Ethics in the Appraisal Profession

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While most real estate appraisal work is accomplished by appraisers in an objective, unbiased, and ethical manner, self interest and selfish business choices will always be with us. Thus, appraisers must constantly identify ethical issues and refine ethical principles in the profession. Regardless of their upbringing or propensity to high professional standards, some appraisers still produce dishonest reports to satisfy their own or their client's interest or produce faulty reports as a result of ignorance, error or lack of effort. This was so 40 or 50 years ago and it remains so today.

There can be no professional justification for any appraiser—motivated by the desire to advocate for his client for monetary reasons or for other reasons of personal gain—to willfully and knowledgeably produce a dishonest appraisal.

For an appraiser to produce a faulty appraisal through ignorance, error, or lack of effort is just as inexcusable.

Faulty appraisals diminish respect for the appraisal profession. People tend to believe that all faulty appraisals are intentionally drafted because the appraiser seeks the reward of a high appraisal fee. This is not so. Undoubtedly, more appraisals are faulty because of lack of knowledge, skill, or application. This article will discuss the changing role of ethics today, covering both dishonesty and professional deficiencies, in contrast with the past.

ETHICS DEFINED AND APPLIED TO APPRAISERS

In its simplest terms, a violation of appraisal ethics is an act which has the potential of causing "damage" to another. To be unethical, an act does not necessarily have to do harm; it merely has to have the *potential* of doing harm as a result of unprofessional conduct by the appraiser. Herein lies one of the great pitfalls of some appraisers' thinking; that is, that an appraiser endeavors to determine if the unethical conduct will do harm (rather than asking whether it has the potential of doing harm). Since the entire appraisal profession (and, for that matter, all of business) is so much more complex today, there is more need than ever to define and adhere to ethical behavior which is in tune with contemporary professional standards. Proper behavior does not have the "built-in" potential of doing harm to others because of an improper act of the appraiser.

Appraisers deal mostly with empirical evidence. Because of this, some appraisers, by misuse of market data, can expose their true character in the performance of their work. The greatest evidence today of the merits of obtaining and keeping integrity can be found in the reputation of appraisers in every large city in the United States and in many small cities. Usually, people lacking a reputation for integrity or who are less than fully honest are not very successful.

Appraisers today have a more difficult time defining their ethical orientation. They may have a more difficult time recognizing the long-term benefits of total objectivity. Yet, they must endeavor to develop an attitude of importance toward their role in the economic picture which will protect them from the various temptations to be unethical.

THINKING THROUGH ETHICS

The traps of improper appraisal ethics can be demonstrated in an analysis of mortgage loan appraisals. We consider unethical behavior mainly from the standpoint of the borrower in mortgage loan situations because, unfortunately, these are the most frequent instances of favoritism; little thought is expended on the failure to adequately value properties and the economic waste and personal harm low appraisals cause.

The fundamental reason for the services of the real estate appraiser in the business of mortgage loans, imposes tremendous responsibility on the appraiser: Statutes and regulations of government dictate that financial institutions with fiduciary responsibility protect the shareholders by obtaining an objective appraisal. If the appraiser's intention is to render an estimate of value on as objective and impartial basis as possible, regardless of the parties involved, then the appraiser's responsibility should not be a burden.

On a practical basis, here are the "big picture" considerations of the mortgage loan appraiser in estimating the value of the property to be offered as security for the mortgage:

1. The borrower can benefit financially if the transaction is completed.
2. The bank will benefit if it is able to make the loan.
3. If this is a sale, the vendor will benefit.
4. The local economy will benefit from either the new project or the existing project.
5. All of the above considerations depend upon a "satisfactory" appraisal by the appraiser.

Obviously, the trap in the above thinking is the lack of consideration of the damage that can be caused if the appraisal is improper, either too high or too low. Ethical considerations of mortgage loan appraisals today mainly focus on too-liberal appraisals which can cause considerable loss to the lender. The recent losses of the savings and loan associations and banks have focused attention on too-high appraisals.

