

Professionalizing Appraisal Reports

by Harry Yasumoto, Ph.D, MBA, SREA, MAI

Harry Yasumoto is vice president of real estate services for Mid-State Bank in Arroyo Grande, California. He has been an instructor for leading real estate appraisal organizations for two decades. He is a charter member of IRWA Chapter 47.

INTRODUCTION

The formation of the Appraisal Foundation, under U.S. regulations, is having an international impact. A new era for the appraisal profession has commenced, which brings about an opportunity to make some long overdue changes for real estate appraisal reports. Since new guidelines are being formulated for state licensing, classroom instruction and seminars, it is a good time to address concerns about future appraisal reports.

The purpose of this article is to improve a vital element of the appraisal profession, that being the important task of communicating the appraisal. The recent problems of many financial institutions, especially savings and loan associations, were in part blamed on shoddy appraisal reports. Whether the accusation was justified is not at issue here. The question is whether the reports can be improved. By most measures the answer is undoubtedly, "Yes." This article addresses some of the current concerns and recommends solutions. Those preparing guidelines, lesson plans and regulations may adopt many, if not all, of the suggestions. More significantly, it is hoped they will recognize some of the shortcomings in existing appraisal reports and report writing guidelines as well as seminars and courses on report writing.

This article is divided into a "Terminology Section" and a "Report Section." There will be some duplications in the two sections that is intended as meaningful emphasis rather than redundancy.

Terminology Section

VALUE DATE

The term *effective date*, which means the date of value in regard to appraisal reports, has recently surfaced. However, the term can be confusing since a reader might conclude that it means the date the report was completed, the date research was completed, or the date the assignment was accepted. *Value date* is a more definitive term than *effective date*; it is more explicit and therefore creates less confusion.

Date of value is also a good term. However, some appraisers feel the term is awkward, so *effective date* was coined. Overall, *value date* is the better term; it is concise and generally more appropriate than the other terms.

OBJECTIVE

The term *purpose* is currently used to describe the goal of the appraisal to estimate values. This author believes that *purpose* should be replaced by *objective*. The objective of the appraisal is to estimate values such as market, liquidation or leasehold. The term *purpose* has a better use for appraisals as recommended in the following segment.

PURPOSE

The term *function* has been used by appraisers to describe how the appraisal is to be used. *Purpose*, however, is more appropriate. Appraisals are used for many purposes including insurance, assessment and sales. Therefore, *purpose* describes the use of the appraisal more clearly than *function*.

METHODOLOGY

The term *scope* is used by some appraisers, and there is confusion as to what it includes. They are confus-

ing *scope* with the *appraisal process* and *valuation process*. The intent of the first use of the term *scope* probably refers to how the data was gathered and the extent to how much data was gathered. Most appraisals should not require an additional section to cover *methodology*, since the "Valuation Process" section should normally address this matter adequately. However, if certain appraisal assignments require more than the normal text on data gathering, *methodology* is a better term to use than *scope*. *Methodology* explains how the data was gathered and sets parameters for the study or report, and is a more definitive term to use in an appraisal report.

COMPENDIUM

The use of "Summary of Important Facts and Conclusion" as a section heading is rather cumbersome. "Compendium" is a better choice; it means a summary of important facts in outline form. Optional headings for this section of the report are "Precis" or "Synopsis."

PHYSICAL

Recently, in regard to forces that affect value, some appraisers have used the term *environmental* along with political, economic and social forces. The term *physical* is a better choice because it is more explicit, referring to tangible features that affect value such as rivers, soils and streets. *Environmental* is too broad a term. You can have a political environment, an economic environment, a social environment as well as a physical environment. The term *environmental* can include all four forces which can lead to confusion.

MOST PROFITABLE USE

Highest and best use is a complex term. It appears to be redundant. It is contradictory in that the highest may not be the best, and visa versa. What

the vast majority of appraisers mean by highest and best use is the most profitable use. Then why not use the term *most profitable use* instead of highest and best use, and remove the nexus between highest and best.

It is possible that the term highest and best use evolved from the courts or the legal profession. If so, it is time for the appraisal profession and academicians involved in real estate appraisal to take control and replace this nebulous term with most profitable use.

