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Note about Revisions to the Guide Notes

The previous edition of the Guide Notes was effective January 1, 2003.

On November 5, 2010, the Appraisal Institute Board of Directors approved and adopted Guide Note 10: Developing an Opinion of Market Value in the Aftermath of a Disaster.

On May 6, 2011, the Appraisal Institute Board of Directors approved and adopted revisions to Guide Note 5: Appraisals of Real Estate with Related Personal Property, Business Property, or Intangible Assets.


On November 16, 2012, the Appraisal Institute Board of Directors approved the retirement of Guide Note 7: Consideration of the Americans with Disabilities Act in the Appraisal Process.

On February 8, 2013, the Appraisal Institute Board of Directors approved and adopted Guide Note 14: Concept of Exposure Time.


On July 26, 2013, the Appraisal Institute Board of Directors approved and adopted revisions to Guide Note 6: Consideration of Hazardous Substances in the Appraisal Process.
Guide Note 2
Cash Equivalency in Valuations

Introduction
Standards Rule 1-2(c) requires that for opinions of market value the appraiser ascertain whether the value is to be the most probable price in terms of cash, in terms of financial arrangements equivalent to cash, or in other precisely defined terms. Standards Rule 1-2(c) further requires that if the opinion of market value is to be based on non-market financing or financing with unusual conditions or incentives, the terms of such financing must be clearly identified and the appraiser's opinion of their contributions to or negative influence on value must be developed by analysis of relevant market data.

The definition of presumed mortgage conditions is an explicit or implicit instruction of the appraiser's client. The instruction may mirror a loan commitment or only sought conditions. The presumed financing may be prospective or existing. There may be more than one presumed mortgage. Components of financing include the amount of the mortgage loan(s), its interest rate(s), its interest payment interval(s), its schedule(s) of debt repayment, required fees for placing the loan(s), and required restrictions or fees for early termination of the loan(s). Any of the components can diminish or enhance market value.

An opinion of market value may presume "all cash," meaning no financing, i.e., that the real estate is debt free at the time ownership is transferred. More likely, the presumption will be "all cash to the seller," meaning the buyer mortgages the real estate as security to a third-party lender who pays part or all of the price in cash; if the financing is part of the price, the non-mortgaged amount is paid in cash by the buyer. In some cases the presumption will be that the seller will partially or entirely finance the purchase, i.e., will "hold paper," meaning take back the buyer's purchase-money mortgage. This could be instead of or in addition to a third-party loan.

Each comparable transaction, the financing of which differs from that presumed for the appraised property, should be adjusted to parity. For example, assume that the property is to be appraised presuming an 80%, self-amortizing, 300-month, 0.677% monthly interest rate loan available to a qualified borrower for the pre-payment of three percent of the loan amount (three placement points). If the loan conditions for one of the comparable sales were identical in each respect except that four placement points were paid, an 0.8% (one point times 80%) increase in the price of that comparable would accommodate its financing difference.

Appraisers, when calculating financing adjustments, often substitute the expected remaining loan term until a logical refinancing date for the longer total loan term.

Many appraisers find it an orderly process to first adjust and analyze each comparable price to its arithmetic equivalent of an all-cash-to-the-seller price. Then, if necessary, they adjust the cash-equivalent conclusion of the comparable prices to the presumed financing of the appraised property. Even when the presumed financing is other than cash-equivalent, this process is favored to reveal the
quantified total effect of the financing. (The expression “cash equivalent” pertains to the seller’s point of view; a loan is not the true equivalent of cash to a purchaser who does not have the alternative of paying cash.)

When appraisers refer to “favorable financing,” they mean favorable to the buyer. Such financing may be unfavorable to the seller but often it is a matter of indifference to the seller.

When the value to be developed for the subject property is market value based on cash, or financing that is equivalent to cash, comparable sales used in the sales comparison approach must be analyzed and adjusted for financing that may have influenced their prices.

A client may request a market value opinion on the assumption that specific financing, other than cash-equivalent, is available. Or the client may request that the property be valued with existing financing. In such cases, the appraiser should be careful to use a market value definition that is consistent with such an assumption. Further, the appraiser must analyze the effect of such financing; it may have no effect on the resulting value, or it may have a favorable or an unfavorable effect.

In responding to the questions posed by the client that initiated the appraisal assignment, the appraiser must adhere to ethical standards and fundamental appraisal principles and practices that are applicable to the market. A clear understanding is necessary between the appraiser and the client as to the interest being valued and the need for the appraiser to analyze existing, available, and/or proposed financing. If the appraisal assignment is to develop an opinion of market value, the definition of market value must not only be consistent with the client’s needs but must also meet the requirements of Standards Rule 1-2(c) as quoted below.

Standards Rule 1-2

(c) identify the purpose of the assignment, including the type and definition of the value to be developed; and, if the value opinion to be developed is market value, ascertain whether the value is to be the most probable price:

(i) in terms of cash; or

(ii) in terms of financial arrangements equivalent to cash; or

(iii) in other precisely defined terms; and

(iv) if the opinion of value is to be based on non-market financing or financing with unusual conditions or incentives, the terms of such financing must be clearly identified, and the appraiser’s opinion of their contributions to or negative influence on value must be developed by analysis of relevant market data.

Comment: When the purpose of an assignment is to develop an opinion of market value, the appraiser must also develop an opinion of reasonable exposure time linked to the value opinion.
Basis for Proper Evaluation
The market value of a clearly identified property interest may be reported in a number of ways: 1) cash, 2) terms equivalent to cash, or 3) with other precisely defined terms. An example of such other terms is the cash value of the equity interest subject to existing or proposed financing. Standards Rule 1-2(c) requires an appraiser to clearly define the terms of such financing and develop an opinion of their contributions to or negative influence on value. Standards Rules 2-2(a)(v) and 2-2(b)(v) require that, if the value opinion is market value, the report state whether it is in terms of cash or of financing terms equivalent to cash, or based on non-market financing or financing with unusual conditions or incentives. Further, if the opinion of market value is not in terms of cash or based on financing terms equivalent to cash, the report must summarize the terms of such financing and explain their contributions to or negative influence on value. The appraiser can either:

- Report two values (as financed and cash-equivalent); or
- Report one value and indicate the positive or negative influence the financing terms have on the value reported.

Standards Rule 1-2(c) contains this reporting requirement so that interested parties will be aware of how much the favorable or unfavorable financing impacts the value reported. Standards Rule 1-2(c) does not imply that different financing terms will always lead to a different value. It simply requires that a proper analysis be made.

Subject Analysis When Financing May Affect Value
When developing an opinion of the value of a property, the appraiser must ascertain whether or not any existing financing is assumable, retirable, or replaceable. Also, the appraiser must estimate the potential value impact of the cost items such as finder’s fees, points, and prepayment penalties and the effect of the present worth of participation by lenders, if any. The appraiser should also judge the duration of any favorable or unfavorable influence from mortgages or participations. It should not be assumed that the benefits or detriment due to financing will continue throughout the stated amortization or participation terms. The value impact of a mortgage fluctuates as interest rates rise and fall. The possibility of retiring unfavorable financing prior to its full payout period should also be considered.

Once a property owner finances the property, ownership may become subject to the terms of the mortgage. The sum of the value of owner equity and the face amount of the balance(s) of the mortgage note(s) may or may not be equal to the free and clear value of the property. Any difference represents the impact that the financing has on the value. The value of a property on the basis of cash or cash equivalency can be developed most directly by comparing it with similar properties that were being sold for cash or its equivalent on the open market. However, if the total consideration for a comparable sale includes something other than cash, e.g., the exchange of property, life tenancy, or other interest, such consideration should be converted to cash equivalency. Analyzing cash equivalency goes beyond the discounting of debt encumbrances.
If sufficient data to permit a direct market comparison is not available, the cash equivalency of existing or proposed financing can be estimated by discounting the contractual terms at current market rates or yield rates for the same type of property and loan term over the expected holding period of the property. However, such mathematical methods should be weighted against other market indications.

**Comparable Analysis When Financing May Have Affected Value**

The same analysis outlined above must also be applied to comparable sales data. The appraiser should ascertain the terms of the financing involved in the acquisition of a comparable property and estimate the influence of such financing, if any, on the sale price. For example, does an all-cash sale differ from a sale in which the buyer assumed existing financing or secured new financing from the seller, a third party, or both? If so, why and what is the impact on price?

A clear distinction must be made between sale prices that are not affected by financing or other considerations, including sale prices for terms considered by the seller to be equivalent to cash transactions, and sales involving premiums or discounts due to financing. If the financing is unfavorable to the purchaser, one way that the difference may be measured is by the cost to retire the debt. Furthermore, the effect of financing on each comparable sale must be considered in light of the market as of the date of the sale, not the date of valuation of the subject. The appraiser should attempt to determine whether or not, at the time of sale, the financing affected the sale price in the minds of the parties to the transaction. If it did, the effect must be analyzed and an adjustment must be made and reported.

**Summary**

In summary, demonstrated knowledge of the market financing available to the subject and comparable sale properties, analytical judgment, and common sense are required of the appraiser in determining whether or not specified financing impacts the value reported.

Standards Rule 1-2(c) requires that an opinion of the impact of favorable or unfavorable financing on market value be developed and Standards Rules 2-2(a)(v) and 2-2(b)(v) require that it be reported. The value reported must be clear and meaningful to the client and cannot be misleading to the intended users.

When non-market financing or financing with unusual conditions or incentives is involved and results in an effect on the value opinion, the appraiser can either:

- Report two values (as financed and cash-equivalent); or

- Report one value and indicate the positive or negative influence the financing terms have on the value reported.
Summary of Standard Practices

1. Accurately report the specific terms of any non-cash-equivalent existing or proposed financing of the subject property, when such financing has an impact on the appraisal problem (SR 1-2(c)).

2. Analyze and report the effect of favorable or unfavorable financing terms on value (SR 1-2(c)).

3. Analyze and make appropriate adjustments to a comparable sale that included favorable or unfavorable financing terms as of the date of sale, when comparing the sale to the property being appraised (SR 1-2(c)).

4. Either report two values, or report one value and quantify the positive or negative influence the financing terms have on the value reported (SR 1-2(c)).

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members, Candidates, Practicing Affiliates and Affiliates with guidance as to how the requirements of the Standards may apply in specific situations.)
Guide Note 3
The Use of Form Appraisal Reports for Residential Property

Introduction
Most residential appraisal assignments require a report on one of the approved forms used in the secondary mortgage market or by the employee-relocation industry.

Use of such forms does not lessen or change the appraiser’s obligation to observe the requirements of the Standards of Professional Appraisal Practice. If a proposed appraisal assignment cannot be completed in accordance with the appraisal development and reporting requirements of USPAP and the Certification Standard and Code of Professional Ethics of the Appraisal Institute, the assignment must not be accepted.

Basis for Proper Evaluation
When using any form report, or signing a form report as a reviewer, it is the responsibility of the appraiser and the reviewer to ensure that the appropriate methods and techniques have been properly employed. Appropriate addenda must be added when additional information is required to complete the appraisal report in accordance with Standard 2 of USPAP.

Highest and best use appears on most forms merely as a box to be checked because the use of the form itself is a statement of highest and best use. Unless a detailed explanation is added to clarify, it is inappropriate to use a single-family dwelling report form if the appraiser concludes that the highest and best use of the property is a different use.

Summary of Standard Practices
1. Consider the intended use, purpose, definitions, assumptions, conditions, and limitations that are inherent in the form report used for a residential appraisal (SR 1-2 (a) through (h)).

2. Sign an appraisal report as a reviewer only when accepting full responsibility for the contents of the report (SR 2-3 and Standard 3).

3. Analyze and report any prior sales of the property being appraised within three years of the date of the appraisal (SR 1-5(b)(i), SR 2-2 (a), (b), and (c)(viii)).

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members, Candidates, Practicing Affiliates and Affiliates with guidance as to how the requirements of the Standards may apply in specific situations.)
Guide Note 4
Reliance on Reports Prepared by Others

Introduction
In this Guide Note an analysis, opinion, or conclusion prepared by others, and upon which an appraiser relies, is referred to as a “report.”

Appraisers often rely, at least in part, on reports prepared by others. Reliance on the reports of others generally increases with the complexity of the appraisal problem. The use of such reports may increase in the future. Appraisers are providing more specialized services and will need more information to make decisions and develop their appraisals.

Reports prepared by others vary in form, content, and applicability. Although they are frequently used in conjunction with proposed properties and transactions, they may also be applicable to existing properties and used in special situations such as litigation and arbitration.

According to USPAP, in the Comment to SR 2-3, appraisers have specific obligations when relying on reports prepared by others:

When signing appraiser(s) has relied on the work done by appraisers and others who do not sign the certification, the signing appraiser is responsible for the decision to rely on their work. The signing appraiser(s) is required to have a reasonable basis for believing that those individuals performing the work are competent. The signing appraiser(s) also must have no reason to doubt that the work of those individuals is credible.

In general, these reports fall into four major classifications:

General Informational Reports
General informational reports are usually descriptive in nature and provide information pertaining to an overall area. They include data on demographics, economic trends, and other such matters. They are not specific to the property being appraised.

Reports Prepared by Licensed or Certified Non-Real Estate Appraisal Professionals
Reports prepared by licensed or certified non-real estate appraisal professionals are specific to the subject property and may be either descriptive or factual in nature. They include engineering services, environmental studies, soil reports, impact studies, survey reports, zoning opinions, audited financial statements, and other reports relating to matters beyond the scope of appraisers’ expertise, or services not typically offered by appraisers.

Reports Prepared by Other Non-Real Estate Appraisal Professionals
Reports in this category are prepared by experts who are not licensed or certified but have specific experience or expertise that an appraiser may rely upon. Examples include reports
pertinent to the appraisal problem from academicians, operators of special use properties, and personal property valuers.

Other Reports
Other reports pertaining to the subject property may be prepared by the client, by another real estate professional, or by others. These reports include financial statements, rent rolls, prior appraisal reports on the subject property, highest and best use studies, rental surveys, computer programs (or other electronic media), cost studies, and others.

Basis for Proper Evaluation
Before relying upon reports prepared by others the appraiser must:

1. have a reasonable basis for believing the individuals preparing the report(s) are competent;
2. have no reason to doubt the credibility of the work of the work preparer(s);
3. consider the criteria under which the reports were prepared;
4. consider the source and extent of the instructions given to the preparer of the reports;
5. determine how the appraiser might rely on this information in making decisions and preparing his or her report; and
6. determine the process and procedures used to evaluate the reports prepared by others.