In addition to possibly causing a loss to the lender, ultra-liberal appraisals may result in an unneeded and eventually defunct project becoming a drag on the local economy. Furthermore, such appraisals can cause financial ruin to the borrower. Rather than benefit the borrower, the appraisal facilitates his downfall. Therefore, particularly in light of recent history of financial institution failures, it is more important than ever not to overestimate the value of the collateral.

Conversely, there is a very significant aspect of ethics involved in underestimating collateral. If an appraiser kills the deal by being unreasonably conservative, he causes an economic loss by frustrating economic progress. When the Resolution Trust Corporation was disposing of properties at bargain-basement prices, this tended to depress markets and to convert appraisers into what I refer to as "submarine commanders," meaning they appraised all properties very low. Many were unable to ascend to more realistic values once the RTC influence was gone and the market returned to normal.

SOPHISTICATED UNETHICAL BEHAVIOR

Decades ago, a prominent appraiser in our area advocated a high unit price of say $1,000 per acre for a rural sugar cane farm through which a pipeline was proposed. The total tract was over 1,000 acres. Value at the time likely approximated $275 per acre. The matter was litigated and the appraiser's value opinion became public knowledge. Unfortunately, the owner died a few months later. The value of the land for estate tax purposes was placed at $225 per acre by this same appraiser. The appraiser had great difficulty justifying his value of $225 per acre to the IRS. Today, such behavior could lead to dire consequences.

Oversight mechanisms since that time make it considerably more difficult to make faulty appraisals, either too high or too low. State appraisal licensing and certification, with their respective Uniform Standards of Professional Practice[1], contain the possibility of loss of the right to practice. Standards require that appraisal reports must be in writing or that the appraiser have support in the files. The appraisal report (or the files) must contain the data and logic upon which the value is estimated. Additionally, there are penalties in the Internal Revenue Code for some flagrant advocacy appraisals.[2]

ADVOCACY INSTEAD OF OBJECTIVITY

But, along with the above progress in regulating the profession and the more complex economic conditions today, there are additional opportunities to advocate. There are whole new fields of appraisal which require ethical consideration. In the area of environmental claims, damage to properties from pollution must be estimated. The effects of Electromagnetic Fields on property values are a new field of appraisal expertise. Class-action lawsuits in these and other fields present new ethical problems for real estate appraisers. The vital interests of the plaintiffs in these matters are a significant motivation for the unethical appraiser to advocate, and the plaintiffs' attorneys are ready, willing, and able to assist.

Apparently, there is more skill in advocacy today than previously. The unethical valuations that are most difficult to pinpont occur when there is limited or no comparable data. In situations where there is market evidence which varies somewhat from the property being appraised, sales adjustment manipulation is the sophisticated advocates' tool. Where there is no direct evidence to form a conclusion, the talented advocate has the most fertile field. Obviously biased judgments are difficult to disprove in limited-data situations.

A common advocacy ploy is to avoid bona fide comparable data and paired data, particularly when estimating impact damages of contamination and other property- damaging events. Sales data in the vicinity of the pollutant when compared with similar sales data far removed from the pollution source should define the market reaction to the pollution.

Since this is market evidence, it should be the best evidence of market value impact. If the evidence does not suit the client of the appraiser, the best evidence is ignored.

Even where bona fide comparable sales do exist and are used by advocate appraisers, these sales can be adjusted to achieve a desired result. For example, adjustments for time or market conditions are exaggerated. Location is a prime target for erroneous adjustments. Quality adjustments can also be manipulated.

