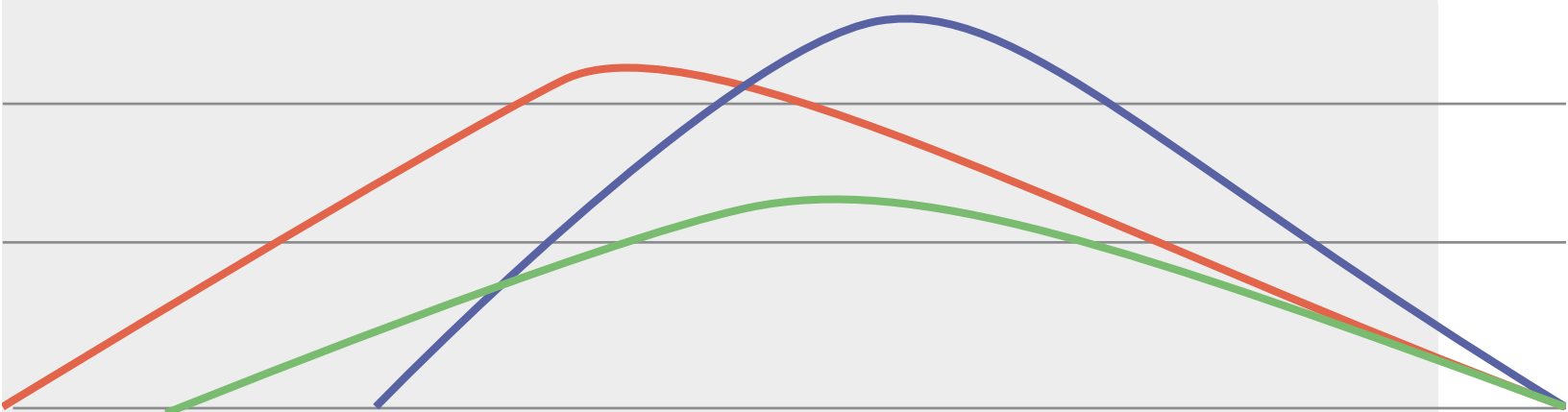


Three **Similar** Appraisers



Three **Different** Values

Can “grading on a curve” help explain these variances?

BY SHAWN WILSON, MAI

In January, I attended an informative session at the Federal Agency Update (FAU) titled, “Appraisal and Acquisition of Real Property Needed for Airport Development.” One of the presenters told a right of way war story about a parcel needed for an airport project. The property was considered a “whole take.” The site had been appraised by three different MAI appraisers, and each had come up with drastically different estimates of market value. The values were estimated at \$800,000, \$1,200,000 and \$1,500,000.

Following the presentation, someone asked, “How could three persons with similar credentials arrive at such divergent values? And why didn’t the correct appraiser report the two who provided incorrect and/or biased opinions of value?”

With roughly 30 participants in the session—comprised of MAIs, right of way agents, FAA personnel, attorneys and others—you can just imagine the variety of responses. Several were of the opinion that the \$1,500,000 appraiser should be turned over to his state’s certification board for investigation and eventual punishment, as well as to the ethics department of the Appraisal Institute. Others had a similar opinion about the \$1,200,000 appraiser. The appraiser with the \$800,000 opinion of market value did not receive as much air time in the discussion.

Certain veterans from acquisition and law felt that the \$1,500,000 and \$1,200,000 appraisers were hired guns. They speculated that the appraisers had unrealistic opinions about supply and demand characteristics in the neighborhood, overly optimistic highest and best use analyses, and even pie-in-the-sky ideas about probability of re-zoning. Most readers of Right of Way magazine have likely encountered similar situations and could provide one or more good war stories of their own.

Date of Valuation

There was also a discussion about situations where appraisal opinions concerning the same property can legitimately diverge. One common reason in past years has been effective date of value. In some areas, when the real estate market was booming, the market value of a property could have been \$800,000 one day and \$1,200,000 just one year later. Within eighteen months, that same property could have been valued at \$1,500,000, given the explosive appreciation occurring in some property segments. The market can decline in much the same way after a boom cycle as well.

\$800,000
\$1,500,000
\$1,200,000

Hypothetical Conditions

According to the 2008 edition of Uniform Standards of Professional Appraisal Practice (USPAP), a hypothetical condition is, “that which is contrary to what exists but is supposed for the purpose of analysis.” Different appraisers who value the same property using the same effective date of value could reach widely divergent market value opinions if one or more of them were operating under such a condition.

For instance, in some urban markets, the ability to begin construction of improvements is tied to the availability of public water and sewer. The question of whether such facilities are available does not always have a simple yes or no answer. In a market experiencing rapid construction, adequate water and sewer capacity may exist on the effective date of value, but may be held in reserve by one or more developments which have been approved for (but have not yet commenced) construction. In order to remove that “moving target” from the negotiation process, a client might provide a hypothetical condition to the appraiser to assume that water and sewer capacity is available.

