EXCEPTIONAL JURISDICTIONAL CONFUSION

Its place in the big picture of standards

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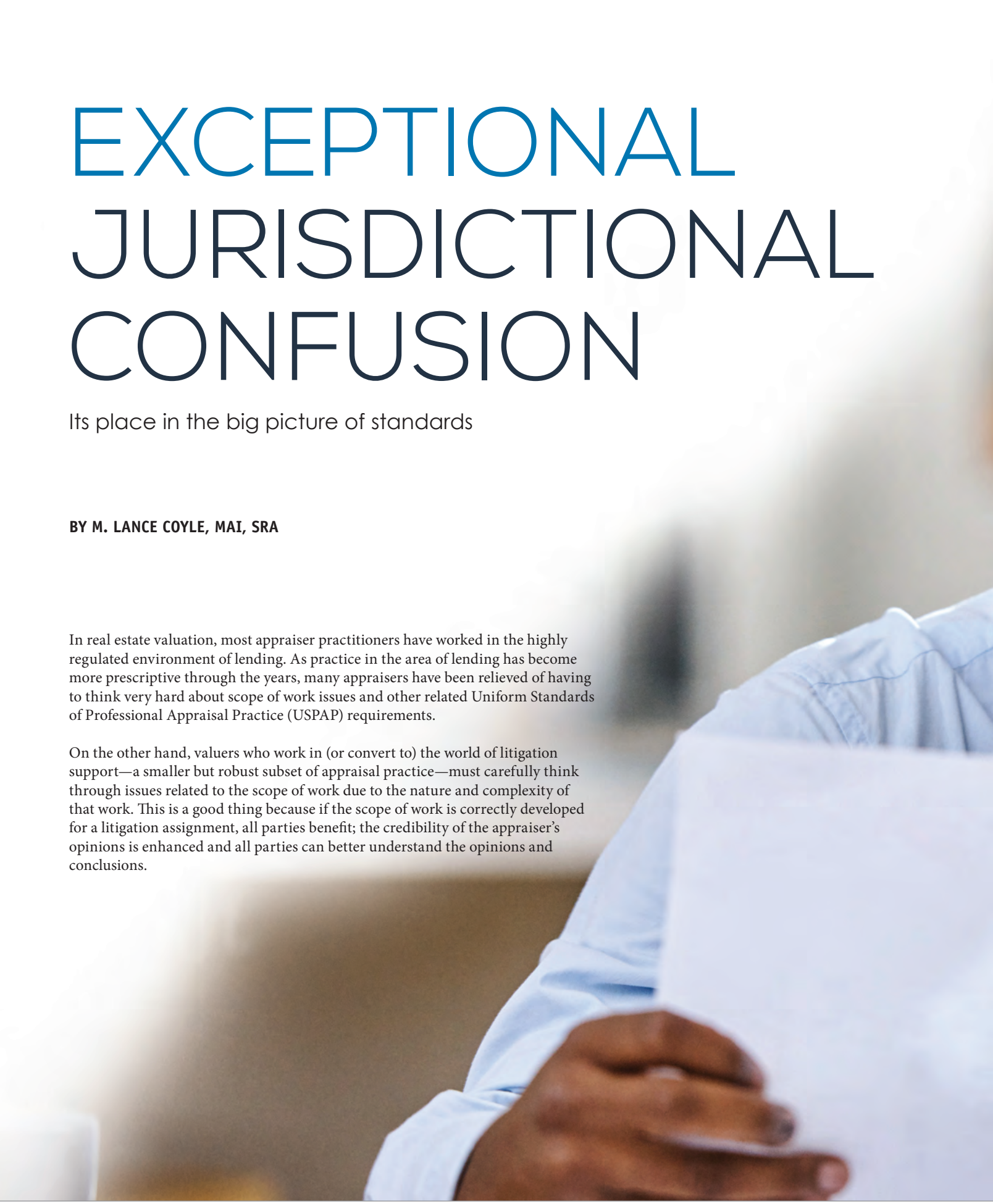
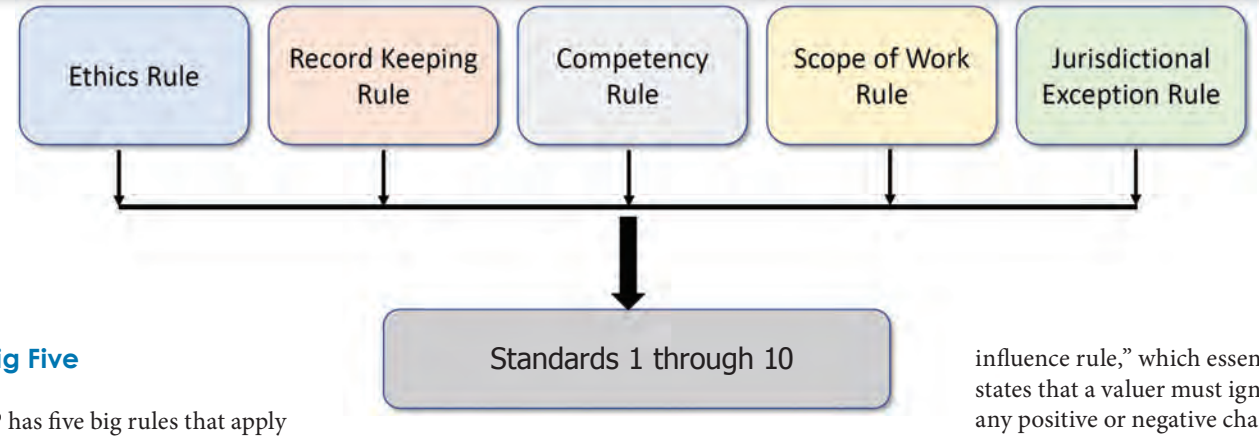