The valuation process may require projections which are influenced by uncertain events. For this reason the basis for all assumptions and projections employed by the individual who prepared the report must be understood and properly utilized by the appraiser.

Standards Rules 1-1(b) and 4-1(b) state that the appraiser must not commit a substantial error of omission or commission that significantly affects the appraisal or the appraisal consulting assignment. Standards Rules 1-1(c) and 4-1(c) state that the appraiser must not make a series of errors that, although individually might not significantly affect the results, in the aggregate affect the credibility of those results.

Standards Rules 2-1(a) and 5-1(a) require that each written or oral appraisal or appraisal consulting report clearly and accurately set forth the assignment results in a manner that will not be misleading. Standards Rules 2-1(b) and 5-1(b) require that each written or oral appraisal or appraisal consulting report must contain sufficient information to enable the intended users to understand the report properly. Standards Rules 2-2(a), (b) and (c)(x) and 5-2(f) require that each written appraisal report or appraisal consulting report state all extraordinary assumptions and hypothetical conditions that affect the analyses, opinions, and conclusions. Standards Rules 2-2(a), (b) and (c)(viii) require the appraiser to describe or summarize in the appraisal report the information analyzed, the appraisal procedures followed, and the reasoning that supports the analyses, opinions, and conclusions. SR 5-2(g) requires the appraiser to summarize, in the appraisal consulting report, the information used in the appraisal consulting analyses, the appraisal consulting procedures applied, and the reasoning
that supports the analyses, opinions, and conclusions. SR 2-2(a)(vii), 2-2(b)(vii), 2-2(c)(vii), and 5-2(f) require the appraiser to address the assignment’s scope of work in the appraisal or appraisal consulting report.

Market value opinions should be supported by market-derived data and assumptions made should be specific to both the market and the property. An appraiser who accepts the projections or assumptions of others without some assurance of the accuracy or reasonableness of the calculations or information provided may violate the aforementioned Standards Rules.

The need for review and assurance of the accuracy or reasonableness of reports prepared by others will vary with their content and applicability. The scope of review or verification required depends on the scope of the assignment, the appraiser’s level of expertise (if any), the type of information used, and the relevance of the information to the opinions and judgments rendered.

The four major classifications of reports require varying levels of review and care on the part of the appraiser, as offered below:

**General Informational Reports**
General informational reports usually require limited verification. Most discrepancies are easily clarified.

**Reports Prepared by Licensed or Certified Non-Real Estate Appraisal Professionals**
Reports prepared by licensed or certified non-real estate appraisal professionals typically offer conclusions as to the adequacy of a specific property component or issue pertaining to the property. These conclusions are generally based on accepted procedures or standards and represent informed opinions on matters beyond the appraiser’s expertise. Absent reasonable doubt, these reports usually can be accepted conditioned upon the qualification that they were prepared by recognized professionals. Should observed or apparent material discrepancies exist between the appraiser’s investigation and the submitted report prepared by a licensed or certified non-real estate appraisal professional, such material discrepancies must be disclosed.

**Reports Prepared by Other Non-Real Estate Appraisal Professionals**
An appraiser’s reliance on reports prepared by these experts is distinct from that of the preceding paragraph in the greater care the appraiser should exercise in determining the pertinent expertise of the author. Standards Rule 2-3, in the Comment, requires that such reports may only be used if the signing appraiser has a reasonable basis for believing that individuals who performed the work are competent and has no reason to doubt the work of those individuals is credible.

**Other Reports**
Other reports prepared by, or at the direction of, the client, other real estate professionals, or others, require a careful review for reasonableness. To the degree possible and practical, computer programs or other electronic media should be reviewed for errors or inconsistencies. The level of investigation should be appropriate to the problem. The appraiser must understand the assumptions on which these reports are based as well as their applicability and validity to the assignment.
Summary of Standard Practices

1. Become familiar with any report prepared by another that is relied upon in the appraisal process and, to the degree possible, understand the basis for its conclusions. Address any questions with the preparer of the report prior to using it in the appraisal process.

2. In conjunction with the scope of work for the assignment, identify or reference in the appraisal report any report prepared by another that was relied upon in developing the appraisal or appraisal consulting opinion or conclusion (SR 2-2(a), (b) and (c)(viii) and SR 5-2(g), as well as SR 2-2(a), (b) and (c)(vii) and 5-2(f)).

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members, Candidates, Practicing Affiliates and Affiliates with guidance as to how the requirements of the Standards may apply in specific situations.)
Introduction

Real property sometimes has associated with it certain items of personal property, business property or intangible assets. This is the case when real property is an essential component of an operating business entity such as a fast food restaurant, convenience store, hotel or nursing home (among others). Real property appraisers may be requested to appraise non-realty assets in conjunction with the real property. The valuation of personal property, business property, or intangible assets requires specific expertise. Before accepting an appraisal or appraisal review assignment involving such assets, an appraiser must first ascertain that he or she has the expertise to complete the assignment competently. The expertise of a personal property or business appraiser may be needed in some cases.

Basis for Proper Evaluation

In developing a real property appraisal, appraisers are required by SR 1-2(e) (iii) to identify “any personal property, trade fixtures, or intangible items that are not real property but are included in the appraisal.” SR 6-2(g) (ii) makes the same requirement regarding mass appraisals. Further, SR 1-4(g) requires that when the scope of work includes such analysis, the appraiser must analyze the effect on value of any personal property, trade fixtures, or intangible items that are not real property but are included in the appraisal. The Comment to SR 1-4(g) states:

When the scope of work includes an appraisal of personal property, trade fixtures or intangible items, competency in personal property appraisal (see Standard 7) or business appraisal (see Standard 9) is required.

Personal Property

Fixtures that are not real estate include trade fixtures, domestic fixtures, and leasehold improvements.

Usually, trade fixtures for business and domestic fixtures, for residences, are installed by or for occupants who at conclusion of occupancy may forfeit them, sell them, remove them, or abandon them, depending upon 1) the lease or sale contract; 2) the contribution made when installed; 3) their investment value to the departing occupant; 4) custom; and 5) other considerations.

Examples include cash registers and refrigerators in convenience stores, and window treatments in residences.
Leasehold improvements (or tenant improvements) are items put in place specifically for use by a tenant. They differ physically from trade/domestic fixtures in that they are constructed on site rather than merely installed (or modified and installed).

Examples include the build-out of a reception area or an office space with partitions, cabinets and countertops.

A securely affixed item may revert to realty at occupancy-termination, if its relocation requires prohibitively expensive damage to itself (e.g., partitioning) or to the building in which it is located (e.g., a wall safe or cooler/freezer box). The value contribution at that time may be negative or positive, depending upon the nature of the item and demand for it at its location.

Appraisals of single-family dwellings, factories, amusement facilities, farms, and ecclesiastical properties, and many office and retail buildings generally include some personal property. But in some assignments, the appraiser may be asked to exclude such items. In all cases, the appraisal report must be clear about which items are included -- and which items are excluded -- from the value opinion.

If the value opinion is to include personal property that is either superior or inferior to that typically found in competing properties, allowance for the difference, on a contributory basis, should be considered in each of the valuation approaches (cost, income or sales comparison) applied in the valuation process.

If the value opinion is to omit personal property that is integral to operating the real estate for its highest and best use, then comparable sale adjustments, cost summations, and income stream analyses should reflect that fact.

Business Property/Intangible Assets Relating to Going Concerns

A going concern is an established and operating business with an indefinite future life. For certain types of properties (e.g., hotels and motels, restaurants, bowling alleys, manufacturing enterprises, athletic clubs, landfills), the physical real estate assets are integral parts of an ongoing business. The value of such a property (including all the tangible and intangible assets of the going concern, as if sold in aggregate) is commonly referred to by layman as "going concern value", "business value" or "business enterprise value." However, these terms are often misapplied. The more accurate terminology is "value of the going concern" including real property, personal property, and the intangible assets of the business.

Appraisers may be called upon to develop an opinion of the investment value, use value, or some other type of value of a going concern, but most appraisals of going concerns require a "market value of the going concern." Due to the nature of the different types of value included, the appraiser should be careful that he or she has the competency to complete this type of valuation assignment. It may be necessary for the real property appraiser to collaborate with a personal property appraiser or a business appraiser or both on such an assignment.

The value of a going concern includes the incremental value associated with the business operation, which is distinct from the value of the real property. The value of the going concern includes an
intangible enhancement of the value of the operating business enterprise, which is produced by the assemblage of the land, buildings, labor (including trained workforce), equipment, and the marketing operation. This assemblage creates an economically viable business that is expected to continue. The value of the going concern refers to the total value of the entirety, including real property, personal property and intangible assets.

A division of realty and non-realty components of value may be required given the intended use of the appraisal. For example, assignments for ad valorem taxation, eminent domain, and real estate lending usually require the appraisal to isolate the values of the separate components. In such cases, the appraiser must ascertain whether the assignment calls for a mere allocation of the value of the entirety among the various components, or whether value opinions are to be developed separately for each component. If value opinions are being developed separately for each component, careful consideration must be given to the type and definition of value being used in each case. The type and definition of value needs to be appropriate for the intended use, but it also needs to be appropriate for the asset type. For example, the intangible assets would not have a “market value” separate from the entirety if they could not be marketed separately. Further, the values of the various assets upon liquidation of the business could be quite different from the values of those assets as part of the ongoing business operation. These issues must be considered carefully when identifying the problem to be solved by the assignment.

Summary of Standard Practices

1. Develop an appraisal of real estate and related personal property only after ascertaining adequate knowledge and experience to complete the assignment competently (Competency Rule).

2. Identify any personal property, trade fixtures, or intangible items that are not real property but are included in the appraisal (SR 1-2(e) (iii)). Analyze the effect on value of any personal property, trade fixtures, or intangible items that are not real property but are included in the appraisal, when the scope of work for the assignment includes such analysis (SR 1-4(g)).

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members, Candidates, Practicing Affiliates and Affiliates with guidance as to how the requirements of the Standards may apply in specific situations.)
Guide Note 6
Consideration of Hazardous Substances in the Appraisal Process

Introduction
The consideration of environmental conditions along with social, economic, and governmental conditions is fundamental to the appraisal of real property. Although appraisal literature has recognized environmental conditions can affect property value, the focus has been on the consideration of climatic conditions, topography and soil, the surrounding neighborhood, accessibility, and proximity to points of attraction. These more general environmental conditions might be apparent to a member of the general public who is not specifically trained as an expert in observing these forces. There is, however, a growing need to give special consideration to the specific impacts of hazardous substances on the valuation of real property. Consistent with accepted guidance on this topic and as incorporated herein, “hazardous substances” would be considered “environmental contamination” when their concentrations exceed appropriate regulatory standards. (See Definitions below).

The purpose of this Guide Note is to provide guidance in the application of the Uniform Standards of Professional Appraisal Practice (USPAP) to the appraisal of real property affected by or potentially affected by environmental contamination and, in particular, to the consideration of environmental contamination in the appraisal process. It is not the purpose of this Guide Note to provide technical instructions or explanations concerning the detection or measurement of the effect of hazardous substances.

Competency
The Competency Rule of the Uniform Standards of Professional Appraisal Practice, for example, requires the appraiser to either:

a) properly identify the problem to be addressed and have the knowledge and experience necessary to complete the assignment competently; or

b) disclose the appraiser’s lack of knowledge or experience to the client before accepting the assignment, take all steps necessary or appropriate to complete the assignment competently, and describe the lack of knowledge and/or experience and the steps taken to complete the assignment competently in the report; or

c) decline or withdraw from the assignment.

The Competency Rule is of particular importance in the appraisal of real property that may be affected by hazardous substances. Most appraisers do not have the knowledge or experience

1As well as the Code of Professional Ethics of the Appraisal Institute and the International Valuation Standards (IVS).
required to detect the presence of hazardous substances or to measure the quantities of such material. The appraiser, like the buyers and sellers in the open market, typically relies on the advice of others in matters that require special expertise.

There is nothing to prevent a professional appraiser from becoming an expert in other fields but the real estate appraiser is neither required, nor expected, to be an expert in the special field of the detection and measurement of hazardous substances. This Guide Note therefore addresses the problem of hazardous substances from the viewpoint of the appraiser who is not qualified to detect or measure the quantities and concentrations of hazardous substances. If an appraiser is qualified to detect or measure hazardous substances, a different set of standards would apply.

In appraisal assignments in which the appraised value is to take into account the effects on value of hazardous substances, most appraisers require the professional assistance of others. In appraisal assignments in which the appraised value does not take into account the possible effects on value of known hazardous substances (i.e. the unimpaired value, see below), the appraiser would not require the professional assistance of others.

The appraiser may accept an assignment involving the consideration of hazardous substances without having the required knowledge and experience in this special field, provided the appraiser discloses such lack of knowledge and experience to the client prior to acceptance of the assignment, arranges to complete the assignment competently and describes the lack of knowledge or experience and the steps taken to competently complete the assignment in the report. This may require association with others who possess the required knowledge and experience or reliance on professional reports prepared by others who are reasonably believed to have the necessary knowledge and experience. If the appraiser draws conclusions based upon the advice or findings of others, the appraiser must have a reasonable basis for believing that the advice or findings are made by persons who are competent. (See Guide Note 4: Reliance on Reports Prepared by Others and the USPAP Comment to SR 2-3.)

Scope of Work
The SCOPE OF WORK RULE requires that, in any assignment, the appraiser establish the appropriate scope of work necessary to complete that assignment. Part of the scope of work decision includes how, and to what extent, the appraisal problem will address known or suspected hazardous materials that may impact the property.

The Comment to the Scope of Work Acceptability section of that Rule states:

The scope of work is acceptable when it meets or exceeds:

- the expectations of parties who are regularly intended users for similar assignments; and
- what an appraiser’s peers’ actions would be in performing the same or a similar assignment.
…An appraiser must be prepared to support the decision to exclude any investigation, information, method or technique that would appear relevant to the client, another intended user, or the appraiser’s peers.

The Scope of Work Acceptability section includes two more major provisions:

- An appraiser must not allow assignment conditions to limit the scope of work to such a degree that the assignment results are not credible in the context of the intended use.
- An appraiser must not allow the intended use of an assignment or a client’s objectives to cause the assignment results to be biased.

The disclosure obligations of the SCOPE OF WORK RULE and SR 2-2(a), (b) and (c)(vii) require that the scope of work performed be disclosed in the appraisal report.