Legal Instruction

An estimate of market value can also be influenced by a legal instruction. I recently came across a situation where an appraisal involved a partial taking from a property that was in the midst of the development approval process. The property owner was seeking a zoning change and plat approval to convert several dozen acres of vacant land to a platted residential subdivision. The application had passed most of the major hurdles, and conceptual plans were on file, although not formally approved. The taking impacted several lots which were to be part of the future subdivision. The government acquisition department

instructed the appraiser to assume that the development approvals had already been received. This caused the market value to be higher for the original appraisal report, but it also reflected the reality of the situation when negotiations commenced several months later.

Apples to Apples

It’s important to assess the relative merit of appraisals which have very different opinions of value. The first step is to confirm that you are comparing apples to apples. One quick technique for checking the similarity of appraisal opinions is to construct a simple spreadsheet which includes market value estimates and the effective date of value. This is not the date that the report was transmitted, but the point in time for which the market value was estimated. USPAP requires both dates, but you may have to thoroughly examine the report to find them both.

Depending on the issues involved in the particular appraisal, there are other categories that can be added to your spreadsheet, such as highest and best use, hypothetical assumptions, legal instructions and severance damages. This fact-based comparison of the appraisals and the market values therein is a necessary part of the analysis for negotiation and acquisition.

This simple grid recaps the value estimated by three appraisers:

Value Estimate	\$800,000	\$1,200,000	\$1,500,000
Appraiser	A	B	C
Client	Government	Owner	Owner
Effective Date of Value	same	same	same
Assumptions	same	same	same

The Real Deal

Tom McCarthy, the eminent domain attorney who was one of the session presenters at FAU, later provided me with additional details about the three appraisers and their estimated values. In the real-life war story, there were three appraisers and four opinions of value.

Three appraisals were prepared for the eminent domain case, and one was for bank financing. The property in question was a total taking of an industrial concern near an airport in Michigan. The subject property was situated on 3.192 acres with four self-storage buildings and a leasable area of 38,153 square feet, plus a small on-site office. The buildings were somewhat dated, and the location was rather rural. All three appraisers had the benefit of the actual (identical) operating statements for the property to use in their market analysis.

For the apples-to-apples test, the grid looked like this:

Value Estimate	\$880,000	\$967,000	\$1,310,000	\$1,900,000
Appraiser	A	A	B	C
Effective Date of Value	8/1/2006	6/13/2007	3/21/2003	6/13/2007
Client	Government	Government	Bank	Property Owner

Mr. McCarthy explained that the biggest element of difference between the appraisals (other than the effective dates of value) was the estimate of future income potential for the property. Appraiser A was less enthusiastic about the prospects of low vacancy and good rent levels. Appraisers B and C were more optimistic about increasing levels of rent and strong occupancy.

As might be expected, between 2003 and 2007, upward trends in value were evident when comparing earlier and later appraisals. For instance, the government appraiser showed an increase in value from \$880,000 to \$967,000 over a period of 10 months, at a time when markets were still appreciating (before the recession officially arrived). A similar comparison could be made between the bank's appraisal at \$1,310,000, to the property owner's eminent domain appraisal at \$1,900,000, which took place approximately four years later.

Mr. McCarthy stated that the highest of the appraisal opinions, \$1,900,000, was very well supported. The analysis included a large amount of comparable data, because Appraiser C had extensive experience in appraising self-storage facilities in the general area.

Even with this additional information and detail, it would be tricky to place these four opinions of value on a bell curve. It is therefore difficult to distinguish which of the three appraisers are extreme in their values, as compared to what an average appraiser would be expected to estimate, because there are still only four estimates in the sample.

Unique Points of View

I have often used an analogy of tax accounting to help explain how appraisers with similar qualifications can arrive at different values for the same property. Imagine a tax accountant working on a fairly complicated tax return, one which involves numerous deductions and the proverbial shoe box filled with receipts. The client may own one or more businesses, several rental properties, a variety of investments and a list of assets with various levels of depreciation.

If the same paperwork was provided to three different Certified Public Accountants (CPAs), each having similar expertise and qualifications in the area of tax accounting, would we expect them to arrive at similar figures for the amount of tax owed to the IRS? It would be unusual if they did. Maybe even miraculous. Why is that?

One explanation is that individual CPAs have different personalities and different points of view. Tax accountants range in mindset from the deeply conservative to aggressively liberal. When it comes to income taxes, the spectrum

from conservative to aggressive exists among both the accountants and the clients. There are some who are willing to pay slightly more tax than required, so they are able to sleep well, even if audited. There are others who cannot abide the idea of paying one penny more than they owe, and they are willing to risk greater exposure in order to hold that position. When selecting a professional, whether an accountant or an appraiser, it helps to identify the intended use of the report, and the culture and personality of your organization.

If three CPAs complete an estimate of taxes owed, the numbers could be all over the board. For argument's sake, let's say those opinions are \$800,000, \$1,200,000 and \$1,500,000. You might surmise that the \$800,000 opinion came from an accountant who is more aggressive than the other two. However, we do not have sufficient information to decide whether or not that accountant is extremely aggressive or mildly aggressive. Likewise, the \$1,500,000 CPA and \$1,200,000 CPA might be perceived as the middle of the road, rather than at the extreme fringe of conservative tax preparers. With a sample of only three accountants, there just isn't adequate information to make those distinctions.

