

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.

GUIDE NOTE 14

The Role of Exposure Time

The Appraisal Institute text *The Dictionary of Real Estate Appraisal*, 6th 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 a reasonable exposure in a competitive market, under all conditions 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. [*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.¹

The Appraisal Institute text *The Dictionary of Real Estate Appraisal*, 6th 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; Comment: Exposure time is a retrospective opinion based on an analysis of past events assuming a competitive and open market.

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) 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.

Comment: 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 1-2(c) states:

When reasonable 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) and 2-2(b)(v) states in part:

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.

¹ 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 Section 1.2.4) direct appraisers not to link their estimates of market value made for federal acquisition purposes to a specific exposure time.

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. USPAP Advisory Opinion 35 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. USPAP Advisory Opinion (35) states that:

The answer to the question “what is the reasonable exposure time” should always incorporate the answers to the question “for what kind of property at what value range...”

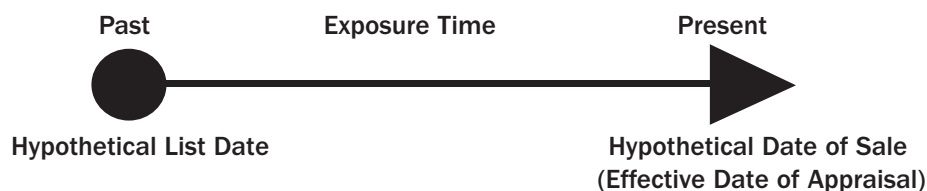
For example, consider an appraisal of a highly desirable waterfront home in a community that includes a wide range of property values. Market research shows that the Exposure Time for the entire community averages approximately 60 to 90 days. Closer examination of the market for waterfront homes in the 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.

Misconceptions

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*, 6th Edition, defines “absorption period” as:

The actual or expected period required from the time a property , group of properties, or commodity is initially offered for lease, 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.

Summary of Standard Practices *continued*

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.)

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