Another form of advocacy used by unethical appraisers is the use of commonly accepted appraisal techniques to their advantage. For example, the duplication of incurable functional obsolescence and incurable physical deterioration is commonplace in the cost approach when de-escalating values in property tax cases. Likewise, economic obsolescence is the least provable form of accrued depreciation that can be exaggerated in these same cases. Non-market capitalization rates are applied in the income approach to inflate values for owners in condemnation appraisals. The best comparable sales are passed over and different sales data are used to support the advocacy in the directsales-comparison approach. The ultimate resort is the use by advocate appraisers of judgment and experience only to justify their false values.

Therefore, along with more complex real estate economics and governmental influence on market value, there also has been progress in appraiser advocacy techniques. It is therefore more important than ever to articulate the data and the logical application of data to avoid the appearance of impropriety. In our litigation appraisals, for example, we insert into the appraisal report what we call "defense comparables" to indicate first that we know about them, and second why they are not reliable comparables. This is a disarming revelation to those who would use these sales.

THE MOTIVATION OF ADVOCACY

Socrates suggested that no thinking person acts in an unethical manner because, if he were knowledgeable, he would know that dishonesty does not pay. My late father and I argued for years over the motivation of those we felt had done faulty appraisals. His leaning was that they were, in fact, crooked and knew they were dishonest. My inclination was that they were merely ignorant about moral values. Neither of us was totally correct. Neither of us had encountered the amoral individual who had no comprehension of wrongdoing or ever felt the slightest guilt.

Self-interest of appraisers comes in many forms. Many observers of our profession believe that appraisers are "bought off" with money to perform their advocacy appraisals. Not always so. Perhaps the biggest temptation for an appraiser to produce an unethical conclusion is the prospect of gaining his client's future work, either from that client or others needing the same results. Another seemingly simplistic, but very human, reason is the simple desire to please the client.

The part that psychological rationalization plays in advocacy appraising is not small. Rationalization provides plausible but untrue reasons for conduct and attributes one's actions to rational and creditable motives, without analysis of true and especially unconscious motives. An advocate appraiser migiht disagree with the method of fixing just compensation in a condemnation case and "load the value" to overcompensate the property owner because of the seeming inequity of the law, a sort of Robin Hood motivation. A Robin Hood appraiser may also "low ball" the assessment value because he believes taxes are too high.

Finally, there are a few appraisal advocates who charge exorbitant fees to advocate for their clients, i.e., they do it for the money. However, such advocacy is not ultimately rewarding. In my experience, those who unethically advocate for their clients do so at meager fees more often than otherwise. Perhaps they erroneously feel that there is no ethical violation because the fee is low.

The character of individuals is a result of their heredity and their personal upbringing. Family attitudes play a significant part in the makeup of appraisers, as do the attitudes of associates. The part that education, radio and television, and even recreation have on our ethical attitudes is most significant. The total impact of all these factors upon our native intelligence determines our attitude and our ability to discern the relative merits of ethical decisions. As Aristotle said, "However precise biological or psychological definitions may be, man varies as moral agent and as citizen according to environmental determinations, educational background, and the influence of family, economic position, social class, means of livelihood, and even the associations of his casual leisure."[3]

Pre-World War II generations claim their contemporaries were raised with more training in honesty and truth than the baby-boomer, "me" generation. The prosperity and increased standard of living over the last 50 years, coupled with more government involvement in business, has resulted in more political and business corruption and more publicity about it. Increased governmental regulations and controls over our civilization, particularly the IRS Code, have increased our propensity to dishonesty. All of this has resulted in great cynicism, and it has likely distorted the perspective regarding ethical business practices of many. Despite all possible reasons to make it understandable why an appraiser might write a dishonest report, one cannot permit cynicism to replace objectivity without diminishing greatly the integrity of the profession.

IGNORANCE, ERROR, AND LACK OF EFFORT

Decisions by well-intentioned appraisers which result in an erroneous act can be the result of ignorance, error, or lack of effort. The possibility of such decisions are much more likely today than previously because appraising real estate is so much more complex. Consider these general areas of need for expertise which did not exist 40 or so years ago or have been radically changed:

1. Financing. There was VA, FHA, and conventional financing, all at relatively close mortgage interest costs. REITS, syndications, limited partnerships, and intricate tax-avoidance schemes did not exist.