Depending on the intended use, the appraisal may be prepared so that the value opinion reflects no known or suspected environmental contamination that may impact the property, or it may be prepared so that the value opinion does reflect known contamination. In either case, the appraiser must take special precautions in the development and reporting process to ensure that the results of the assignment are credible and that the report is not misleading.

**Extraordinary Assumptions and Hypothetical Conditions**

In assignments involving contaminated properties or properties that may be adversely impacted by environmental contamination (contaminated property assignment), the appraisal will likely be premised on one or more Extraordinary Assumptions and/or Hypothetical Conditions. Typically in these types of assignments, Extraordinary Assumptions are used when relying on the work of others, such as environmental engineers or other technical specialists, while Hypothetical Conditions are used when the appraiser estimates the value of a property known to be contaminated in an unimpaired or uncontaminated condition.

**USPAP** provides the following definition for “extraordinary assumption”:

An assumption, directly related to a specific assignment, as of the effective date of the assignment results, which, if found to be false, could alter the appraiser’s opinions or conclusions.

**Comment:** Extraordinary assumptions presume as fact otherwise uncertain information about physical, legal, or economic characteristics of the subject property; or about conditions external to the property, such as market conditions or trends; or about the integrity of data used in an analysis.

In addition, it may be appropriate to premise the appraisal on an extraordinary assumption in the event there is suspected but not confirmed contamination. An environmental assessment by a qualified environmental professional would be required for such conclusions or determinations.

Standards Rule 1-2(f) requires that in developing an opinion of value the appraiser identify "any extraordinary assumptions necessary in the assignment." The Comment states:
An extraordinary assumption may be used in an assignment only if:

- it is required to properly develop credible opinions and conclusions;
- the appraiser has a reasonable basis for the extraordinary assumption;
- use of the assumption results in a credible analysis; and
- the appraiser complies with the disclosure requirements set forth in USPAP for extraordinary assumptions.

Standards Rules 2-2(a),(b) and (c)(x) require the appraiser to clearly and conspicuously state in the appraisal report all extraordinary assumptions upon which the value opinion is premised. These reporting Standards Rules also require a clear and conspicuous statement that the use of these extraordinary assumptions might have affected the assignment results.

Standards Rule 2-1 requires the report to “clearly and accurately disclose all … extraordinary assumptions … used in the assignment.”

USPAP provides the following definition for “hypothetical condition”:

A condition, directly related to a specific assignment, which is contrary to what is known by the appraiser to exist on the effective date of the assignment results, but is used for the purpose of analysis.

Comment: Hypothetical conditions are contrary to known facts about physical, legal, or economic characteristics of the subject property; or about conditions external to the property, such as market conditions or trends; or about the integrity of data used in the analysis.

Standards Rule 1-2(g) requires that in developing an opinion of value the appraiser identify “any hypothetical conditions necessary in the assignment.” The Comment states:

A hypothetical condition may be used in an assignment only if:

- use of the hypothetical condition is clearly required for legal purposes, for purposes of reasonable analysis, or for purposes of comparison;
- use of the hypothetical condition results in a credible analysis; and
- the appraiser complies with the disclosure requirements set forth in USPAP for hypothetical conditions.

Standards Rules 2-2(a),(b) and (c)(x) require the appraiser to clearly and conspicuously state in the appraisal report all hypothetical conditions upon which the value opinion is premised and to state that their use might have affected the assignment results.

Standards Rule 2-1 (c) requires the report to “clearly and accurately disclose all … hypothetical conditions … used in the assignment.” SR 2-2 (a), (b) and (c)(x) requires the appraiser to “clearly and conspicuously” state all extraordinary assumptions and hypothetical conditions and that their use might have an effect on assignment results. These Standards Rules do not require that the appraiser
quantify the impact on value, such as by both valuing the property subject to the hypothetical condition and valuing it not subject to the hypothetical condition.

An example of the disclosure of such a hypothetical condition is:

It is reported that groundwater contamination is present beneath the subject property. In accordance with the client’s instructions and consistent with the intended use of this appraisal report, the value opinion is based on the hypothetical condition that the subject property is not impacted by groundwater contamination. The appraiser cautions against the use of this appraisal report for any use other than the intended use stated herein.

When such disclosure is required it may be placed anywhere in the appraisal report (provided that is clear and conspicuous) including but not limited to the letter of transmittal, scope of work disclosure, or general comments section, depending on the type and length of report prepared. In an oral report, the appraiser should present the same information, if possible.

Definitions

Over the past few years, a common and generally accepted set of definitions related to the appraisal of properties that may be impacted by contamination have emerged. These are as follows:

<table>
<thead>
<tr>
<th>CONTAMINATED PROPERTY VALUATION - SPECIALIZED TERMS AND DEFINITIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Diminution in Value (Property Value Diminution):</strong> The difference between the unimpaired and impaired values of the property being appraised. This difference can be due to the increased risk and/or costs attributable to the property’s environmental condition.</td>
</tr>
<tr>
<td><strong>Environmental Contamination:</strong> Adverse environmental conditions resulting from the release of hazardous substances into the air, surface water, groundwater or soil. Generally, the concentrations of these substances would exceed regulatory limits established by the appropriate federal, state and/or local agencies.</td>
</tr>
<tr>
<td><strong>Environmental Risk:</strong> The additional or incremental risk of investing in, financing, buying and/or owning property attributable to its environmental condition. This risk is derived from perceived uncertainties concerning: (1) the nature and extent of the contamination; (2) estimates of future remediation costs and their timing; (3) potential for changes in regulatory requirements; (4) liabilities for cleanup (buyer, seller, third party); (5) potential for off-site impacts; and (6) other environmental risk factors, as may be relevant.</td>
</tr>
<tr>
<td><strong>Environmental Stigma:</strong> An adverse effect on property value produced by the market’s perception of increased environmental risk due to contamination. (see Environmental Risk, above).</td>
</tr>
<tr>
<td><strong>Impaired Value:</strong> The market value of the property being appraised with full consideration of the effects of its environmental condition and the presence of environmental contamination on, adjacent to, or proximate to the property. Conceptually, this could be considered the “as-is” value of a contaminated property.</td>
</tr>
</tbody>
</table>

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### Basis for Proper Valuation

The specialized terms and definitions are an important part of the valuation framework for appraising properties that may be impacted by environmental contamination. This framework begins with the following formulae or equations:

- **Impaired Value** = \( \text{Unimpaired Value} - \text{Cost Effects (Remediation and Related Costs)} - \text{Use Effects (Effects on Site Usability)} - \text{Risk Effects (Environmental Risk/Stigma)} \)
- **Property Value Diminution** = \( \text{Cost Effects (Remediation and Related Costs)} + \text{Use Effects (Effects on Site Usability)} + \text{Risk Effects (Environmental Risk/Stigma)} \)
- **Impaired Value** = \( \text{Unimpaired Value} - \text{Property Value Diminution} \)

These equations set forth the relationships between the key elements of the valuation framework, and highlight the steps to be taken by the appraiser in such assignments. Three general steps are typically taken. The first involves the estimation of the unimpaired value, as defined above. This estimate is usually undertaken with a Hypothetical Condition that the property is being appraised as if uncontaminated (See section on Hypothetical Conditions, above). The second general step involves the estimation of property value diminution. Property value diminution can have three forms: cost effects, use effects and risk effects. The third step involves the estimation of the impaired value of the subject property. This value can usually be derived by deducting an estimate of diminution from the unimpaired value. These estimates must be appropriate and well supported by market data typically involving actual transactions by market participants. As noted in *The Dictionary of Real Estate Appraisal, Fifth Edition*, “market participants” are “individuals actively engaged in transactions.” Further, the International Valuation Standards (IVS) advise that market participation should be in the relevant market or market segment matching the characteristics and influences reflecting the subject.
and/or subject properties. Thus, non-market participants and related non-market and non-transactional data would not establish an appropriate basis for estimating property value diminution.

**Cost Effects**

Cost effects involve deductions for costs to remediate a contaminated property by reducing concentrations of contamination to below appropriate regulatory standards. Accordingly, prerequisites for such a deduction would be: (1) that the property was contaminated, with concentrations of hazardous materials above appropriate regulatory standards; (2) that the costs were necessary for remediation of the property; and (3) that the costs would be borne by a prospective purchaser of the property rather than by a third party such as the current owner or the owner of adjacent property or some other third party responsible for the remediation. The market may not recognize any and all potential costs but only those costs necessary to achieve regulatory compliance and reduce concentrations of hazardous materials to below the appropriate regulatory standard. Regulatory standards are those established by the appropriate state, local or federal authority. The appraiser should rely on those entities to establish this threshold. Other thresholds and cleanup objectives desired by landowners or others would not establish an appropriate basis for a market based cost effects deduction.

**Use Effects**

Use effects involve limitations on the utility of a site due to contamination and its remediation. In some situations, these effects may result in a limitation on the highest and best use of a property and this potential effect should be analyzed by the appraiser. For example, at the conclusion of some approved remedial action plans, especially those utilizing risk-based standards, subsurface contamination may remain in place so long as certain conditions are met. These conditions, which may have a deed recordation, could limit site utility or the use of the site for alternative future uses. However, the appraiser should be aware that not all site use limitations will have an effect on market value and it is the market and its reaction, as borne out in actual market data, to these limitations that should be the primary focus of the appraiser’s work in estimating use effects.

**Risk Effects**

Lastly, risk effects can result from uncertainties concerning the contamination and its remediation and other factors (see Definitions). If the uncertainties and perceptions of the market result in reductions in property value (property value diminution) then the appraiser might conclude that the subject property suffers from environmental stigma. Environmental stigma for the appraisal profession is the product of uncertainty and adverse perceptions of the market but is always measured on the basis of actual market data and transactions that reflect these perceptions. The appraiser is cautioned that not all uncertainty and increased concern and perceptions in the market may reduce property values, and that any analysis of risk effects and stigma must be based on actual data from the relevant market or submarket and should not be assumed to occur without such evidence. Further, the appraiser should employ relevant and generally accepted methods and techniques to analyze the relevant and reliable market data in order to develop an opinion concerning the existence and extent of any risk and stigma that may exist before applying such a deduction to the subject property or properties. Lastly, important considerations in the estimation of risk effects are the subject property’s stage in the

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3 IVS § 19
remediation lifecycle (before, during or after cleanup) and the whether the subject and any sales comparables are source, non-source, adjacent or proximate sites as these factors can and do influence the extent to which a property will suffer from environmental risk and stigma.

**Summary of Standard Practices**

1. Disclose to the client the appraiser’s lack of knowledge and experience with respect to the detection and measurement of hazardous substances (Competency Rule).

2. Take the necessary steps to complete the assignment competently such as personal study by the appraiser, association with another appraiser who has the required knowledge and experience, or obtaining the professional assistance of others who possess the required knowledge and experience (Competency Rule).

3. Identify as an extraordinary assumption reliance on any third party reports or obtained expert association that may have contributed to the valuation beyond the appraiser’s own competence.

4. Identify in the appraisal process and state in the report if the appraisal is based on an extraordinary assumption or hypothetical condition that the property is appraised as if unaffected by hazardous substances (SR 1-2(f) and/or (g), SR 2-1(c), and SR 2-2(a)(x), 2-2(b)(x), and 2-2(c)(x)).

5. Identify in the appraisal process the environmental condition of the subject property and surrounding properties, and the existence of documented instances of environmental contamination that may affect the value of the property. (SR 1-2(e)(i)).

6. Identify the scope of work necessary to complete the assignment, including the manner and degree to which the existence of environmental contamination will be addressed (SCOPE OF WORK RULE).

7. Consistent with the SCOPE OF WORK RULE, develop an opinion of unimpaired value of the subject property using an appropriate Hypothetical Condition clearly disclosed in the report.

8. If part of the appraiser’s assignment and consistent with the SCOPE OF WORK RULE, use generally accepted methods and techniques based on actual market data to analyze the extent to which the subject property may be adversely impacted by any cost, use or risk effects (property value diminution).

9. Where and if appropriate, apply the estimates of cost, use and risk effects (property value diminution) to estimate the value of the subject property in its impaired condition.

(Please Note: The purpose of this Guide Note to the Standards of Professional Appraisal Practice is to provide Members, Candidates, Practicing Affiliates and Affiliates with guidance as to how the requirements of the Standards may apply in specific situations.)
Guide Note 8
Use and Applicability of Letters of Transmittal

Introduction
A letter of transmittal means any type of written letter, memorandum, or statement that serves as a notice of delivery from the appraiser to a second party of a report containing an opinion or conclusion concerning real estate. The letter of transmittal may be a part of the appraisal report, or it may be a separate document.

The Uniform Standards of Professional Appraisal Practice do not require the use of a letter of transmittal. In many cases, such as with brief form reports, a letter of transmittal is not practical. With a few exceptions, USPAP is silent with regard to the use, or nonuse, of a letter of transmittal. The Management section of the Ethics Rule addresses “...fees, commissions, or things of value connected to the procurement of an appraisal, appraisal review, or appraisal consulting assignment” and requires that disclosure of such fees, if any, “...should appear in the certification of a written report and in any transmittal letter in which conclusions are stated.” The Standards Rules that require a signed certification to be included in the report (SR 2-3, 3-6, 5-3, 8-3, and 10-3) mention that any appraiser who signs a letter of transmittal (if one is used) must also sign a certification.

When used appropriately, a letter of transmittal is a good business practice. Used inappropriately, the letter of transmittal may inadvertently cause the appraiser to be in violation of USPAP.

The letter of transmittal can serve the following purposes:

1. It is a communication between the appraiser and the client, identifying the client who authorized the appraisal and establishing the fact that the appraiser has completed his or her contractual obligation in compliance with a previous contract, agreement, or letter of engagement.

2. It confirms the business and/or fiduciary relationship agreement between the client and the appraiser as to the work product embodied in the assignment and may enable the appraiser to limit the widening of that relationship to unintended users.

3. It may call attention to unusual conditions of the engagement, hypothetical conditions, extraordinary assumptions, or unusual limiting conditions that affect the assignment.

4. It may be used to establish the client as the party ordering the report and responsible for payment of the associated fee, while putting the client on notice that certain limitations (such as the right of publication and the possibility of submitting the report to a peer review committee) apply.

5. It may disclose the scope of work applied in the assignment so that the client and intended users of the report understand the level of reliability.
6. It may state the report option used and, in a Restricted Use Appraisal Report, may contain the use restriction required by Standards Rule 2-2(c) that limits reliance on the report to the client.