In real estate valuation, most appraiser practitioners have worked in the highly regulated environment of lending. As practice in the area of lending has become more prescriptive through the years, many appraisers have been relieved of having to think very hard about scope of work issues and other related Uniform Standards of Professional Appraisal Practice (USPAP) requirements.

On the other hand, valuers who work in (or convert to) the world of litigation support—a smaller but robust subset of appraisal practice—must carefully think through issues related to the scope of work due to the nature and complexity of that work. This is a good thing because if the scope of work is correctly developed for a litigation assignment, all parties benefit; the credibility of the appraiser's opinions is enhanced and all parties can better understand the opinions and conclusions.

USPAP's Five Big Rules

These always apply to appraisal and appraisal review



The Big Five

USPAP has five big rules that apply to each and every appraisal and/or appraisal review assignment. These five big rules take precedence over everything else in USPAP. In a sense, they are superior to all the other requirements, acting as an umbrella over the rest of USPAP. But it's more than that; they govern which additional rules apply and even what portions of those rules apply.

Among the five big rules, one is essentially administrative (the Record Keeping Rule) and two are essentially general conduct-oriented (the Ethics Rule and the Competency Rule). They are specific as to behaviors, but they are not specific as to the mechanics of development and reporting of an appraisal, which are enumerated elsewhere. However, the final two big rules (the Jurisdictional Exception Rule and the Scope of Work Rule) work hand in hand. They are the rules that specifically determine how the appraisal or appraisal review is to be executed. In fact, the Scope of Work Rule directly determines which of Standards 1 through 10 are used, as well as what *portions* in those standards are needed.

Jurisdictional Exception Rule

The Jurisdictional Exception Rule is a short and fairly straight-forward requirement. Its basic concept is that if a valuer is absolutely unable to comply with one of the mandatory requirements of USPAP due to a law or regulation, an exception to USPAP is allowed for that requirement. However, the remainder of USPAP is preserved and will still apply to all other aspects of the assignment and the appraiser who prepares it. Appraisers who work in the litigation support arena are often confused about the applicability of the Jurisdictional Exception Rule because litigation assignments typically involve many laws, rules and regulations.