2. Standards of Professional Practice. Today, various regulations of the Appraisal Foundation and the Appraisal Institute dictate methods and procedures of appraising and appraisal reports which must be followed.

3. Sophisticated Income Capitalization. As late as the Fourth Edition in 1964, The Appraisal of Real Estate covered direct, sinking fund, residual and annuity capitalization only.

4. Governmental Influence. Condemnation law and jurisprudence, Internal Revenue Code, wetland regulations, local zoning, subdivision and building regulations, and numerous other governmental activities are substantially more complex than they were years ago.

5. Pollution. The condition of a property has always affected its value; however, there were no Federal regulations relating to asbestos, lead paint, chemical waste products, and other contaminants for which the purchaser might have to pay dearly today.

Following are some major examples of federal laws affecting appraisals today which did not exist even 20 years ago:

Comprehensive Environmental Compensation and Liability Act (CERCLA 42 U.S.C. 9601 et seq., 1980), as amended by the SuperFund Amendments and Reauthorization Act (SARA, 42 U.S.C. Paragraph 9601 et seq. 1986);

The Resource Conservation and Recovery Act (RCRA, 42 U.S.C. Paragraph 6901 et seq.);

The Toxic Substances Control Act (TSCA, 42 U.S.C. Paragraph 2601 et seq.);

The Emergency Planning and Community Right-to-Know Act (EPCRA, 42 U.S.C. Paragraph 11001 et seq.);

The Clean Air Act, (42 U.S.C. Paragraph 7401-7642);

The Clean Air Act, (42 U.S.C. Paragraph 1251 et seq.)[4]

The Housing and Community Development Act of 1992, Public Law 102-550.

Back in the "good old days," there was less to be ignorant about. The net results of faulty appraisal because of ignorance are no different now as opposed to then; there are just more detailed matters about which to make mistakes. The burden on neophytes entering the appraisal field is enormous today as compared with 40 or so years ago.

Faulty appraisals as a result of ignorance may come from the appraiser's lack of knowledge of certain aspects of financing, environmental regulations, and governmental laws or regulations. There is no excuse for ignorance about standards of professional practice or the use of reasonable techniques of income capitalization, these are fundamental to all appraising. There should be no reason other than pride that appraisers who want help with technical matters, particularly with the appraisal of unfamiliar types of properties, cannot obtain such help from their fellow appraisers. Every appraiser worth being labeled "professional" should be, and usually is ,willing to help his or her fellow appraisers.

Errors in appraising can be committed within the framework of the greater amount of detail required in appraisal reports today and, therefore, are considerably more likely than in days past. Consider income capitalization, for example. Valuation error is more likely with spread sheet parameters and execution than with direct, residual, or annuity capitalization. This is particularly true for appraisers attempting different scenarios, which the computer allows them to do.

Mathematical errors today may be fewer in the execution of given programs since the computer does the calculations.

Unfortunately, the computer cannot read the leases, check income and expense statements, reach conclusions as to the rate of escalation of income/expense which is market oriented, or input changes in variable percentages for future projections. The appraiser must put in the effort to complete this necessary analysis.

Faulty appraisals as a result of lack of effort are much more likely when more effort is needed. Faults as a result of lack of effort stem first from the appraiser not obtaining the best comparable data for all three approaches. Secondly, they stem from inadequate efforts to relate the data. And, lastly, they stem from contradictions within the report content. Lazy people do not make good appraisers!

The extent and repetitiveness of report requirements of many financial and governmental institutions for a full narrative report are still an amazement to me. Because many aspects of the appraisal are repeated in various sections of the report, this leads to greater possibilities for inconsistencies. The sheer effort to produce these monumental "demonstration-type" reports deters the appraiser from concentrated effort to produce the most meaningful value conclusion. So, lack of effort may result from a combination of concentration on the report-production requirements by the appraiser rather than the appraisal value, plus the potential error of contradictions in these extensive reports.