7. It may, if the letter of transmittal is a part of the appraisal report, include the signed certification required by Standards Rule 2-3.

The letter of transmittal need not contain a statement of the value or other opinion(s) as set forth in the body of the report. If it does, however, the appraiser must try to ensure that the letter remains attached to the remainder of the report. If the letter of transmittal contains the appraiser’s conclusion(s) and becomes detached from the body of the appraisal report, the letter could be used or construed as an appraisal report in itself. The reader of the letter could be misled or confused since the letter in itself will not typically meet the reporting requirements of USPAP.

If a Member, Candidate or Practicing Affiliate signs the letter of transmittal, the Appraisal Institute will consider the report to have been "delivered" for purposes of enforcing E.R. 1-1(e), which provides:

It is unethical to knowingly contribute to or participate in the preparation or delivery of a report containing an appraisal, appraisal review, appraisal consulting, or real property consulting analysis, opinion, or conclusion that reasonable appraisers would not believe to be justified, whether or not such report is signed or delivered by the Member, Candidate or Practicing Affiliate.

Basis for a Proper Letter of Transmittal
The following is an example of a letter of transmittal which is considered to be consistent with the guidelines outlined in this Guide Note.

March 15, 20XX

First Client Bank, Inc.
1932 Atkinson Drive
Chicago, Illinois

RE: The Hempstead Office Building, 2391 “A” Avenue, Greenville, Illinois
    Lot 23, Block 19, Glen Forest Office Park Subdivision, City of Greenville,
    Green County, Illinois

Dear [Mr. or Ms. Client]:

In fulfillment of the agreement outlined in the letter of engagement dated January 30, 2XXX, we are pleased to present the attached report of our appraisal of the leased fee estate in the referenced parcel of real estate, as of December 31, 2XXX. The report sets forth our opinion of market value along with supporting data and reasoning which form the basis of our opinion.

The value opinion reported is qualified by certain definitions, limiting conditions, and certifications which are set forth on pages 5 through 9 of this report. We particularly call to your attention to the
extraordinary assumption set forth on page 8 dealing with the possible existence of hazardous or toxic materials on the premises appraised.

We also point out that the value developed is based on the hypothetical condition that the City of Greenville approved a Special Use Permit for the property as of the date of value. This hypothetical condition is addressed in detail on page 35 of the report.

This report was prepared for and our professional fee billed to First Client Bank, Inc. It is intended only for use by your internal management, your auditor, and appropriate regulatory authorities. It may not be distributed to or relied upon by other persons or entities without our written permission.

The property was inspected by John Evans, SRPA, and the appraisal was developed by Mr. Evans and Sally Briggs, MAI. If you have any questions concerning the report, please contact Ms. Briggs at (312) 555-7789.

Sincerely,

BROWN & BRIGGS
By: John J. Briggs, MAI, Managing Partner

To avoid potential for abuse, the letter of transmittal should be prepared in such a way that it cannot be mistaken for or misused itself as an appraisal report. It should be simply a statement of delivery and completion of an assignment. It would be a good practice for the appraiser to avoid summarizing the opinion(s) or conclusion(s) developed in the report, referring the reader, instead, to the body of the report itself. Thus, the reader or user of the report will see the opinion only in its proper context, with appropriate explanations, extraordinary assumptions, hypothetical conditions, limiting conditions, definitions, disclaimers, etc.

If the appraiser deems it appropriate to include the value opinion or other conclusion in the letter of transmittal, it should be qualified with a statement such as the following:

As a result of our analysis, we have formed an opinion that the market value (as defined in the Report), subject to the definitions, certifications, extraordinary assumptions, hypothetical conditions, and limiting conditions set forth in the attached Report, as of December 31, 2XXX, was:

ONE MILLION DOLLARS ($1,000,000).

THIS LETTER MUST REMAIN ATTACHED TO THE REPORT, WHICH CONTAINS 94 PAGES PLUS RELATED EXHIBITS, IN ORDER FOR THE VALUE OPINION SET FORTH TO BE CONSIDERED VALID.
Summary of Standard Practices

1. If the value opinion is set forth in the letter of transmittal, include sufficient information in the letter so that it meets the reporting requirements for the appraisal report.

2. State any unusual circumstances associated with the assignment, such as unusual conditions of the engagement, extraordinary assumptions or hypothetical conditions used, or unusual limiting conditions.

3. Reference the appraisal report being transmitted, including its number of pages.

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members, Candidates, Practicing Affiliates and Affiliates with guidance as to how the requirements of the Standards may apply in specific situations.)
Guide Note 10
Developing an Opinion of Market Value in the Aftermath of a Disaster

Introduction
Natural disasters include hurricanes, floods, tornadoes, earthquakes, tsunamis, fires, severe winter storms, avalanches and mudslides, among others. Disasters can also be caused by human action or error; examples include terrorist attacks, riots, wars, panics in the financial markets, industrial accidents, chemical leaks, oil spills, shipping accidents, airline crashes, and structural failures of dams, bridges or buildings. Disasters tend to occur suddenly, taking the public by surprise, even when the location is known to be prone to such an occurrence. Depending on the nature of the disaster, injuries and death may be widespread and destruction of property may occur to varying degrees. Initially the collective reaction to any disaster is shock, then disbelief, mourning and sorrow. Eventually, there is recovery; those affected move on with their lives. Damaged property is repaired and destroyed property is often replaced.

The human tragedy aside, the aftermath of a disaster can be especially problematic in real property valuation assignments. During that time period, real property markets in affected areas often exhibit instability, even chaos. Analyzing data in such markets presents an array of challenges. How can an appraiser develop a credible opinion of market value in the aftermath of a disaster?

Characteristics of “Market Value”
“Market value” is the focus of many appraisal assignments. This Guide Note is intended to address market value assignments only; if the objective of an assignment is not market value, not all of the discussion in this Guide Note will apply.

There are many different definitions of “market value” in use, but all exhibit common characteristics. The entry for “market value” in the Definitions section of the Uniform Standards of Professional Appraisal Practice (USPAP), 2010 - 2011 Edition, addresses these common characteristics:

MARKET VALUE: a type of value, stated as an opinion, that presumes the transfer of a property (i.e., a right of ownership or a bundle of such rights), as of a certain date, under specific conditions set forth in the definition of the term identified by the appraiser as applicable in an appraisal.

Comment: Forming an opinion of market value is the purpose of many real property appraisal assignments, particularly when the client’s intended use includes more than one intended user. The conditions included in market value definitions establish market perspectives for development of the opinion. These conditions may vary from definition to definition but generally fall into three categories:
1. the relationship, knowledge, and motivation of the parties (i.e., seller and buyer);
2. the terms of sale (e.g., cash, cash equivalent, or other terms); and
3. the conditions of sale (e.g., exposure in a competitive market for a reasonable time prior to sale).

The Appraisal Institute The Dictionary of Real Estate Appraisal, 5th Edition, includes the following in its entry for "market value":

The most widely accepted components of market value are incorporated in the following definition:

The most probable price, as of a specified date, in cash, or in terms equivalent to cash, or in other precisely revealed terms, for which the specified property rights should sell after reasonable exposure in a competitive market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress.

The Dictionary goes on to cite the definition of "market value" used by agencies that regulate federally insured financial institutions in the United States:

The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- Buyer and seller are typically motivated;
- Both parties are well informed or well advised, and acting in what they consider their best interests;
- A reasonable time is allowed for exposure in the open market;
- Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
- The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

(12 C.F.R. Part 34.42(g); 55 Federal Register 34696, August 24, 1990, as amended at 57 Federal Register 12202, April 9, 1992; 59 Federal Register 29499, June 7, 1994)

The International Valuation Standards Committee defines “market value” as follows:

The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s-length transaction after proper
marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion. 
(International Valuation Standards, Eighth Edition.)

It is important to observe that the following elements are common to each of the foregoing definitions:

- Market value results when the parties are typically motivated, are generally well informed, and are acting in their best interest;

- Market value results when the property is exposed on the market for a reasonable length of time;

- Payment is in cash or its equivalent.

An appraiser must be especially mindful of these characteristics of market value when appraising in a chaotic or unstable market. Quite often, in the aftermath of a disaster, these characteristics are absent from the transactions that occur – if any occur at all. For example, buyers and sellers might choose to act before they have full information. Because of the disaster, they might be extraordinarily motivated to buy or to sell. Exposure times for properties on the market might become extended, or might suddenly become contracted. Sometimes, market activity will virtually cease altogether in the aftermath of a disaster; open escrows fall out; prospective sellers cancel plans to sell; and prospective buyers cancel plans to buy. The lack of data only further exacerbates the challenge for the appraiser.

Applicability of Basic Valuation Principles

Any appraisal problem must be approached using recognized appraisal methodology and in light of basic valuation principles, regardless of whether market conditions are at their most chaotic. Applying established approaches to solving valuation problems will help to simplify even the most complex assignments. Valuation in the aftermath of a disaster requires special attention to the fundamental appraisal principles of supply and demand, anticipation, change, substitution, contribution, externalities, and balance.

Supply and Demand

In economic theory, the principle that states that the price of a commodity, good, or service varies directly, but not necessarily proportionately, with demand, and inversely, but not necessarily proportionately, with supply. In a real estate appraisal context, the principle of supply and demand states that the price of real property varies directly, but not necessarily proportionately, with demand and inversely, but not necessarily proportionately, with supply.

Anticipation

The perception that value is created by the expectation of benefits to be derived in the future.

Change

The result of the cause and effect relationship among the forces that influence real property value.
Balance
The principle that real property value is created and sustained when contrasting, opposing or interacting elements are in a state of equilibrium.

Substitution
The appraisal principle that states that when several similar or commensurate commodities, goods, or services are available, the one with the lowest price will attract the greatest demand and widest distribution. This is the primary principle upon which the cost and sales comparison approaches are based.

Contribution
The concept that the value of a particular component is measured in terms of its contribution to the value of the whole property, or as the amount that its absence would detract from the value of the whole.

Externalities
The principle that economies outside a property have a positive effect on its value while diseconomies outside a property have a negative effect upon its value.

Valuation Considerations
Forces that influence real property values include social trends, economic circumstances, governmental controls and regulations and environmental conditions. Any or all of these might be impacted by a disaster. Factors that create value include utility, scarcity, desire and effective purchasing power. Again, any or all of these might become issues in the aftermath of a disaster. Property utility might be impacted by damage or destruction; properties might be more scarce because damaged or destroyed properties are removed from the overall supply; desire for property might increase because displaced homes and businesses need replacement space; and effective purchasing power might be impacted by changes in lending policies and practices in the area in response to the disaster.

A disaster might have a drastic impact on both supply and demand, causing them to suddenly be out of balance. There may be a dramatic drop in supply due to destruction and damage. At the same time, there may be a spike in demand because those who suffered loss or damage to owned or leased real estate will need to find replacement space. Many will not have the luxury of time in doing so. This is especially true with regard to residential real estate; people need to find alternative shelter immediately. As a result, sharp increases in asking and selling prices might be observed. This raises several questions from an appraisal viewpoint: Do such higher prices represent “market value”? Are the parties to the transactions “typically motivated” and acting in their best interest or is their behavior irrational? Are the properties being exposed on the market for a “reasonable” length of time prior to sale?

The principles of substitution, contribution and externalities help provide the answers to these questions. As in any assignment, identification of the subject’s market area is critical. Generally, all properties in the subject’s market area are similarly impacted by the disaster. “Typical” motivations and “reasonable” exposure times are therefore measured by what is observed in that market area during the same time period. In other words, “normal” is redefined – at least for the time being.
The principles of anticipation and change are especially relevant to valuation assignments in the aftermath of a disaster. There is generally a great deal of uncertainty in the market during this time period. Is the disaster likely to be repeated in the near future? Will further damage and destruction result? What is the extent of the damage? To what degree can structures be replaced? Are there environmental concerns, and if so, to what extent? And how long will it take before things return to “normal”? The impact of such uncertainty may be readily perceived but difficult to measure. Uncertainty in real estate markets means increased risk to property owners and investors. Such increased risk might be reflected in higher capitalization and discount rates. It might also be manifested in “discounted” prices – which to some degree might offset upward pressure on prices resulting from increased demand and decreased supply.

The appraiser must be especially mindful of issues relating to the date of value. Ideally, comparable data must be selected from the same market area and must be subject to the same market conditions. Transactions that occurred prior to the disaster will not reflect the same market conditions as those occurring after.

Following a catastrophic event, there may be few if any truly comparable sales from which to support a value opinion as of the current date. Additional data may need to be taken into consideration such as experience from other disaster-affected areas or anecdotal information obtained from interviews with market participants, for example. It is important that appraisers continue to apply and rely upon the same methods and techniques as in other assignments, remembering the analysis necessary to determine comparability of data.

Some appraisal assignments require the date of value to be prior to the disaster. Such retrospective valuations include those provided to assist insurers and insureds in establishing loss amounts for insurance purposes. In these cases, the appraiser must rely on data that occurred prior to that retrospective value date. Such transactions occurring in that time period would not have been impacted by the disaster. The difficulty in these retrospective valuations is that the appraiser cannot obtain firsthand information about the characteristics of the property that are relevant to the assignment as of the date of value; i.e., one cannot go back in time to visually inspect the property. The appraiser must therefore rely on the best available information about the nature of the subject property as of the date of value.

Such an appraisal would be based on one or more extraordinary assumptions about the property condition and other characteristics that are presumed to be true in the appraisal assignment.

The more problematic appraisal assignments are those for which the date of value occurs in the aftermath of the disaster. If no data is available on transactions that occurred in the aftermath of the disaster, data on transactions that occurred prior will require adjustment for market conditions. Such adjustments may be difficult to substantiate. An appraiser must be extremely careful in the use of such data and the estimation of any such market conditions adjustment. In time, more transactions will occur and more data will become available for analysis. Until then, the appraiser must work with what is available. The terms and conditions of any sales that do occur must be analyzed more closely; buyer and seller motivations must be investigated more thoroughly, and the nature of the property’s exposure on the market must be examined.
Sustainability of Value

A client might request an opinion of value, but to many clients the answer to another question may be paramount: How durable is that value? Are values in the aftermath of a disaster likely to be sustained over time? If values have risen in the aftermath of the disaster, are they likely to fall again in the near future? If values have fallen, are they likely to rise again? It is important to recognize that these questions are separate from the question of value, and answering them goes beyond the provision of an appraisal.