Along with replacing highest and best use with most profitable use, another recommendation should be made. Recently, a new test in estimating the most profitable use has evolved in addition to the tests of what's legally permissible, economically feasible and physically possible. That new test is what's maximally productive. Many appraisers had some reservations about this test when it was developed because it really is a part of the other three tests (legal, economic and physical). With the use of the term most profitable use, the test of what's maximally productive becomes inherent and therefore needs not be singled out; it becomes a part of the tests of legally permissible, economically feasible and physically possible.

However, in lieu of the maximally productive test, there is one other test which is recommended. That test is one of being socially acceptable. In today's environment, the public at large is becoming so involved in planning and building that the test of being socially acceptable should be considered in arriving at the most profitable use. For example, in some jurisdictions, society demands what building materials should be used, the style of architecture in the design, the quality and quantity of landscaping, and even the type and color of paint to be applied. Consequently, it

is time to include the test of being socially acceptable among the tests for the most profitable use.

VALUATION PROCESS

Normally, narrative appraisal reports include a section entitled the "Appraisal Process" before the discussion of the three approaches to value. This section seems to be more than necessary in reports and is considered by some as giving away trade secrets or professional "know how." The accountant does not explain what steps are taken in preparing an audit report. The doctor does not give you a step-by-step process of how a conclusion is reached in a complicated illness. In any event, if this section is used, it should be called the "Valuation Process." Some appraisers, be-

cause of the term *appraisal process* used in guidelines, describe this section by defining the problems, gathering the general data, gathering the specific data, and then include the three approaches. This becomes very cumbersome and was probably never intended to be the focus of this section. There is more discussion about the "Valuation Process" section in the "Report Section" of this article.

DIRECT SALES APPROACH

Some time ago, the term *market data approach* was replaced by *direct sales comparison approach*. The reason given was that all the approaches used market data and, therefore, direct sales comparison approach was the better term. The concept for the

Continued on Page 18

RIGHT OF WAY	SERVICES
JAMES DANIELS & ASSOCIATES, INC. 210 WEST SIXTH STREET, SUITE 506 FORT WORTH, TEXAS 76102 (817) 338-0221 -- OFFICE (817) 877-0921 -- FAX	<ul style="list-style-type: none"> ◆ ENVIRONMENTAL STUDIES ◆ ABSTRACTING OWNERSHIP RECORDS ◆ RIGHT OF ENTRY ◆ SURVEYING ◆ APPRAISAL SERVICES ◆ APPRAISAL REVIEW ◆ NEGOTIATIONS ◆ RELOCATION ASSISTANCE ◆ EXPERT WITNESS TESTIMONY ◆ PROJECT MANAGEMENT ◆ PROJECT IMPACT STUDIES <p style="text-align: center;">COMPLETE TURN KEY RIGHT-OF-WAY ACQUISITION SERVICES BILLY R. STEWART, P.E., DIRECTOR</p>

Professionalizing Appraisal Reports

Continued from Page 17

change was good. However, all the approaches also use a comparison technique. Consequently, the word comparison seems inappropriate if the concept from the original change is applied. Therefore, the term *direct sales approach* or *sales approach* is recommended in lieu of *direct sales comparison approach* or *sales comparison approach* as used by some appraisers. Direct sales or sales aptly describes how the approach is different from the cost and income approaches. It also shortens the name of the approach. Along these lines, the use of the term *income approach* is suggested instead of the term *income capitalization approach*.

ECONOMIC BONUS

A few years ago, the term *entrepreneur's profit* started to appear in the cost approach. This apparently was initiated to reconcile the differ-

ence between the normal cost approach and the direct sales approach, especially for single-family residences. When the economy was booming, the supply could not keep up with the demand, so a gap was created between the two approaches. The gap was created by economic conditions, so this difference should be called an *economic bonus* to the builder or developer. When the housing market reflects an over supply, the builder or developer may be willing to lower the ordinary profits to maintain the crew of workers and other overhead costs to keep the business going. In such a case, an *economic loss* may be an appropriate adjustment to apply to reconcile the cost and direct sales approaches. Economic bonus is a better term than *entrepreneur's profit*, since one would think *entrepreneur's profit* would apply not only in the cost ap-

proach, but also to buyers in the direct sales approach and investors in the income approach. Since the lag in the building trades creates the gap, the condition is more aptly described by the term *economic bonus*.