However, if you were able to hand that same box of receipts and pile of financial information to 10 accountants, a more definite pattern would begin to emerge. With estimates of tax owed available from 100 accountants, a clear central tendency would become obvious. Let's imagine that 50 of those accountants were over \$1,000,000 and 50 were below \$1,000,000. If that were the case, the CPA

at \$1,500,000 might look exceedingly conservative, while the \$800,000 CPA would appear to be only somewhat more aggressive than average.

If resources were unlimited and 1,000 accountants were given the task, a narrow range of probable tax owed would likely emerge, and definite extremes of conservative and aggressive estimates could be more clearly identified.

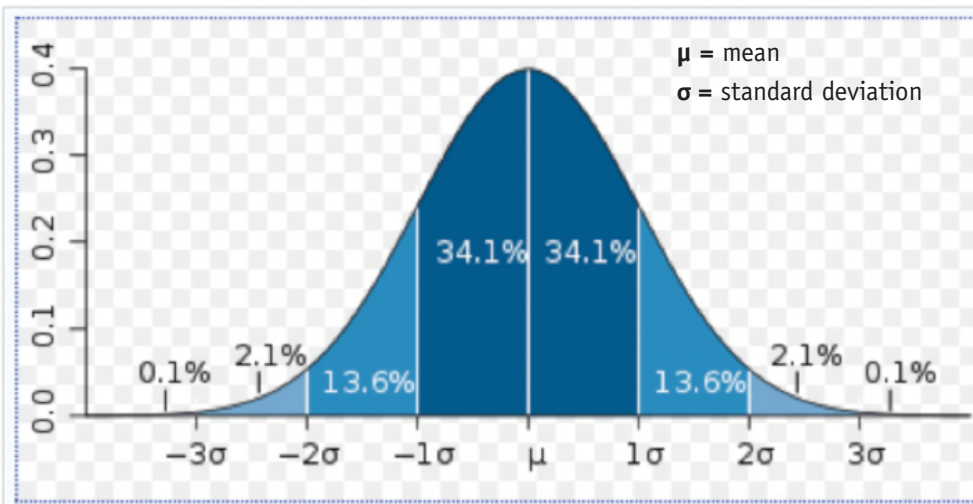
Relation to the Curve

Grading on the curve is not a concept exclusive to the classroom. That same statistical method helps describe the normal distribution or “bell curve” that exists in nearly all neighborhoods where numbers reside. For the most part, appraisers not only measure value using statistical methods, but they also behave in a statistical fashion.

Normal Distribution

Just as the larger sample of tax accountants would be expected to yield a normal distribution for estimated taxes, a larger sample of appraiser opinions would tend to yield a normal distribution of market value estimates. The extremely conservative appraisal opinions would be on the left side of the curve, positioned two or three standard deviations from the center. Likewise, the wild-eyed, ultra-high estimates would be outliers at the extreme right hand side of the curve.

In the real world, only two or three market value estimates are typically available. As a result, even the most careful right of way agents, appraisal reviewers, property owners and juries have a difficult time placing divergent opinions of value in their appropriate positions on the bell curve.



Statistical Training

Following the FAU, an Appraisal Institute meeting commenced. During that meeting, I came across several other appraisers who had participated in the Three Appraisers/Three Values session. Over the next few days, we continued discussing the issues and how various people had reacted to them. We considered the comments of the non-appraisers in the session who seemed to agree that the \$800,000 appraiser was okay, the \$1,200,000 appraiser was a bit suspect, and the \$1,500,000 appraiser must have been an advocate with an extreme opinion.

In a normal distribution, the great majority of values lie near the center of the curve, as depicted in this sample graph from Wikipedia.

Wikipedia also provides this short refresher course on the topic:

In statistics, there is a 68-95-99.7 rule (also known as the three-sigma rule or empirical rule). This rule states that, in a normal distribution, almost all values lie within three standard deviations of the mean:

- About 68% of the values lie within 1 standard deviation of the mean.
- Roughly 95% of the values lie within 2 standard deviations of the mean.
- Almost all (actually, 99.7%) of the values lie within 3 standard deviations of the mean.

Many of the appraisers who participated in the discussion are right of way experts who do a fair amount of government work. Given the same information, few of them agreed with the non-appraiser's assessment because, 1) there was not enough information, and 2) it is possible that the \$1,200,000 and \$1,500,000 appraisers were in the right ballpark, while the \$800,000 professional was looking a bit extreme. Part of this is surely attributable to the training in statistical methods that appraisers receive, and the fact that we work with these statistics virtually every day. This tends to make appraisers distrustful when faced with extremes at both ends of the bell curve. It also illustrates, once again, that appraisal is an art, rather than a science.

Of course, it is impractical to hire 10 or more appraisers to analyze the same data set to determine the average valuation that represents the center of a normal distribution. However, use of a comparison grid and market information about those who are preparing the appraisals may provide critical insight to assist right of way professionals in grading on the curve. 🌀