To some degree, the sustainability of value over time will be reflected in the current market value, because market participants build their expectations into prices; if they believe values will rise in the long run, they might be willing to pay more now. After a disaster there is much more uncertainty, and this tends to cause buyers and sellers to be more cautious. In the aftermath of a disaster there is more than the normal amount of risk in the marketplace. The market may be very fluid. Changes to market conditions may cause changes in market value to occur more rapidly than usual.

It may be helpful to communicate to the client the relative reliability of the value opinion. It is appropriate to point out in the appraisal report that the data upon which the appraisal is based is limited in quantity or quality and that this affects the reliability of the conclusions. If acceptable to the client, expressing the value opinion within a range may be an appropriate way to address this situation.

Competency Issues

The requirements of the Competency Rule in USPAP become greatly enhanced in assignments to develop market value opinions in the aftermath of a disaster. The Competency Rule identifies several types of competency, including competency with regard to (1) a property type (2) a market (3) a geographic area and (4) an analytical method. An appraiser who previously possessed sufficient competency to appraise a given property type in a given area might not have sufficient competency to appraise the same property type in that area in the aftermath of a disaster.

Government agencies and other bodies such as Fannie Mae, Freddie Mac, and the bank regulatory agencies might issue guidance or impose additional requirements on appraisers working in the affected areas after a major disaster. Appraisers must be cognizant of such additional requirements and pay them particular attention, as they may become enforceable requirements for such assignments.

Appraisers should be wary of requests to provide services other than appraisal services for which they lack competency. For example, in the aftermath of a disaster, some clients might request a signed report indicating the condition of a property, noting any damage or destruction. Unless the appraiser possesses the requisite competency to make judgments about these matters, the appraiser must not take on assignments that require competency that is beyond that of a real property appraiser.

Appraisers must avoid making statements of fact about what they believe they observed, when such statements are not substantiated by the necessary expertise. For example, an appraiser might observe what he or she thinks is mold in a flood-damaged property; but without definitive input from
an expert in mold, making a statement about the presence of mold might be misleading. Instead, the appraiser’s statements should be limited to what he or she actually observed. Instead of stating that mold was observed, state that “a black substance was observed on the walls.”

Appraisers must not allow their personal involvement in the disaster to affect their objectivity. This can be challenging in the wake of a disaster that has affected one’s own family, friends and/or hometown. An appraiser must be prepared to decline any assignment in which he or she cannot maintain impartiality.

Summary of Standard Practices

1. Developing an opinion of value in the aftermath of a disaster might require competency that surpasses or is different from that required prior to the disaster.

2. The characteristics of the applicable definition of market value must be carefully examined when appraising in a chaotic or unstable market.

3. Valuation in the aftermath of a disaster requires special attention to the fundamental appraisal principles of supply and demand, anticipation, change, substitution, contribution, externalities, and balance.

4. Transactions that occurred prior to the disaster will not reflect the same market conditions as those occurring after. Ideally, comparable data must be selected from the same market area and must be subject to the same market conditions as the subject property.

5. In appraisal assignments for which the date of value is a retrospective date prior to the disaster, the appraiser must rely on comparable sales that occurred prior to that retrospective value date.

6. In appraisal assignments for which the date of value is a retrospective date prior to the disaster, the appraiser must rely on the best available information concerning the nature of the subject property as of the date of value. Such an appraisal would be based on one or more extraordinary assumptions about the property condition and other characteristics that are as presumed to be true in the appraisal assignment.

7. Unless the appraiser possesses the requisite competency to make judgments about these matters, the appraiser must not take on assignments that require competency that is beyond that of a real property appraiser.

(Please note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members, Candidates, Practicing Affiliates and Affiliates with guidance as to how the requirements of the Standards may apply in specific situations.)
Guide Note 11
Comparable Selection in a Declining Market

Introduction
A declining market is generally characterized by few transactions and falling values. Declining markets present valuation challenges because there are fewer transactions available to analyze as comparables (“comps”) in the sales comparison approach or to support an estimate of external obsolescence in the cost approach. In a declining market, transactions used in an appraisal assignment require adjustments for changes in market conditions, but such adjustments are difficult to support without current transactions. Also, transactions that do occur often do so under conditions that do not align with the conditions of the value definition applicable to the assignment.

Basis for Proper Evaluation
Standards Rule 1-4 states, “In developing a real property appraisal, an appraiser must collect, verify, and analyze all information necessary for credible assignment results.”

Standards Rule 1-4 (a) goes on to state: “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.”

Characteristics of “Market Value”
“Market value” is the focus of many appraisal assignments. There are many different definitions of “market value” in use, but all exhibit common characteristics. The entry for “market value” in the Definitions section of the Uniform Standards of Professional Appraisal Practice (USPAP), 2012 - 2013 Edition, addresses these common characteristics:

MARKET VALUE: a type of value, stated as an opinion, that presumes the transfer of a property (i.e., a right of ownership or a bundle of such rights), as of a certain date, under specific conditions set forth in the definition of the term identified by the appraiser as applicable in an appraisal.

Comment: Forming an opinion of market value is the purpose of many real property appraisal assignments, particularly when the client’s intended use includes more than one intended user. The conditions included in market value definitions establish market perspectives for development of the opinion. These conditions may vary from definition to definition but generally fall into three categories:

1. the relationship, knowledge, and motivation of the parties (i.e., seller and buyer);
2. the terms of sale (e.g., cash, cash equivalent, or other terms); and
3. the conditions of sale (e.g., exposure in a competitive market for a reasonable time prior to sale).
The Appraisal Institute *The Dictionary of Real Estate Appraisal, 5th Edition*, includes the following in its entry for “market value”:

The most widely accepted components of market value are incorporated in the following definition:

The most probable price that the specified property interest should sell for in a competitive market after a reasonable exposure time, as of a specified date, in cash, or in terms equivalent to cash, under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably, for self-interest, and assuming neither is under duress.

The *Dictionary* goes on to cite the definition of “market value” used by agencies that regulate federally insured financial institutions in the United States:

The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- Buyer and seller are typically motivated;
- Both parties are well informed or well advised, and acting in what they consider their best interests;
- A reasonable time is allowed for exposure in the open market;
- Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
- The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

*(12 C.F.R. Part 34.42(g); 55 Federal Register 34696, August 24, 1990, as amended at 57 Federal Register 12202, April 9, 1992; 59 Federal Register 29499, June 7, 1994)*

The International Valuation Standards include the following definition of “market value”:

The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

*(International Valuation Standards, Eighth Edition.)*

It is important to observe that the following elements are common to each of the foregoing definitions:

- Market value results when the parties are typically motivated, are generally well informed, and are acting in their best interest;
- Market value results when the property is exposed on the market for a reasonable length of time;
- Payment is in cash or its equivalent.
Comparable Selection

Appraisers must consider all relevant transactions that have occurred in the market area and then determine which of those transactions should be used in the sales comparison analysis to arrive at a credible value opinion for the subject property. The best comps are those that are most similar to the subject property in terms of location, size, condition and other features that buyers and sellers believe make a difference to price. After selecting the best comps, the appraiser adjusts for material differences between each comp and the subject property. The appraiser must analyze each comp to ascertain what adjustments are needed. Factors that may require adjustment include atypical buyer/seller motivations and sales concessions.

When the objective of the assignment is market value, ideally each comp selected for use in the sales comparison approach should have sold under the conditions specified in the definition of market value being used. For example, the buyer and seller should have been typically motivated. The seller should not have been under any compulsion to sell, nor the buyer under any compulsion to buy. The marketing effort and exposure time on the market should have been typical for that property type in that market. Payment should have been in cash or terms equivalent to cash; i.e., the seller should not have granted cash or non-cash concessions to bring a sale at the stated price.

When the conditions of the sale do not reflect the conditions outlined in the market value definition, either (1) the appraiser must consider making adjustments for such differences if it is to be used as a comp, or (2) the sale must not be used as a comp.

Distressed Sales as Comparables

Distressed sales such as foreclosure sales and short sales are common in a declining market. Depending on the severity of the local market downturn, some, many, or even all sales that occur do so under distressed conditions.

Appraisers cannot categorically discount foreclosures and short sales as potential comps in the sales comparison approach. However, due to differences between their conditions of sale and the conditions outlined in the market value definition they might not be usable as comps. Foreclosures and short sales usually do not meet the conditions outlined in the definition of market value. A short sale or a sale of a property that occurred prior to a foreclosure might have involved atypical seller motivations (e.g., a highly motivated seller.) A sale of a bank-owned property might have involved typical motivations, so the fact that it was a foreclosed property would not render it ineligible as a comp. However, if the foreclosed property was sold without a typical marketing program, or if it had become stigmatized as a foreclosure, it might need to be adjusted if used as a comp. Further, some foreclosed properties are in inferior condition, so adjustments for physical condition may be needed.

As is always the case in selecting sales to use as comparables, appraisers must investigate the circumstances of each transaction, including whether atypical motivations were involved, sales concessions were involved, the property was exposed on the market for a typical amount of time, the marketing program was typical, or the property condition was compromised. Adjustments might need to be made for these circumstances. When it is necessary to use a distressed sale as a comp, the appraiser must carefully analyze the current local market to determine if an adjustment for conditions of sale is needed. If no adjustment is warranted, the lack of adjustment should be explained.
Physical condition and conditions of sale are two distinctly different factors that must be considered separately. They may be related to some degree in a distressed market, but not necessarily. An appraiser must not assume, for example, that a property was in inferior condition simply because it was a foreclosure.

The level of investigation needed to meet the requirement for sufficient diligence is generally more than is needed in non-distressed market situations. Further, supporting such adjustments can be particularly challenging when there are few current transactions to analyze. Competency in performing such investigation and analysis are required.

**Disposition Value and Liquidation Value**

The objective of an appraisal assignment might be disposition value or liquidation value rather than market value:

- Market value addresses the question, What would the property likely sell for on the date of value after a typical exposure period on the open market?
- Disposition value answers the question, What will the property likely sell for after a limited exposure on the market given the seller is compelled to sell?
- Liquidation value answers the question, What will the property likely sell for after a severely limited exposure on the market given the seller is extremely compelled to sell?

In the case of both disposition value and liquidation value, the limited or severely limited exposure time on the market is specified by the client.

Disposition value is defined in the Appraisal Institute *Dictionary of Real Estate Appraisal, 5th Edition* as:

The most probable price that a specified interest in real property should bring under the following conditions:

1. Consummation of a sale within a future exposure time specified by the client.
2. The property is subjected to market conditions prevailing as of the date of valuation.
3. Both the buyer and seller are acting prudently and knowledgeably.
4. The seller is under compulsion to sell.
5. The buyer is typically motivated.
6. Both parties are acting in what they consider to be their best interests.
7. An adequate marketing effort will be made during the exposure time specified by the client.
8. Payment will be made in cash in U.S. dollars or in terms of financial arrangements comparable thereto.
9. The price represents the normal consideration for the property sold, unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

This definition can also be modified to provide for valuation with specified financing terms.

Liquidation value is defined in the Appraisal Institute Dictionary of Real Estate Appraisal, 5th Edition as:

The most probable price that a specified interest in real property should bring under the following conditions:

1. Consummation of a sale within a short time period.
2. The property is subjected to market conditions prevailing as of the date of valuation.
3. Both the buyer and seller are acting prudently and knowledgeably.
4. The seller is under extreme compulsion to sell.
5. The buyer is typically motivated.
6. Both parties are acting in what they consider to be their best interests.
7. A normal marketing effort is not possible due to the brief exposure time.
8. Payment will be made in cash in U.S. dollars or in terms of financial arrangements comparable thereto.
9. The price represents the normal consideration for the property sold, unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

This definition can also be modified to provide for valuation with specified financing terms.

The appraiser’s analysis must be consistent with the type of value being sought. It is misleading to use sales that occurred under distress conditions, fail to adjust them (when necessary) for the conditions of the market value definition that were not met, and refer to the resulting value as market value. Ideally, when market value is the objective, the comps selected sold under the conditions stated in the market value definition and therefore they do not require adjustment for those conditions. Likewise, when disposition value is the objective, the comps selected sold under the conditions stated in the disposition value definition (including “specified exposure time” and “seller compelled to sell.”) The same principle holds true when the objective is liquidation value. However, in a declining market with few transactions, it is generally not realistic to expect that such ideal comps could be found. More likely, comps that sold under different conditions than stated in the value definition must be used and then adjusted as necessary and appropriate.

Appraisers must be careful to identify when sales are occurring at market value, disposition value or liquidation value. Even when the only sales occurring are distressed sales, they do not represent market value if they do not meet the conditions of the definition of market value.

With both liquidation value and disposition value, the time allowed for completion of the sale (exposure time) is not necessarily typical for the market for that property type; rather, it is limited, and it is specified by the client. If that time period is the same as what is typical in the current market, disposition value could be equal to market value.
Market Identification

Market analysis is a critical part of the process of developing a market value, disposition value, or liquidation value opinion. The appraiser must identify the subject’s market and understand the supply and demand forces at work in that market. Not all markets move in the same direction at the same rate. For example, volatility may be more prevalent in one location compared to other locations. Generalizations about macro-economic trends in the broader geographic area are not necessarily applicable to a specific market area. Similarly, trends observed for one price range or property type might not be applicable to other price ranges or property types.

In some markets, a “two-market” phenomenon might be observed, whereby there is a measurable difference between properties selling under non-distress conditions and virtually identical properties selling under distressed conditions. This phenomenon may become more prevalent as market conditions begin to improve. In other markets, there may be no measurable difference between properties selling under distressed conditions and those that are not.

Buyer and seller motivations may vary greatly depending on their specific circumstances. Often in a distressed market, buyers expect to find “deals” and will only purchase properties they believe are “undervalued.” Seller motivations can vary greatly, too. Sellers with equity may be more willing to sell (even if they have lost equity because of a market decline) than sellers who have very little or no equity. On the other hand, some property owners may willingly dispose of a property – even by defaulting – if they perceive there is little upside potential in the market and their cost to hold the property is burdensome.

Appraisers must remain aware of buyer and seller perceptions about how the market is likely to change in the near future. If market participants anticipate an improvement in the market or a further decline, their actions are likely to reflect that anticipation.

Lack of Available Sales Data

A declining market will likely exhibit very little sales activity. When the sales comparison approach is necessary, but there are virtually no current sales in the market area to analyze as comps, the appraiser must:

1. Expand the geographic area for comp search, then adjust for location as appropriate, and/or
2. Use less recent sales, then adjust for market conditions as appropriate.

