

Professionalizing Appraisal Reports

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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

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