VALUE CONCLUSION

The term *reconciliation* connotes correction or compromise of figures or facts to arrive at a balance. It has somewhat of a negative connotation, since it implies that the "Reconciliation" section of the appraisal report adjusts concepts or figures to arrive at a single figure that can be comfortable from all approaches. In reality, this exercise is nearly impossible and is seldom, if ever, done. Hence, the term *value conclusion* is suggested as the title for this section. Other sections of the report should develop *indicated values*. However, if value conclusions must be used in other segments of the appraisal report, the subject section could be entitled the "Final Value Conclusion." Because this can become somewhat confusing, the terms *indicated values* and *value conclusion* are preferred.

All of the terminology changes suggested above should lead to a more understandable and effective report. They also should improve the appraisal language for daily communications, both orally and in writing.

Report Section

TRANSMITTAL LETTER

Despite many years of arguments by leading appraisal organizations on whether the transmittal letter should be inserted before the title page of the appraisal report or after it, this article recommends that the transmittal letter not be part of the report at all. The letter should be used as its title suggests: to transmit the report, as other transmittal letters are used. It should be separate from the report, i.e., a loose document outside the cover of the appraisal report. If there



Right of Way Appraisal Specialists

Allen, Williford & Seale has been providing appraisals on right of way projects since 1977. Our staff is committed to thorough quality reporting within the time constraints of your project. Right of way organizations across the country rely on **Allen, Williford & Seale** for complete appraisal services. Call us on your next project.

- Appraisals
- Impact Studies
- Market Studies
- Expert Witness Testimony
- Litigation Support
- Appraisal Review & Management
- Training & Seminars

Allen, Williford & Seale

14925 Memorial Drive, Suite 200
Houston, Texas 77079
713/493-4444

Serving State, Federal, Local Agencies;
Pipelines; Utilities; Communications;
and Private Industry

is reason to draw attention to a certain part of the report or explain a unique situation within the sections, an introduction, a preface or a foreword section is recommended for the report. This would also allow an appropriate place for acknowledgments when necessary. The introduction, preface or foreword section should be placed after the title page, but before the table of contents.

ASSUMPTIONS AND LIMITING CONDITIONS

This article has two basic suggestions for the "Assumptions and Limiting Conditions" section of the appraisal report. First is placement; instead of inserting the section near the end of the report as many appraisers do, it should be placed in front, right after the table of contents. The client or reader has a right to know all the assumptions and limiting conditions on which the report was based prior to reading its content and conclusions. This will prevent any surprises as one reads the report in its entirety. The second recommendation is to separate "Assumptions and Limiting Conditions" into two sections called "Special" and "General." The "Special" section would be items that are peculiar to the subject appraisal for some reason or another. The "General" section would include items that usually apply to all appraisal assignments.

COMPENDIUM

As discussed in the "Terminology Section" of this article, the title "Compendium" is recommended in lieu of "Summary of Important Facts and Conclusions." This enhances the content and appearance of the appraisal report.

TAXES AND ASSESSMENTS

The "Tax and Assessment" section in many reports are often over-emphasized. This is especially true when considering the limited number of times the appraiser concludes the

taxes and assessments for the subject property are not typical and has a special impact on the value of the property. Some appraisers seem to utilize this section to expand the appraisal report with verbiage that has a minimum of significance. In fact, except in special cases when the taxes and assessments are not considered typical, it is recommended this section be eliminated and be included in a section entitled "Operating Costs." The "Operating Costs" section should include the annual taxes and assessments as well as costs of other items needed to operate and maintain the property. These items would include such costs as water, sewer, electricity, natural gas or propane, and garbage and/or trash hauling fees as a minimum. Other costs to consider for possible inclusion are telephone service, cable television service, landscape maintenance, and even paint-

ing if these expenses are lower or higher than what is considered typical for the area. The appraisal reports on income properties usually cover the operating costs rather adequately. However, to have a summary page or two of the items in outline form under "Operating Costs" would provide a quick reference of significant information to the client. A three- to five-year history with comments on future trends would be helpful.