When adjustments cannot be quantified using paired sales, other recognized methods of supporting adjustments may be applied, such as surveying market participants, analysis of rent or net income differentials, or cost analysis. Analysis of current listings can help provide an indication of market conditions and trends. The volume of listings, the change over time in volume of listings, and average days on the market should be analyzed to assist in making a determination about changes in market conditions.

Appraisers must be careful not to presume that the cost approach is a superior valuation technique to the sales comparison approach when comparable sales are lacking. Proper application of the cost
approach requires the use of cost data that is current as of the date of value, as well as estimation of any external obsolescence that might exist due to market conditions.

**Summary of Standard Practices**

1. Develop an appraisal of real property in a declining market only after ascertaining adequate knowledge and experience to complete the assignment competently (Competency Rule).

2. Identify the market for the subject property and the economic trends within that market.

3. Understand the type and definition of value applicable to the assignment, and apply valuation methodology that is consistent with that definition.

4. When selecting comparable sales, do not exclude or include any solely because they occurred under distress conditions.

5. In the sales comparison approach, recognize when adjustments need to be made for conditions of sale to comparables that sold under conditions that differ from the conditions set forth in the definition of value applicable to the assignment.

6. When comparable sales data are lacking, expand the geographic area for search and/or use less recent sales, then adjust as appropriate for location or market conditions.

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members, Candidates, Practicing Affiliates and Affiliates with guidance as to how the requirements of the Standards may apply in specific situations.)
Guide Note 12
Analyzing Market Trends

Introduction
Since the value of a property is equal to the present value of all of the future benefits it brings to its owner, market value is dependent on the expectations of what will happen in the market in the future. Therefore, a critical step in the development of a market value opinion is analysis of the market trends. The market trends study should include what market participants (buyers, etc.) believe will happen to market conditions in the future as well as current supply and demand, and anticipated changes to supply and demand. The interaction of these factors profoundly impacts the highest and best use, and in turn the market value of a property.

Analyzing current and anticipated market conditions is more complicated – and more critical – when a market is rapidly changing, either upward or downward. A “bubble” market might suddenly turn and decline; a “bust” market might suddenly start to improve.

To what extent is an appraiser responsible for recognizing changes in market conditions? What steps must an appraiser take to ensure due diligence is done regarding the analysis of market trends?

Basis for Proper Evaluation
The Uniform Standards of Professional Appraisal Practice (USPAP) include rules that address these questions.

Standards Rule 1-3 states:

When necessary for credible assignment results in developing a market value opinion, an appraiser must:

(a) identify and analyze the effect on use and value of existing land use regulations, reasonably probable modifications of such land use regulations, economic supply and demand, the physical adaptability of the real estate, and market area trends; and

Comment: An appraiser must avoid making an unsupported assumption or premise about market area trends, effective age, and remaining life.

(b) develop an opinion of the highest and best use of the real estate.

Comment: An appraiser must analyze the relevant legal, physical, and economic factors to the extent necessary to support the appraiser’s highest and best use conclusion(s).

(Emphasis added)
USPAP’s Scope of Work Rule states that an appraiser must “determine and perform the scope of work necessary to develop credible assignment results.” Scope of work includes the type and extent of data researched and the type and extent of analyses applied to arrive at opinions and conclusions. Thus, the extent of the analyses of market conditions and trends is a scope of work issue. Along with other aspects of scope of work, the extent of these analyses must be determined at the outset of each assignment.

Standards Rule 1-6 requires the appraiser to:

(a) reconcile the quality and quantity of data available and analyzed within the approaches used; and
(b) reconcile the applicability of the approaches, methods and techniques used to arrive at the value conclusion(s).

Reconciliation is an important step in the valuation process, especially when market conditions are such that good quality, current data is lacking.

**Factors That Cause Markets to Change**

Real estate markets are characterized by cycles. Real estate cycles typically involve successive periods of expansion, peak levels of activity, contraction, and troughs.

*Factors that cause markets to change* are distinctly different from *symptoms of change*. Examples of symptoms of change include changes in vacancy rates (a leading indicator), falling or rising property prices, increases in the frequency of concessions and seller financing, sales prices exceeding listing price, and other conditions symptomatic of larger, more basic problems. Factors that cause markets to change are generally the product of macro-level forces. They influence market psychology and drive behavior in profound, sometimes dramatic ways. Such causative factors can involve a single defining event or a slower moving series of events that are evolutionary in nature and sometimes not readily apparent to real time observers. Whether they consist of a single defining event or series of related events, these causative factors are indicative of shifts in underlying political and social as well as economic conditions.

Factors that cause markets to change may be capital (transactional) based or fundamental (space user) based. Examples of capital based factors that cause markets to change include:

1. Changes in public policy, particularly related to monetary policy and government spending, taxation, interest rates, the availability of financing and capital formation, length and facilitation of the local entitlement process, and employment initiatives.
2. Inflationary/deflationary pressures on the regional, national, and global economies.
3. Overabundance of investment capital resulting in increased competition (often too much money chasing too few deals), overly aggressive investment strategies, progressively lax underwriting standards.

Examples of fundamental (space user) based factors that cause markets to change include:
1. Changes in migration patterns and population shifts which cause overcapacity in some areas and undersupply in others.

2. Economic shock caused by events such as 9/11, the Lehman bankruptcy, the dot.com bust of the early 2000s, the Arab oil embargo of the 1970s, and periodic spikes in the price of oil, all of which caused wide-scale disruption in property markets affecting everything from corporate strategy, personal live/work decisions, and increased cost of property operation to demand for hotel rooms and second homes.

3. Aging population with its increased demand for retirement communities, congregate care facilities and smaller housing size.

4. Changes in technology such as green buildings, cloud computing, and internet shopping, which affect employment patterns, new industry formations, and new property types (e.g., server farms, disaster recovery facilities.)

5. Natural disasters and industrial accidents, which are usually local or regional in nature.

6. Changes in affluence and income distribution that influence affordability and consumer and discretionary spending habits.

7. Overbuilding and increases in competitive supply.

Market Analysis

*Market analysis* is defined as "a process for examining the demand for and supply of a property type and the geographic market area for that property type."\(^4\)

While appraisers generally analyze historic data (e.g. comparable sales) in the valuation process, it is important to recognize that the value of a property is dependent on the future benefits that a property will bring to its owner. Future benefits include the rights to use, occupy, and enjoy the property as well as the right to receive income it may produce. Market values are therefore forward-looking. Data used in the valuation process must be adjusted for market conditions as necessary so the market value conclusion reflects this forward-looking stance as of the date of value. Market analysis provides the framework for making determinations about market conditions adjustments.

Market analysis is a critical step in the appraisal process. Adequate market analysis must be completed before highest and best use analysis, and the determination of highest and best use is critical to an appraisal assignment when market value is the objective.

Market analysis provides the data input to identify the highest and best use of a property in terms of (1) property use (2) market support (economic demand) and timing (absorption rates), and (3) market participants (probable users and buyers.)\(^5\)

Most market analyses can be completed using a six-step process:

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\(^4\) Appraisal Institute, The Dictionary of Real Estate Appraisal, 5th ed. (Chicago: Appraisal Institute, 2010).

\(^5\) Stephen F. Fanning, Market Analysis for Real Estate: Concepts and Applications in Valuation and Highest and Best Use. (Chicago: Appraisal Institute, 2005.), p. 5
1. Define the product (property productivity analysis): Identify physical, legal and location attributes that shape productive capabilities and potential uses.

2. Market delineation: Identify the market for the use.

3. Demand analysis: Identify characteristics of the most probable user. Analyze demand drivers such as population, income, employment.

4. Supply analysis: Survey and forecast competition. Analyze existing supply, new inventory coming on line in the near future, and proposed construction.

5. Analysis of the Interaction between supply and demand: Determine if marginal demand exists, predict when market will move out of equilibrium.

6. Forecast subject capture: Analyze market penetration.

A seventh step, perform financial feasibility analysis of alternative uses and threshold testing, can be added for proposed properties.

The manner and degree to which these steps are carried out within an appraisal assignment are scope of work issues. The scope of work for an assignment must be appropriate given the intended use. It is the appraiser’s responsibility to determine the scope of work for the assignment. The scope of work must meet or exceed what the appraiser’s peers’ actions would be in the same or a similar assignment, and with the expectations of parties who are regularly intended users for similar assignments.

The appraiser must decline or withdraw from an assignment if the client will not allow the appraiser’s scope of work to be adequate for the assignment. The level of market analysis performed must be appropriate for the assignment and not limited solely because the client wishes to reduce the appraisal cost.

The level of analysis can range from simple to highly sophisticated. On a simple level, demand may be inferred from current market conditions, or rates of change used to develop projections. On the more sophisticated level, an in-depth analysis of forecast (fundamental) demand is performed.

Fundamental market analysis may be useful and necessary when analyzing or performing an appraisal of a property for new construction, or when appraising property in a volatile or rapidly changing market. In terms of real estate products, whether it be apartments, industrial, retail or office properties, fundamental market analysis answers the questions of “when and how much.”

Competent appraisers continuously interact with buyers, sellers and agents of transaction activity. Ideally, appraisers have frequent and sustained interaction with buyers or lessees in particular. Such interaction allows appraisers to ascertain, analyze, and understand the motivations of market participants. Appraisers must be familiar with the local market dynamics and be able to perform trend analysis and/or fundamental market analysis to the degree necessary for the specific assignment.

However, appraisers are not expected to be prognosticators. Unforeseen events can completely eradicate conclusions that have been based in trend analysis or fundamental market analysis. A market value opinion is as of a particular date, and it is an attempt to reflect the anticipations of market participants as well as market fundamental trends and analysis. Events subsequent to the date of value
that were not anticipated by market participants can cause values to change -- in some cases, significantly.

**Signs of a Changing Market**

Signs of a changing market are symptoms, as opposed to causes. An appraiser observes the symptoms, but must understand the underlying cause or causes in order to properly analyze market trends.

For appraisers and market participants, a “bust” market is usually relatively obvious. However, it can be difficult to spot a “bubble” market when in the midst of one. Further, it can be difficult to tell when a bust market has started to turn and improve, or when a bubble market has begun to decline.

A bubble may be evidenced by:

1. Rate of return associated with a property type, economic characteristics of tenants or users are not typical and tend to be very low. For example, capitalization rates may be very low and or indicate negative leverage, which is often a sign of speculation.
2. Buyers become emotionally involved and act irrationally, contrary to the market value definition.
3. Prices increase at a faster rate than rents.
4. Rates of return decrease below long-range trends.
5. Prices rise while rents and net incomes remain stable or are declining.
6. Traditional buyers are replaced by new ones. “Everyone” starts to invest in real estate.
7. The number of transactions increases.
8. Shorter marketing times.
9. Average days-on-market decreases.
10. Very few expired listings.
11. An increase in the number of properties remaining vacant after purchase.
12. Condominium conversions become more common.
13. The number of persons employed in the real estate sector (real estate sales, mortgage lending) significantly increases.
14. Rents increasing faster than the ability of tenants to pay.
15. Sales prices above affordability of users.

A bust market may be evidenced by:

1. Sellers are reluctant to sell and realize losses; therefore, there are few sales, at least initially.
2. An increase in the rate of foreclosures, to the point where foreclosures become the predominant sales.
3. An increase in seller concessions, both in terms of frequency and magnitude.
4. A tightening of credit markets. Traditional financing becomes more difficult to obtain.
5. An increase in the use of “creative” financing, generally involving seller financing. These arrangements serve to keep nominal prices from falling, at least in the initial stages of a bust.
6. Longer marketing times.
7. Average days-on-market increases.
8. The number of expired listings increases.
9. The number of persons employed in the real estate sector declines.
GUIDE NOTE 12

11. Rents not rising at the rate of the last few years.
12. Vacancy increasing.

Reconciliation
There are two risks inherently associated with any appraisal that are of particular concern to the intended user. The first is the risk that the reliability of the value conclusion may be adversely impacted by a lack of quality data. The second is the risk that the value might not be sustainable over time. A well thought-out and clearly presented reconciliation process can assist the intended user with these risks.

In the reconciliation process, the appraiser must consider the quality as well as the quantity of data, and how those factors might have impacted the quality of the value opinion. In a slower market with fewer transactions, there are fewer sales available for analysis in the sales comparison approach. Also, when there are fewer transactions, there is less market evidence available for selection of capitalization and discount rates.

The reconciliation process may indicate that more research is needed or that new analyses must be performed. It may reveal conflicts or unresolved questions that need to be answered.

When necessary, the appraisal report should include a discussion of evidence that the value conclusion may not be sustainable into the foreseeable future. This is potentially a controversial and challenging conversation to have with one’s client, but it may be a critical issue to highlight.

Summary of Standard Practices
1) Make the appropriate scope of work determination for the assignment given the intended use.

2) Apply market analysis at the level appropriate for the assignment and consistent with the scope of work determination.

3) Understand the causes of a changing market.

4) Recognize the signs of a changing market.

5) Communicate the market analysis clearly in the appraisal report.

6) Clearly present the reconciliation process in the appraisal report and discuss as appropriate the likelihood that the value might not be sustainable into the foreseeable future.

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members, Candidates, Practicing Affiliates and Affiliates with guidance as to how the requirements of the Standards may apply in specific situations.)
Introduction

Federally insured lending institutions in the United States are subject to regulations regarding real estate appraisals. For lending transactions involving real estate, a lender must obtain an appraisal from a state licensed or certified appraiser. There are twelve exemptions from this requirement. For three of these twelve exemptions, in lieu of an appraisal by a licensed/certified appraiser the lender may obtain an evaluation.\(^6\)

An evaluation provides a market value of the real estate collateral. The preparer must be appropriately qualified and sufficiently independent from the transaction, but need not be a state licensed or certified appraiser. Even so, appraisers are often called upon to provide them.

How can an appraiser prepare an evaluation for a lender and comply with the Uniform Standards of Professional Appraisal Practice (USPAP)?

Basis for Proper Practice

The Interagency Appraisal and Evaluation Guidelines issued by the federal agencies\(^7\) in December 2010 provide full details about when appraisals and evaluations are required, who can provide them, and how they must be performed. Section V (pp. 20-22) addresses the independence requirements for both appraisals and evaluations. Section VI (pp. 22-23) addresses the selection, evaluation and monitoring the performance of those providing these services. Section XI (pp. 28-29) addresses when evaluations are required. Section XII (p. 30) addresses the development process for an evaluation, and Section XIII (pp. 31-32) addresses the required content of an evaluation report. Section XV (pp. 32-33) addresses the review of appraisal and evaluation reports.