Appraisers endeavor to excuse a lack of effort on the size of the fee or the lack of sufficient time to do adequate research. Appraisers also blame incompetent help for faulty work. The Standards of Professional Appraisal Practice rule these out as legitimate excuses for poor work.[5] Whatever assignments are undertaken, the contents are the responsibility of everyone who signs an appraisal report. It would be difficult to find an appraiser who has publicly placed the blame for a faulty report on himself and his laziness. Undoubtedly, however, many appraisers have admitted to themselves this shortcoming. An appraiser cannot be lazy in learning applicable regulations, coordinating his own judgment with technological improvements, or seeking advice in areas where his expertise is lacking. Faulty reports due to negligence are just as harmful to the profession as intentionally dishonest reports.

PRACTICAL GUIDELINES TO MAINTAINING PROFESSIONAL STANDARDS

Today, more than ever before, appraisers perform a useful and necessary function in our economic system. This being the case, the first requisite of the appraiser to recognize his or her worth is acceptance of the role of being a servant to the client. What are the legitimate needs of the client? How can I assist the client in reaching his or her primary objective? Appraisers can and should relate to the clients in such a way as to have empathy for their legitimate goals.

Included in ethics is not wasting the client's money. For example, if the client says she needs an appraisal, but in reality all she needs is counseling advice, the appraiser should not do a full, formal appraisal. If the client requests a conditional appraisal based upon a condition which the appraiser feels is unattainable, the appraiser should reject the job. Ethics begins with full knowledge of the service needs of the client.

Once the purpose of the service to be performed is determined, there needs to be a clear understanding of the fee arrangement. Ethics is also involved in fee arrangements. It is unfair to the clients to take advantage of them and it is unfair to yourself to value properties without being adequately compensated. The appraiser should establish up front what other expertise is needed to perform the service, such as cost estimators, specialists in the particular industry (such as shipbuilding), certified public accountants, and what this additional expertise will cost the client. It is most important to delineate all of these to the client, especially to attorneys in litigation cases, prior to accepting the assignment.

My firm does free appraisals, but these are for charities or pro-bono agencies. In connection with fees, we do charge a much higher fee when the time constraints are very limited. On flat-fee jobs, our rates are set both on the amount of work involved and the importance of the task. For example, our fee is higher when the assignment involves the possibility of litigation.

The appraiser should make clear to the client that the value conclusion is going to be objective, unbiased, and fair, not only to the client but also to any other interested party. It may be uneconomic, but the appraiser should gain a measure of self-respect and pride in urging the client to seek another appraiser if, in fact, the client expects other than a reasonable, objective value conclusion. Clearing the air up front makes breathing easier throughout the entire client/appraiser relationship.

Appraisers may be faced with a client who disagrees with the value findings. Clients today are considerably more sophisticated than three decades ago. The ethical appraiser will first listen to and endeavor to understand the position of the client. Many appraisers make the tactical error of defending their position even before understanding their client's objections. Sometimes the client has a legitimate argument. If the client's position is either capricious, or one of advocacy, the appraiser can retain the ultimate feeling of integrity by holding his or her position.

At times, appraisal reviewers with considerable experience and skill will have differences with the appraiser. Appraising is an inexact science. If the differences are over technical matters, this usually can be resolved without any loss of integrity. If the differences are a matter of judgment, then the appraiser who is sure of the original report conclusions can stand steadfast. Appraisers need not substitute the judgment of the reviewer for their judgment.