In a litigation assignment that involves a condemnation action—and depending on individual state law—an appraiser may be asked to ignore any changes in market value that result as a consequence of the project for which the taking is necessary or any changes that take place in the neighborhood for the same reasons. Sometimes, a valuer may be prohibited by law or regulation from reporting ad valorem tax data or certain lease data. Additionally, they might have a requirement to exclude or include certain comparable data or zoning information, among many others. These requirements differ from the typical practices that are found in appraisals prepared for regulated lenders.

One common situation that arises often is rooted in what is known in condemnation law as the "project influence rule," which essentially states that a valuer must ignore any positive or negative change in the market value of a property (in the "before" condition) as a result of the same public project for which all or a part of the property is being taken. However, in the requirements for the development of an appraisal, USPAP includes language about analyzing anticipated public improvements and their effect on value, as well as analyzing the effect on use and value of existing and modified land use regulations. Specifically, USPAP Standard Rule 1-4(f) states: *"When analyzing anticipated public or private improvements, located on or off the site, an appraiser must analyze the effect on value, if any, of such anticipated improvements to the extent they are reflected in market actions."*

Thus, for many practitioners, it appears a conflict exists. The project influence rule requires a valuer to ignore the effect on value created by the project which has necessitated the taking, but USPAP appears to require the valuer to analyze anticipated public improvements and their effect on value. Many appraisers conclude that this apparent conflict in requirements prevents them from complying with USPAP and a Jurisdictional Exception is then created. This is a common mistake, probably as a result of a lack of understanding

of the concept of scope of work and how the various parts of USPAP work together to determine the appropriate requirements of developing an appraisal.

Scope of Work Rule

The Scope of Work Rule in real estate valuation is something akin to the function of a recipe in cooking. If the problem to be solved is to produce a cake for a friend, I know I'll need some flour, baking powder, eggs and other ingredients. If it's my friend's birthday, it might need some special frosting or decoration to match the intended use and maybe some chocolate to match her particular definition of birthday cake. And if my friend has special dietary needs, I might need to use a sugar substitute instead of granulated sugar as a special condition. I will also need competency in baking skills necessary to correctly identify and execute the techniques of mixing, temperature control, timing, proper equipment and oven baking. On the other hand, if my purpose is to create a dinner entrée, such as a Chicken Piccata, I don't need baking techniques at all and I don't need the same ingredients. Instead, I will need to know how to pan sauté and I'll need some chicken, wine and capers.

In the same way, the scope of work in an appraisal assignment tells me how to solve the problem based on the data needed (the ingredients), the techniques employed (baking or sautéing), the property characteristics (cake or entrée), the intended use (a birthday celebration) and any special circumstances (a person with dietary restrictions), among others. In a real estate appraisal, Standards 1 and 2 will be applicable resulting from the Scope of Work decision, while Standards 3 through 10 would be ignored. A business appraisal would use Standards 9 and 10 only, and so on.

Project Influence

Among the most critical components of developing a proper scope of work in a litigation support assignment is the requirement to follow the "laws and regulations" applicable to the assignment. These are just three little words buried in one paragraph and their importance is often overlooked. In a condemnation appraisal, the project influence rule is usually an overarching and important requirement. It is exactly what is meant by "laws and regulations" that are identified in the Scope of Work Rule. Remember, the Scope of Work Rule has precedence over the Standards Rules 1-10, so if the rules and regulations applicable to the assignment prohibit the valuer from analyzing "anticipated public or private improvements, located on or off the site," then that requirement takes precedence over any requirements found in Standard 1 and that portion of the standard is simply ignored. In a similar fashion, the rules and regulations applicable to an assignment prepared for tax appeal litigation must be followed. Rules and regulations applicable to an environmental contamination case are another example. This is why understanding the Scope of Work Rule is so important in any type of litigation case.