Portions of USPAP that are relevant to this topic include the DEFINITIONS section, the SCOPE OF WORK RULE, and STANDARDS 1 and 2.

The DEFINITIONS establish the application of certain terminology in USPAP. See especially the definitions of appraisal and report.

The SCOPE OF WORK RULE presents obligations related to problem identification, research and analyses.

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\(^6\) For the remaining 9 exemptions, the lender is not required to document the collateral value with either an evaluation or an appraisal from a state licensed or certified appraiser.

\(^7\) These agencies include the Office of the Comptroller of the Currency, Treasury (OCC); the Office of Thrift Supervision, Board of Governors of the Federal Reserve System (FRB); Federal Deposit Insurance Corporation (FDIC); and the National Credit Union Administration (NCUA).
STANDARDS 1 and 2 establish requirements for the development and communication of a real property appraisal.

Additional guidance from the Appraisal Standards Board can be found in Advisory Opinions 11 and 12 concerning the reporting options and Advisory Opinion 21 concerning USPAP compliance.

What is an Evaluation?
An evaluation is defined in the Interagency Appraisal and Evaluation Guidelines as “A valuation permitted by the Agencies’ appraisal regulations for transactions that qualify for the appraisal threshold exemption, business loan exemption, or subsequent transaction exemption.”

When are Evaluations Used?
A lender may obtain an evaluation in lieu of an appraisal when the loan transaction:

- Has a transaction value equal to or less than $250,000;
- Is a business loan with a transaction value equal to or less than the business loan threshold of $1 million, and is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment, or
- Involves an existing extension of credit at the lending institution, provided that:
  - There has been no obvious and material change in market conditions or physical aspects of the property that threaten the adequacy of the institution’s real estate collateral protection after the transaction, even with the advancement of new monies; or
  - There is no advancement of new monies other than funds necessary to cover reasonable closing costs.

Who Can Prepare Evaluations?
According to the Interagency Appraisal and Evaluation Guidelines, persons performing evaluations should be independent of the loan production and collection processes and have no direct, indirect or prospective interest, financial or otherwise, in the property or transaction. In addition, the Guidelines stipulate that an institution should have criteria for selecting, evaluating, and monitoring the performance of persons who perform evaluations. The criteria should ensure that:

- The person selected possesses the requisite education, expertise, and experience to competently complete the assignment.
- The work performed by persons providing evaluation services is periodically reviewed by the institution.
- The person selected is capable of rendering an unbiased opinion.

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8 Interagency Appraisal and Evaluation Guidelines, December 2010, p. 60.
• The person selected is independent and has no direct, indirect, or prospective interest, financial or otherwise, in the property or the transaction.

• Persons who perform evaluations should possess the appropriate appraisal or collateral valuation education, expertise, and experience relevant to the type of property being valued. Such persons may include appraisers, real estate lending professionals, agricultural extension agents, or foresters.10

Individuals who perform evaluations need not be state licensed or certified appraisers. However, state licensed and certified appraisers are not precluded from providing them. Because appraisers are independent and qualified to provide valuations of real property, they are often called upon to provide evaluations.

The Guidelines state that an institution should review evaluations (and appraisals) to ensure they comply with the Agencies’ appraisal regulations and are consistent with supervisory policies and the institution’s own internal policies. The review should ensure the evaluation contains sufficient information and analysis to support the decision to engage in the transaction.11

What are the Development Requirements for Evaluations?

The Interagency Appraisal and Evaluation Guidelines establish parameters for the development of an evaluation. An evaluation must:

• Be consistent with safe and sound banking practices,

• Support the institution’s decision to engage in the transaction,

• Provide a reliable estimate of the collateral’s market value as of a stated effective date prior to the decision to enter into the transaction,

• Be based on a valuation method that is appropriate for a transaction rather than the method that renders the highest value, lowest cost, or fastest turnaround time,

• Address the property’s actual physical condition and characteristics,

• Address the economic and market conditions that effect the estimate of the collateral’s market value, and

• Not be based on unsupported assumptions, such as an assumption that the property is in average condition, the zoning will change, or the property is not affected by adverse market conditions.12

While the Guidelines do not state that a property inspection is necessary in all cases, they do say the institution should “establish criteria for determining the level and extent of research or inspection necessary to ascertain the property’s actual physical condition, and the economic and market factors that

should be considered in developing an evaluation.” If a property inspection is not performed, “the institution should be able to demonstrate how these property and market factors were determined.”

The Guidelines further clarify that broker price opinions (BPOs), automated valuation models (AVMs), and tax assessment values (TAVs) do not suffice in themselves as evaluations. However, they can be used to assist in the development of an evaluation.

What are the Reporting Requirements for Evaluations?

According to the Interagency Appraisal and Evaluation Guidelines:

An evaluation should contain sufficient information detailing the analysis, assumptions, and conclusions to support the credit decision. An evaluation’s content should be documented in the credit file or reproducible. The evaluation should, at a minimum:

1. Identify the location of the property.
2. Provide a description of the property and its current and projected use.
3. Provide an estimate of the property’s market value in its actual physical condition, use and zoning designation as of the effective date of the evaluation (that is, the date that the analysis was completed), with any limiting conditions.
4. Describe the method(s) the institution used to confirm the property’s actual physical condition and the extent to which an inspection was performed.
5. Describe the analysis that was performed and the supporting information that was used in valuing the property.
6. Describe the supplemental information that was considered when using an analytical method or technological tool.
7. Indicate all source(s) of information used in the analysis, as applicable, to value the property, including:
   a. External data sources (such as market sales databases and public tax and land records);
   b. Property-specific data (such as previous sales data for the subject property, tax assessment data, and comparable sales information);
   c. Evidence of a property inspection;
   d. Photos of the property;
   e. Description of the neighborhood; or
   f. Local market conditions.

8. Include information on the preparer when an evaluation is performed by a person, such as the name and contact information, and signature (electronic or other legally permissible signature) of the preparer.\textsuperscript{15}

How Can an Appraiser Provide an Evaluation and Comply with USPAP?

USPAP addresses the development of a real property appraisal in STANDARD 1 and the communication (reporting) of a real property appraisal in STANDARD 2. The SCOPE OF WORK RULE allows considerable flexibility in the development process. The scope of work for an assignment may be adjusted as appropriate for the intended use. The degree of property inspection, the extent of the data collection process, and the type and level of analysis can vary as needed, as long as the resulting opinions and conclusions are credible in light of the intended use. For purposes of preparing an evaluation per the Interagency Appraisal and Evaluation Guidelines, consideration may be given to these factors.

For example, in some cases it may be possible to rely on a prior appraisal report for information about the property, such as its size and physical attributes. When this is done, the report must clearly state the source of the information, that it was assumed to be accurate, and that the value conclusion might be different otherwise.

In other cases, an “at least” conclusion might be all that is required. USPAP permits a value conclusion to be stated as a single number, a range, or a relationship to some amount\textsuperscript{16} – for example, “not more than,” “not less than,” or “at least” some benchmark amount. The benchmark amount could be a prior appraised value, sale price, or other amount that is relevant to the intended use.

Narrowing the scope of work could also mean omitting one or more of the three approaches to value. For example, if the sales comparison approach is the primary approach (as is often the case for single family residences and owner occupied commercial properties), it may be appropriate to omit the cost and income approaches. If the income approach is the primary approach (as is often the case for income-producing properties), it may be appropriate to omit the sales comparison and cost approaches. While all three approaches are generally helpful, not all three are critical to every valuation problem, given the intended use.

Under STANDARD 2, three reporting options are available for written appraisal reports. The minimal report option is the Restricted Use Appraisal Report. This option is permitted only when the client is the sole intended user of the report. A Restricted Use Appraisal Report is not required by USPAP to include the data and analysis used to arrive at the value opinion, or a detailed property description, though it can be supplemented to include that information. Because the Interagency Appraisal and Evaluation Guidelines require this detail, a Restricted Use Appraisal Report that meets the minimum requirements of USPAP would not be sufficient to serve as an evaluation. However, a Restricted Use Appraisal Report that is supplemented so it includes all of the information required by the Guidelines should be sufficient.

\textsuperscript{15} Interagency Appraisal and Evaluation Guidelines, December 2010, pp. 31-32.
\textsuperscript{16} Uniform Standards of Professional Appraisal Practice, DEFINITIONS. See Comment to the entry for appraisal.
The following outline is intended to assist in creating a Restricted Use report format that meets minimum requirements of USPAP as well as the Interagency Appraisal and Evaluation Guidelines for an evaluation. While additional elements may be added, none should be deleted, as deleting elements might cause the report to fail to meet USPAP’s reporting requirements and/or the Interagency requirements for an evaluation. Note that editing is required for the italicized items.

**OUTLINE FOR AN EVALUATION**

**CLIENT/INTENDED USER:** For the sole use of *Lender ABC*. This report is not intended for use by other parties.

**INTENDED USE:** To assist the client in establishing collateral value in a lending transaction that requires an “evaluation” as set forth in the Interagency Appraisal and Evaluation Guidelines. This report is not intended for any other use.

**ASSIGNMENT OBJECTIVE:** To develop an opinion of the Market Value, as defined by the federal financial institution regulatory agencies, of the stated interest in the subject property.

**EFFECTIVE DATE OF VALUE OPINION:** DD/MM/YYYY

**REAL PROPERTY INTEREST VALUED:** Fee simple/Leased Fee/Leasehold/other

**IDENTIFICATION OF REAL ESTATE:** 100 Main St., City, State

**CURRENT LISTING/CONTRACT INFORMATION:** The subject property is/is not currently listed/under contract for $XXX,XXX. This asking/contract price is/is not consistent with the appraiser’s opinion of market value. (If not consistent, explain discrepancy.)

**PREVIOUS SALE DATA:** Include data and analysis of any transaction within the last 3 years involving the subject property.

**ASSIGNMENT CONDITIONS:** Clearly state any extraordinary assumption(s) on which the analysis is premised and state that the use of the extraordinary assumption might have affected the assignment results.

**DATE OF REPORT:** DD/MM/YYYY

**SCOPE OF WORK:** In preparing this appraisal, I:

- Describe level of inspection. Include the date of property inspection, if applicable.
- Describe process of gathering information on comparable land and improved sales, rents operating expenses, construction costs, accrued depreciation, capitalization and/or yield rates.
- Describe how comparable sales and/or rental information was confirmed.
- Describe valuation approaches used and address the exclusion of any of the typical approaches (sales comparison, cost, income).

**REPORT OPTION:** This report is a Restricted Use Appraisal Report in accordance with Standards Rule 2-2(c) of the Uniform Standards of Professional Appraisal Practice. Additional supporting documentation is retained in the appraiser's workfile. The appraiser’s opinions and conclusions set forth in this report may not be understood properly without additional information in the appraiser’s workfile. However, in order to meet the requirements for an “evaluation” according to the Interagency Appraisal and Evaluation Guidelines, this report has been supplemented with additional information about the subject property and its market, as well as the data, reasoning, and analyses that were used in the valuation process.

**LOCATION DESCRIPTION:** Describe the property’s location and discuss local market conditions.
PROPERTY DESCRIPTION: Provide a description of the property and its current and projected use. Discuss the property’s physical condition. Attach photographs.

TAX ASSESSMENT DATA: Assessed land value: $XXX,XXX Assessed improvement value: $XXX,XXX Tax year: YYYY

HIGHEST AND BEST USE CONCLUSION: Current use/other (if other, describe).

VALUATION ANALYSIS: Describe the analysis that was performed (approaches) and the supporting information that was used in valuing the property. For example, if a sales comparison approach was performed, include an adjustment grid showing comparable analysis. If an income approach was performed, show development of income and expense estimates, capitalization rate and/or discount rate. Include sources of comparable sales information. Include external data sources (such as market sales databases and public tax and land records).

VALUE CONCLUSION: $XXX,XXX

ESTIMATED EXPOSURE TIME (amount of time the subject property would have been on the market to bring a sale as of the effective date of the value opinion): 1 month

CERTIFICATION:
I certify that, to the best of my knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions and are my personal, impartial, and unbiased professional analyses, opinions, and conclusions.
- I have no (or the specified) present or prospective interest in the property that is the subject of this report and no (or the specified) personal interest with respect to the parties involved.
- I have performed no (or the specified) services, as an appraiser or in any other capacity, regarding the property that is the subject of this report within the three-year period immediately preceding acceptance of this assignment.
- I have no bias with respect to the property that is the subject of this report or to the parties involved with this assignment.
- My engagement in this assignment was not contingent upon developing or reporting predetermined results.
- My compensation for completing this assignment is not contingent upon the development or reporting of a predetermined value or direction in value that favors the cause of the client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of this appraisal.
- My analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Uniform Standards of Professional Appraisal Practice.
- I have (or have not) made a personal inspection of the property that is the subject of this report. (If more than one person signs this certification, the certification must clearly specify which individuals did and which individuals did not make a personal inspection of the appraised property.)
- No one provided significant real property appraisal assistance to the person signing this certification. (If there are exceptions, the name of each individual providing significant real property appraisal assistance must be stated.)
• The reported analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Code of Professional Ethics and Standards of Professional Appraisal Practice of the Appraisal Institute.

• The use of this report is subject to the requirements of the Appraisal Institute relating to review by its duly authorized representatives.

• (Designated Members Only) As of the date of this report, I have/have not completed the continuing education program of the Appraisal Institute.

• (Candidates Only) As of the date of this report, I have/have not completed the Standards and Ethics Education Requirement of the Appraisal Institute for Candidates.

• (Practicing Affiliates only) As of the date of this report, I have/have not completed the Standards and Ethics Education Requirement of the Appraisal Institute for Practicing Affiliates.

___________________________
Signature

Summary of Standard Practices

1. “Evaluations” per the Interagency Appraisal and Evaluation Guidelines are market value opinions that may be provided by individuals who are not state licensed or certified appraisers. However, state licensed and certified appraisers may provide them.

2. The Interagency Appraisal and Evaluation Guidelines set forth development and reporting requirements for “evaluations.” The reporting requirements do not exactly align with the reporting requirements for an appraisal under USPAP. However, an appraiser subject to USPAP can prepare an “evaluation” that meets both the Guidelines and USPAP.

3. USPAP allows an appraiser to adjust the scope of work for a valuation assignment as long as the resultant value opinion is credible, given the intended use. When preparing an “evaluation” the appraiser may consider narrowing the scope of work as appropriate.