For example, a dispute arose over a significant appraisal submitted to a federal agency in Washington, D.C., by myself and an associate. Our presence was required at a meeting at which the government review appraiser and the Justice Department attorney who disagreed were present. The head of real estate of that agency requested that the review appraiser and attorney for the Land Division of the U.S. Justice Department delineate their claim. It was, as you might expect, that our appraisal was too high and we were paying the landowner too much. When asked to reply, I urged the chairman of the meeting to ascertain if there was any data omitted from the report or any aspect of the report other than judgment for which they dissented. The review appraiser and attorney replied there was not. To this, I inquired if their only beef was with my judgment. They replied, "Yes." My answer was that the government had paid for our judgment, not theirs. I did not avow our judgment to be impeccable; however, I did indicate it was ours and we stood pat. The agency head, a man of practical wisdom, indicated that he stood by us and that the meeting was closed.

DEVELOPING ETHICAL HABITS

Appraisers who are truly aware of the significant role they play in the economics of this country should develop an attitude of objectivity, impartiality, and honesty which permeates their total professional career. This basic orientation should tactfully be a part of client relationships and be evidence of the appraiser's character. Integrity means that appraiser cannot be bought, coerced, or made to give anything other than a fair conclusion in all assignments.

What results from total ethical behavior is not only a feeling of self-worth, but also self-satisfaction. There is no justification for an appraiser taking any but the high road. This requires not only high principles, but diligence, in order to avoid faulty appraisals based on ignorance, error, or lack of effort.

The ability to maintain an impeccable reputation requires the avoidance of ignorance. It does not matter that the faulty appraisal was a matter of ignorance on the part of the appraiser rather than a dishonest act, the appraisal is still faulty. Those using or knowing of the appraisal may not be aware of why the work is bad. Appraisers can avoid faulty appraisals as a result of ignorance by seeking advice and help from other appraisers or experts.

Errors of technique or mathematics are, at best, sloppy. Professionals in any field have only time and talent to sell. If the appraiser allows this type of work to impinge on the appraiser's reputation, then public perception of the appraiser's ethical orientation may suffer. International Business Machines had a slogan years ago which merely said "Think." There is logic to all valuations where adequate concentration and thought is demonstrated.

Lack of effort is dishonest in that it cheats the client of the appraiser's best efforts. Getting by is a mark of a lazy appraiser. Even if the value conclusion is correct, this may not be of as much service to the client as an appraisal with the most relevant comparables, the tidiest adjustments, the most accurate income and expense projections, and so forth.

The appraisal of real estate today is considerably more complex than it was three, four, or five decades ago. Add to this the various governmental and organizational rules and requirements of the appraiser, and the role of ethical behavior is more demanding today than ever. What the appraiser does reflects not only on his work but also on the professional generally. The bad publicity of the savings and loan and bank problems a few years ago was not good for the profession. The Standards of Professional Appraisal Practice is evidence of the expanding role of ethics.

The more things change, the more they are the same. Even though the profession and various governmental regulatory bodies have formulated standards, what Socrates thought still holds true: "Man needs to know true good and not confuse it with anything else, so as to keep from using strength, health, wealth, or opportunity wrongly. If a man has this knowledge, he will always act on it, since to do otherwise would be to prefer known misery to known happiness ... knowledge of good is the one knowledge of which it is impossible to make an ill use; the possession of it is a guarantee that it will always be used properly."[6] ❑

NOTES

[1] Most states have accepted the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Standard Board of the Appraisal Foundation (1985) with modifications in some cases.

[2] Internal Revenue Service Code, Section 6662 (1982) Accuracy-Related and Fraud Penalties. "Substantial valuation misstatement" is identified as 200 percent or more (or 50 percent or less) of the amount determined...to be the correct amount.

[3] *The New Encyclopedia Britannica*, 15th Edition, 1983, Volume 1, p. 1170.

[4] Bowen P. Weisheit, Sr. "Will New Environmental Laws Redefine Just Compensation," *The Appraisal Journal*, January 1992, p. 59-67

[5] USPAP, op. cit. - competency Provision, page 4 and Standard 1, page 11.

[6] *Encyclopedia Britannia* - Macropodia, 15th Edition 1983, Volume 16, p. 1004.

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