However, this still does not answer the question concerning the creation of a Jurisdictional Exception. Can the appraiser fully comply with USPAP when these seemingly conflicting conditions exist?

Evolving

Valuation standards have evolved and changed through the years, including the fundamental mechanics of how they work. For a long period of time, the requirements of Standard 1 were mostly mandatory and many valuers seem to have this idea still firmly embedded in their consciousness. This is part of the reason for current confusion. Later, the idea of "departure" was introduced, giving valuers more flexibility in how appraisal opinions were developed and introducing the idea that some requirements are contingent, depending on the problem to be solved. Departure was later dropped in favor of the more elegant and sophisticated scope of work concept.

With this evolution in standards, not all of the requirements enumerated in Standard 1 are mandatory today. In fact, some are "contingent." For some reason, the contingent aspects of Standard 1 are lost on many valuers.

Defining Contingency

What does the word "when" mean? This might seem like an innocuous question due to its common usage, but the word "when" is used liberally within the standards. In fact, the word "when" appears at the beginning of a sentence 12 times in Standard 1 and is one of the keys to understanding how to execute appraisal development once the scope of work is correctly developed. The fact that the word is so commonly used in everyday English leads to complacency regarding its use in the standards, which creates confusion.

The word "when" is mostly defined in the dictionary in terms of a time concept; this is how it is used in the common vernacular. Here's just one example of how it is confusing: Standards Rule 1 states in 1-4(a): *"When a sales comparison approach is necessary for credible assignment results, an appraiser must analyze such comparable sales data as are available to indicate a value conclusion."*

A casual reading of this USPAP passage could easily be interpreted by a valuer as being something like this: "I'm going to write up my sales comparison approach today and while I'm doing that, I need to be

sure to analyze such comparable sales data as are available to indicate a value conclusion." But this is wrong and is not what the word "when" means in the context of appraisal standards.

The word "when" in USPAP really means "if" and it establishes that some of the clauses in USPAP Standard 1 are contingent. An expanded concept of the word "when" might also mean the following: "If needed for credible assignment results established under the Scope of Work Rule." The word "when" is not a time concept in USPAP; it is a contingency.

USPAP Requirements

An analysis of Standard 1 reveals 24 requirements that are must-do's. There is no contingency and no option. For instance, an appraiser *must* not commit a substantial error, be careless or negligent, identify the client, identify the definition of value and so on. However, there are 19 clauses that are contingent on the scope of work and in the case of the project influence rule in a condemnation case, Standards Rule 1-4(f) is one of them. The very first word of the SR 1-4(f) clause is "when," but now we understand that it really means "if."

Circling back, remember that the Scope of Work Rule requires that valuers follow the *laws and regulations* applicable to the assignment. In a condemnation appraisal, if the laws and regulations require the valuer to ignore an analysis of anticipated public or private improvements and their effect on value, then that portion of USPAP Standard 1 *is not applicable at all and would not be done.* And because this portion of USPAP is contingent on the scope of work, there is no departure from the requirements as it is not a mandatory requirement. In fact, complying with the laws and regulations in the Scope of Work Rule means that the valuer is proactively complying with USPAP (not failing to comply) because the scope of work specifically excludes the analysis of anticipated public or private improvements. Perhaps it would be illustrative to think about the meaning of USPAP Standard 1-4(f) along these lines: "If it is necessary under the scope of work to achieve credible results, analyze anticipated public or private improvements and their effect on value; if the laws and regulations applicable to the assignment prohibit analyzing public or private improvements, then ignore anticipated public or private improvements." Thus the valuer *can* comply with the requirements of USPAP and no jurisdictional exception is created.

A Closer Look at Jurisdictional Exceptions

Remember that a jurisdictional exception is created only when the law or regulation prevents the appraiser from complying with the Standards. The project influence rule does not create this condition, as USPAP is structured so that the appraiser can comply. The combination of the Scope of Work Rule and the concept of hypothetical conditions (which are a part of problem identification in the Scope of Work Rule) allow exceptions to standards requirements.

