisal report as it relates to the value conclusion. In other words, what effect would the fault have on the final value conclusion?

Does the typographical error or even a minor comparable adjustment error have any significance at all relevant to the value conclusion?

- Appraisal reviews should contain a statement that urges the client to obtain another appraisal of the same property at the same time as the original appraisal, in case any legal proceedings against the original appraiser regarding this appraisal are undertaken. Testimony against another appraiser based solely on an appraisal review of the original appraiser should be discouraged unless and until the appraisal reviewer has appraised the property using the same time and market conditions as the original appraiser. Any appraisal can be torn apart by subjective, biased opinions. The only true test of an appraisal is by comparison with another appraiser's report, done at the same time and under the same circumstances as the original appraisal.

CERTIFICATION OF THE REVIEW APPRAISER

The following could logically be included in a review appraiser's certification:

This is to certify that this appraisal review has been accomplished in an objective manner.

1. That all parts of the appraisal have been analyzed, and the reviewer has indicated in this review those parts found acceptable in addition to those found deficient.
2. That this reviewer has explained his or her rationale for all deficiencies in methodology or technique found in the appraisal report.

3. That this reviewer has not referred to matters that have occurred since the date of valuation.
4. That this reviewer has accepted the original report's premises, including the definition of the appraisal problem and the description of the property, unless otherwise noted and explained.
5. That if this reviewer has faulted any facts or data in the appraisal report, he or she has checked reliable sources to verify the true facts.
6. That this reviewer has attempted to differentiate between those deficiencies of the original appraisal that may influence the value conclusion and those that do not.

IMPORTANCE OF APPRAISAL REVIEWS

It is no longer true that the appraisal review is merely a tool to enable the profession to determine whether an appraisal report is valid enough to justify a proposed right-of-way taking or a mortgage loan. Because appraisal reviews have been used by plaintiffs and their attorneys to sue individual apprais-

ers, it is important that review appraisers conduct objective and fair reviews. Biased reviewers should be required to account for their actions in accord with the seriousness of the action taken against the original appraiser.

Obviously, unethical conduct is unprofessional conduct that may prove potentially harmful to others. Perhaps the most unethical and unprofessional act one appraiser can commit against another appraiser is one that leads to a civil action against the original appraiser, which could result in financial loss and potential damage to his or her professional reputation.

Reform can be accomplished without depriving the review appraiser of the freedom to disagree with some or all of the appraisal report. But, the review appraiser should act in a professional manner. This entails reporting what is proper about the appraisal report as well as what is not. It also involves explaining the significance of each fault as it relates to the final value conclusion, without the benefit of hindsight. And, most of all, the review appraiser should use fair, objective standards to review an appraisal, not unsubstantiated, subjective judgments.