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members, Candidates, Practicing Affiliates and Affiliates with guidance as to how the requirements of the Standards may apply in specific situations.)
Guide Note 14
Concept of Exposure Time

Introduction
An analysis and opinion of Exposure Time is required for appraisals where the definition of value is tied to a reasonable or stipulated exposure time. A discussion of Exposure Time allows the intended user(s) to put the appraiser’s value opinion into context. It also serves as the foundation on which appraisers describe market conditions, analyze comparable sales, and reconcile an opinion of value to the actual sale price.

Analyzing the Exposure Time linked to the value opinion has long been a requirement of professional appraisal practice. This Guide Note seeks to provide clarity on the concept of Exposure Time.

The Role of Exposure Time
The Appraisal Institute text The Dictionary of Real Estate Appraisal, 5th Edition, includes the following in its entry for “market value”:

The most widely accepted components of market value are incorporated in the following definition:

The most probable price that the specified property interest should sell for in a competitive market after a reasonable exposure time, as of a specified date, in cash, or in terms equivalent to cash, under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably, for self-interest, and assuming that neither is under duress. [Emphasis added]

Because market value definitions typically include a condition that a reasonable time is allowed for exposure in the open market, the concept of Exposure Time has an important role in the appraisal process. Appraisers must develop an opinion of the Exposure Time linked to the value opinion because reasonable exposure in the market is a condition of the definition of market value.¹⁷

The Appraisal Institute text The Dictionary of Real Estate Appraisal, 5th Edition, defines “Exposure Time” as:

The estimated length of time the property interest being appraised would have been offered on the market prior to the hypothetical consummation of a sale at market value on the effective date of the appraisal; a retrospective estimate based on an analysis of past events assuming a competitive and open market.

¹⁷ Appraisers must be aware of assignment conditions that apply to the appraiser of the assignment. For example, the Uniform Appraisal Standards for Federal Land Acquisition (Yellow Book) direct appraisers not to link their estimates of market value made for federal acquisition purposes to a specific exposure time.
A discussion of Exposure Time allows the intended user(s) of an appraisal to put the value opinion into context. It also serves as the foundation on which appraisers describe market conditions, analyze comparable sales, or reconcile an opinion of value to the actual sale price.

**USPAP Requirements**

*Uniform Standards of Professional Appraisal Practice (USPAP)*, 2012 - 2013 Edition, defines “exposure time” as the:

estimated length of time that the property interest being appraised would have been offered on the market prior to the hypothetical consummation of a sale at market value on the effective date of the appraisal.

Sort: Exposure time is a retrospective opinion based on an analysis of past events assuming a competitive and open market.

The Comment to USPAP Standards Rule 1-3 (c) states:

When exposure time is a component of the definition for the value opinion being developed, the appraiser must also develop an opinion of reasonable exposure time linked to that value opinion.

The Comment to the reporting requirements of USPAP Standards Rules 2-2 (a)(v), 2-2 (b)(v), and 2-2 (c)(v) states:

When an opinion of reasonable exposure time has been developed in compliance with Standards Rule 1-2(c), the opinion must be stated in the report.

Statement on Appraisal Standards No. 6, *Reasonable Exposure Time in Real Property and Personal Property Opinions of Value* elaborates on the obligations of USPAP.

**The Importance of Exposure Time**

Exposure Time matters to the valuation process because:

1. Reasonable exposure in the market is a condition of the definition of market value.

2. Improper identification of the reasonable Exposure Time in a market value opinion can lead to a value conclusion that is not credible.

3. The study of market conditions and Exposure Time allows for proper analysis of market activity.

4. Recognition of reasonable Exposure Time is part of the process of evaluating the suitability of sales as comparables.
5. An understanding of reasonable market Exposure Time is needed to recognize and evaluate the impact of limited market exposure in liquidation transactions.

6. Analysis of a prior sale of the subject requires a comparison of the reasonable Exposure Time linked to the value opinion and the exposure period associated with the sale.

The Exposure Time associated with a market value opinion can affect the value opinion. The length of time that a property is exposed in the market impacts the number of potential buyers for the property. Longer exposure to the market typically results in more potential buyers, and shorter exposure to the market typically results in fewer potential buyers. The number of potential buyers who are aware of a property’s availability can influence the sale price. It follows then that when value opinions are based on market exposure that is inadequate or excessive, the value opinion is not market oriented. Improper identification of the reasonable Exposure Time in a market value opinion can lead to a value conclusion that is not credible.

The proper analysis of a sale transaction requires an understanding of the reasonable Exposure Time associated with a market value opinion. When the objective of the assignment is market value, ideally each comparable selected for use in the Sales Comparison Approach should have sold under the conditions specified in the definition of market value being used. One condition is that the marketing effort and exposure to the market should have been typical for that property type in that market.

Analyzing and understanding market activity requires knowledge of reasonable exposure times for the subject property type in that market. An unusually fast sale may suggest that a property was underpriced or that the seller was under duress. Increasing exposure times can become the basis to expect that the market is softening. When the conditions of a sale do not reflect the conditions outlined in the value definition, then the appraiser must consider making adjustments for such differences or the sale must not be used as a comparable.

The analysis of prior sales of the property being appraised is a fundamental component in market value appraisals and a requirement of USPAP. In order to reconcile a prior sale price with the appraiser’s opinion of value, the appraiser must analyze the marketing history and evaluate the reasonableness of the exposure period associated with the sale. Inadequate or excessive exposure to the market is a factor that should be considered in analyzing the prior sale. Limited market exposure is a factor in the lower sale prices that often result from liquidation transactions. A second factor in a liquidation transaction is that the seller is under extreme compulsion to sell. An appraiser must have an understanding of a reasonable Exposure Time in order to recognize and evaluate the impact of limited market exposure. Analysis of a prior sale of the subject requires a comparison of the reasonable Exposure Time linked to the value opinion and the exposure period associated with the sale.

Developing an Opinion of Reasonable Exposure Time

Exposure Time is different for various types of property and under various market conditions. It is not a fixed period and should not be a boilerplate statement. The reasonable exposure period is a function of the price, market conditions, and property characteristics.

The basis for an opinion of Exposure Time can include consideration of one or more of the following:
• Statistical information about days on market for similar types of property
• Information gathered through sales verification
• Interviews of market participants
• Market information from data collection services

Gathering and analyzing information for days on the market from these sources is required for proper development of an opinion of Exposure Time.

When evaluating market data, appraisers must focus on the period of exposure needed to sell a property priced within a reasonable range of market value. Meaningful analysis of days on market requires consideration of the number of days at a price proximate to the market value, excluding exposure time at a price not considered reasonable by market participants. Statement on Appraisal Standards No. 6 in USPAP (2012 - 2013 Edition) provides an example of proper analysis:

…an office building… could have been on the market for two years at a price of $2,000,000, which informed market participants considered unreasonable. Then the owner lowered the price to $1,600,000 and started to receive offers, culminating in a transaction at $1,400,000 six months later. Although the actual exposure time was 2.5 years, the reasonable exposure time at a value range of $1,400,000 to $1,600,000 would be six months.

The data used in the development of an Exposure Time opinion must be drawn from the subject market, including consideration of property type, location, property characteristics, typical buyer, and price segment. Statement on Appraisal Standards No. 6 in USPAP (2012 - 2013 Edition) states that:

The answer to the question “what is the reasonable Exposure Time?” must incorporate the answers to the question “for what kind of property at what value range?”

For example, consider an appraisal of a highly desirable waterfront home in a community that includes a wide range of property values. Market research shows that the Exposure Time for the entire community averages approximately 60 to 90 days. Closer examination of the market for waterfront homes in the subject price range and in the subject neighborhood indicates that a more appropriate estimate of the subject Exposure Time is 120 to 180 days. An appraiser must focus on data that is similar in location, market appeal and price range to properly support an opinion of Exposure Time.

In a second example, the subject of the appraisal assignment is an industrial building with warehouse ceiling height of 16 feet. The market demands and most competing properties have 24 feet of clear height. In addition to considering the effect of this functional deficiency on value and rental revenue, the appraiser would need to evaluate the effect on marketability and Exposure Time. Commonly, the time required to obtain a buyer will be extended for a property with functional obsolescence. The appraiser could consider market time data for properties that have sold with similar obsolescence issues or interview market participants to support an opinion of Exposure Time.

The use of generic or overly broad market data to support an Exposure Time opinion is inappropriate. Opinions of Exposure Time can be presented as a single time period (e.g. six months) or as a range of
time (e.g. six to twelve months). Both are acceptable, but must be supported and linked to the value opinion.

**Conceptions**
The term Exposure Time is often confused with the term “marketing time,” but they are not the same. Market value is the most probable price that a property interest should sell for in a competitive market after it has been exposed to the market for a reasonable period. Exposure Time is the period of time preceding the effective date the appraisal. Exposure Time is an opinion of the length of time a property would have been exposed to the market in order to sell at the appraiser’s opinion of market value. An opinion of Exposure Time is not intended to be a forecast. Consider the following illustration:

Marketing time is deemed to start at the effective date of the appraisal, looking forward in time. It is a prediction of how long a property would require exposure to the market in order to find a buyer, under either typical or prescribed circumstances.

Confusion between Exposure Time and marketing time can arise because most sources of market information report historical information about days on market as “marketing time.” In this context, the marketing time is a historical number that reflects the length of time a property was exposed to the market prior to sale. This, by definition, is Exposure Time.

The absorption period is a concept that is sometimes also confused with Exposure Time. The Appraisal Institute text *The Dictionary of Real Estate Appraisal, 5th Edition*, defines “absorption period” as:

> The actual or expected period required from the time a property is initially offered for purchase or use by its eventual users until all portions have been sold or stabilized occupancy has been achieved…

Forecasts of the absorption period are required to project lease-up for vacant properties or the sale of units/lots. In appraisals of these property types, the absorption period is a forward looking projection that concludes with stabilized occupancy or sellout of the inventory. It should not be confused with Exposure Time.

The confusion surrounding Exposure Time and marketing time sometimes leads to generalized statements of the Exposure Time for a market area or property type. Providing general Exposure Time opinions fails to recognize that Exposure Time opinions are property specific and are linked to a specific value opinion.
Because Exposure Time is a component of the definition of market value, it is sometimes referred to as an assumption of the assignment. This is a misconception because Exposure Time in a market value assignment is an opinion based on market analyses, not an assumption that is accepted as a condition of the assignment. Statements that “the value opinion assumes the property has been exposed to the market for a period of X months” are inappropriate.

Another misconception concerns the selection of comparable sales in an assignment. Is the Exposure Time opinion based on the comparable sales used in an analysis, or are the comparable sales selected based on the Exposure Time? The selection of comparable sales precedes forming an opinion of the reasonable Exposure Time. Comparable sales are selected based on the relevant elements of comparison for the property and market characteristics. The market data gathered in the investigation and analysis of comparable sales then informs and aids in the process of developing an opinion of the reasonable Exposure Time.

**Liquidation Value and Disposition Value**

Understanding reasonable Exposure Time is a key element in providing opinions of disposition value and liquidation value where the Exposure Time is specified by the client or a stipulation of the assignment and not market oriented. These value opinions are based on limited or extremely limited exposure to the market. The objective of an appraisal assignment might be disposition value or liquidation value rather than market value. While market value addresses the question of what would the property likely sell for after a typical exposure period on the open market, disposition value and liquidation value are based on limited or severely limited Exposure Time on the market. Liquidation value, for example, stipulates that a normal marketing effort is not possible due to the brief exposure time. Disposition value on the other hand, also includes the requirement of consummation of a sale within a future exposure time specified by the client.

When the Exposure Time is specified by the client or a stipulation of the assignment and not market oriented, the resulting value opinion is probably not consistent with market value. With both liquidation value and disposition value, the time allowed for completion of the sale (Exposure Time) is not necessarily typical for the market for that property type; rather, it is limited and it is specified by the client. Thus, in these assignments Exposure Time is not an opinion of the appraiser, but a condition of the assignment.

An understanding of Exposure Time concepts provides a foundation for the selection and adjustment of comparable sales in disposition value and liquidation value assignments.

The definition of disposition value presents the notion of “future exposure time” with a condition of consummation of a sale within a future exposure time specified by the client. The notion of a “future exposure time” may appear to be a contradiction in terms. How can there be a future Exposure Time, when Exposure Time is seemingly in the past? If an appraiser is seeking a value based on the property selling in no more than a client-defined number of months from now, a prospective valuation is being sought. That is where the future exposure period manifests, because the Exposure Time is in the future relative to the date of report. The value opinion is based on the property being on the market no more than a certain number of months. It is in the future compared to the date of the report, but still pre-dates the effective date of value consistent with the definition of Exposure Time.
Summary of Standard Practices

1. Appraisers must develop an opinion of the Exposure Time linked to a value opinion because reasonable exposure in the market is a condition of the definition of market value.

2. A discussion of Exposure Time allows the intended user(s) to put the value opinion into context.

3. Exposure Time serves as the foundation on which appraisers describe market conditions, analyze comparable sales, or reconcile an opinion of value to a sale price.

4. Exposure Time is an opinion of the length of time a property would have been exposed to the market in order to sell at the estimated market value. An opinion of Exposure Time is not intended to be a forecast.

5. Exposure Time is not a fixed period or boilerplate statement. It is different for various types of property and under various market conditions. It is a function of the price, market conditions, and property characteristics.

6. Opinions of Exposure Time can be presented as a single time period or as a range of time.

7. Gathering and analyzing information for days on market from data services, comparable sales, and market participants is required for proper development of an opinion of Exposure Time. The use of generic or overly broad market data to support an Exposure Time opinion is inappropriate. The data used in the development of an Exposure Time opinion must be drawn from the subject market, including consideration of property type, location, property characteristics, typical buyer, and price segment.

8. The proper analysis of a sale transaction requires an understanding of the reasonable Exposure Time associated with a market value opinion. When the conditions of the sale do not reflect the conditions outlined in the market value definition, then the appraiser must consider making adjustments for such differences or the sale must not be used as a comparable.

9. Improper identification of the reasonable Exposure Time in a market value opinion can lead to a value conclusion that is not credible.

10. Understanding the reasonable Exposure Time associated with a market value opinion is a key element in providing opinions of disposition value and liquidation value. An appraiser must have an understanding of a reasonable market exposure in order to recognize and evaluate the impact of limited market exposure.

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members, Candidates, Practicing Affiliates and Affiliates with guidance as to how the requirements of the Standards may apply in specific situations.)