In single-family residential reports, operating costs are often overlooked or not stated except for taxes. Since most buyers or renters are interested in these costs, they should have more emphasis in residential reports. Having a section entitled "Operating Costs" would allow for quick reference for readers to ascertain this valuable information.

Continued on Page 20

LINDERLAKE CORPORATION

FIELD SERVICES GROUP

"Service You Can Count On"

Committed to servicing the Telecommunications Industry, Public Utilities, State and Local Governments, and Private Industry from Coast to Coast.

CALL or WRITE for our Statement of Qualifications regarding:

REAL ESTATE DIVISION

Right-of-Way Negotiations
Title Searches
Fee Purchases
Permitting
Appraisals
Relocation Assistance
Records Management
Lease Acquisitions
Site Acquisitions
Tower Site Acquisition
Tower Site Disposition

ENGINEERING DIVISION

Telecommunications Design
Computer-Aided Design/Drafting
Feasibility Studies
Design and Plan Preparation
Construction Management
As-built Recording/Archiving

OSP SERVICES DIVISION

Underground Facility Locating
Route Surveillance
System Audit
Right-of-Way Maintenance

12855 South Cicero Avenue • Second Floor • Alsip, Illinois 60658
Telephone Number: (708) 385-5855 • Facsimile: (708) 385-5875

Quality Licensed or Experienced Professionals Encouraged to Apply
EQUAL OPPORTUNITY EMPLOYER

Professionalizing Appraisal Reports

Continued from Page 19

MOST PROFITABLE USE

The "Most Profitable Use" section of the report requires several recommendations that suggest improvements for both the appraiser and the client. Briefly, the report writing guidelines for this section include a definition of the section heading, analyzing the most profitable use as if the property is vacant, and also as if the property is improved. Some thought should be given to possibly eliminating the "as vacant" analyses for this section of the report, especially for income properties since it really involves a feasibility study which could become more comprehensive than the appraisal report itself. It should be a separate assignment from the appraisal. Most appraisals do not call for a value different than the property that is currently improved. Therefore, except in unique situations, "as vacant" analyses for appraisal reports should be excluded as it seems to have a minimum of value. As discussed in the "Terminology Section" of this article, the four tests to develop the most profitable use as vacant and as improved should be legally permissible, economically feasible, physically possible and socially acceptable.

These first few recommendations are focused on the single-family residential appraisal report. Addressing the matter first as vacant, there really is not an enormous amount of discussion required to arrive at a conclusion, especially if the site is zoned for single-family residential use and the surrounding properties are improved with single-family residences. This is another reason to eliminate "as vacant" studies in appraisal reports. When addressing the most profitable use as improved, a more comprehensive analysis is warranted. The discussion should consider such items as size, number of bedrooms, architectural style and garage size. The analysis should include all of the four tests.

The recommendations for income properties differ somewhat, especially when focusing on the "as vacant" portion of the problem as currently in vogue. The zoning for income sites generally allow for a wider variety of uses than in single-family residences. Consequently, the legally permissible test requires a more comprehensive discussion. Of course, the other three tests should be analyzed to arrive at a convincing conclusion. When addressing the "as improved" aspect of the problem, the emphasis generally switches from the legal question to the physically possible test. The economically feasible and socially acceptable tests also play significant roles in the "as improved" analysis.

The "Most Profitable Use" section of the appraisal report can allow a tremendous amount of analysis to be conducted. A variety of uses can be addressed, numerous sizes of units can be considered, market surveys can be conducted, feasibility studies can be completed and the possibilities can be virtually endless. However, the appraiser must use good judgment as to the extent of the analysis to be conducted to be able to arrive at a reasonable and convincing conclusion. This section of the appraisal report is used by some appraisers to unnecessarily expand the content of the report. This portion of the appraisal report appears to require as much emphasis as any in report writing classes or seminars to provide the proper perspective for appraisers. The quality and quantity of data to use and the number of analyses to apply are often a dilemma for the naive as well as the more experienced appraisers and analysts.

VALUATION PROCESS

The "Valuation Process" section of the appraisal report should not be called "Appraisal Process" as is often done by appraisers. The purpose of this section is to let the reader or cli-

ent know the steps taken in the three valuation approaches and what was done to arrive at a final value conclusion. This section should not include text on defining the problem or gathering the data and should not be called the "Appraisal Process" section.