Along with general assumptions, extraordinary assumptions, hypothetical conditions, and laws and regulations, jurisdictional exceptions are considered an "assignment condition." Assignment conditions are one of the critical assignment elements that must be identified in order to satisfy USPAP's requirement to recognize the problem

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to be solved. If the laws and regulations in an assignment are properly followed and it is clearly established that a jurisdictional exception does not exist, are any further disclosures, conditions or requirements needed? Some argue that use of a hypothetical condition is duplicative since that portion of USPAP is not applicable if scope of work is correctly developed and following the laws and regulations satisfies the requirement to properly account for assignment conditions. However, a hypothetical condition explaining that the project doesn't exist when in fact it does, helps to clarify and inform the reader of how the valuation problem is being undertaken. It also demonstrates that the appraiser understands and is complying with the project influence rule. Further, in the case of an appraisal prepared for eminent domain acquisition, it is usually necessary to include a hypothetical condition that any "after the taking" valuation assumes that the project has already been completed on the effective date of the appraisal.

Yellow Book

This is not the end of the confusion regarding the Jurisdictional Exception Rule. If you are an appraiser providing valuation services for the condemnor in a federal acquisition, you are subject to and must comply with the Uniform Appraisal Standards for Federal Land Acquisitions (UASFLA), often called the Yellow Book. In the section titled "Consideration of Land Use Regulations and Anticipated Public Projects," the UASFLA advises:

Section 1.2.7.3.3 of these Standards provides that the appraiser disregard any changes in a property's neighborhood brought about by the government's project. Section 1.4.3 further instructs appraisers to disregard recent rezoning (or the probability of rezoning) of the subject property if such action was the result of the government's project. Section 4.3.2.4.1 (Exceptions, under Zoning and Permits) explains the legal basis for these instructions. These instructions are contrary to USPAP Standards Rule 1-3(a), which requires appraisers to identify and analyze the effect on use and value of existing land use regulations and probable modifications thereof, and to USPAP Standards Rule 1-4(f), which requires appraisers to analyze the effect on value of anticipated public improvements located on or off site. Therefore, the instructions to appraisers in these Standards in this regard are considered jurisdictional exceptions.

Unfortunately, these instructions found in the UASFLA manual identifying the need to ignore SR 1-4(f) as a jurisdictional exception are incorrect, as we know from the preceding explanation. This further confuses the public and appraisal practitioners. Notwithstanding, valuers should follow client instructions and regulations, including the requirements of the UASFLA. The UASFLA is an assignment condition that should be complied with, as it is one of the laws and regulations that are applicable to the assignment. There is no single way to handle this conflict with the client, but communication with the client is paramount, particularly with regard to scope of work issues and how the appraisal is to be prepared. An explanatory paragraph in the appraisal report where scope of work issues are discussed may also be worthwhile.

In Summary

When valuers provide litigation support services they also often provide related expert witness testimony and standards are often ignored or minimized. Standards can be confusing, hard to understand and for many participants, just plain boring. Some lawyers take the position that testimony about standards is simply not persuasive from a tactical perspective. Some lawyers don't invest the time necessary to understand the standards. Some administrative law judges or special commissioners may prefer to hear testimony that is focused on valuation issues, rather than "technicalities" in appraisal standards. But if the issue of standards is in play and if opposing counsel discovers that standards have not been carefully followed, not only will a valuer experience a very uncomfortable session on the witness stand, but the valuer's credibility will be impacted. Imagine a medical malpractice case where the medical provider did not follow standard procedures of care. There is no reason for parties of a condemnation case to be confused about the Jurisdictional Exception Rule. ✪

M. Lance Coyle, MAI, SRA served as the 2015 President of the Appraisal Institute, as well as on its Education Committee and Body of Knowledge Committee. A member of the AI faculty, he has over 30 years providing valuation services, mostly in Eminent Domain cases and today offers appraisal reviews of reports prepared in litigation cases.