Some appraisers confuse this section with the "Value Conclusion (Reconciliation)" section. One should keep in mind that the "Valuation Process" section is prescriptive in nature. That is, it conveys what you will be doing. The "Value Conclusion" section, however, is descriptive in nature; it conveys what has been done.

As discussed in the "Terminology Section" of this article, one might question whether the "Valuation Process" section is a necessary part of a report. If it is retained, the above changes for this section are recommended.

CERTIFICATION

The "Certification" section of the appraisal report is usually well written except for one major flaw. Many appraisers do not include the property value and the value date. It seems the value date and property value are an essential item in the "Certification" section. Some report-writing guidelines do not include the value or date of value as part of the "Certification" section. Perhaps it seems too obvious to the authors of these guidelines.

EXHIBITS

Appraisal report exhibits such as photographs, maps, plans and charts should be inserted where they are discussed in the report rather than placed in an "Addenda" section. This method allows the reader to more conveniently refer to the exhibits. The "Addenda" section should be used only for superfluous information or for items that may be awkward to present in the main body of the appraisal report.

Just Compensation


A MONTHLY REPORT ON EMINENT DOMAIN

All pages in the report should be consecutively numbered, including pages with maps, photographs and plans. "Addenda" section pages also should be numbered. It is unfortunate to see so many reports with pages numbered incorrectly. With the abundance of paraphernalia at one's disposal for preparing graphics, maps and plans, exhibits should be completed in a neat and legible manner. All maps and plans should include an arrow pointing north in the proper manner.

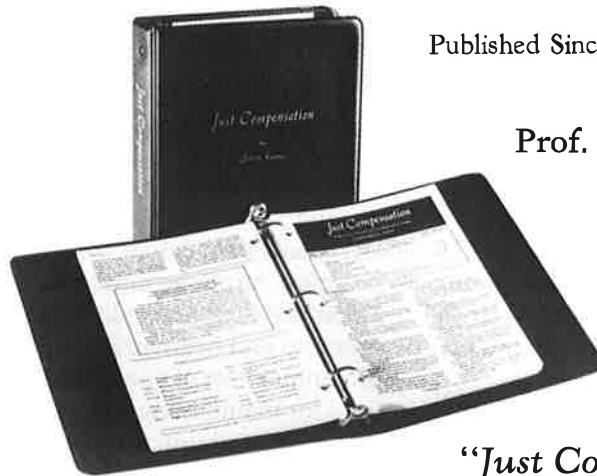
PROOFREADING

Proofreading of reports is a vital step in the report writing process. It is recommended that each section be proofread separately when completed. Then, the entire report should be proofread as a whole. If time permits, it is suggested that the report be set aside for a few days and then the writer proofread it again after some time has elapsed. Proofreading should consist of checking for grammatical, typographical and mathematical errors. The appraiser should be cognizant of the fact that all the excellent work in completing the appraisal assignment can be negated by a report that consists of numerous errors.

CONCLUSION

If better solutions than those suggested in this article can be developed, the better for the appraisal profession. If this article challenges others to write or motivates appraisers to adopt and institute higher standards, it will have met its goals. Perhaps a renaissance for practical and improved report writing will develop. 

Published Since 1957



Prof. Gideon Kanner
Editor

"Just Compensation" is a monthly reporting service that provides summaries of reported court cases on eminent domain, inverse condemnation and relocation assistance. It also brings news of seminars, articles of interest in professional journals, and new books.

"Just Compensation" keeps you informed of the latest developments in eminent domain valuation and inverse condemnation liability. You get prompt, concise and accurate information each month, by first class mail.

If you work as a right-of-way acquisition professional, appraiser or lawyer, you can't afford to be without this handy source of information that has given the edge to its readers for the past 35 years.

SPECIAL INTRODUCTORY OFFER to new subscribers

To try "Just Compensation" for one year at ONE-HALF the current \$95.00 subscription rate, send \$47.50 or your purchase order to:

Just Compensation
P.O. Box 5133
Sherman Oaks, CA 91403

You get a FREE binder (\$6.00 value) if your payment is sent with your order.