

Market Value: What Does It Really Mean?

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Abstract

Appraisers are routinely confronted with multiple definitions of the terms *market value* and *fair market value*, depending on the purpose of the assignment. Many value definitions in common use are needlessly subjective and in clear conflict with other definitions. Particular problems revolve around the value standard (highest versus most probable) and varied conditions imposed on the hypothetical market, which in many cases do not comport with the realities of the marketplace. This article seeks to explore how we got here, and what we might do to bring some clarity and consistency to the term *market value*.

Introduction

Definition of *value* is integral to real estate valuation and is one of several assignment elements identified in the Uniform Standards of Professional Appraisal Practice (USPAP).¹ While there are many types of value (assessed value, business value, disposition value, insurable value, investment value, liquidation value, public interest value, use value, etc.), market value is the subject of most appraisal assignments.

Whether the term is “market value” or “fair market value” is of little practical consequence, as noted in an eminent domain decision by the U.S. Supreme Court where the Court observed “the term ‘fair’ hardly adds anything to the phrase ‘market value.’”² *The Dictionary of Real Estate Appraisal*, sixth edition, indicates fair market value to be “equivalent” to market value in non-technical usage, and “similar in concept” with respect to technical usage in condemnation, litigation, and tax situations.³ But, definitions of *market value* and *fair market value* vary widely in two major respects:

- Value standard (most probable versus highest price, or in some cases no specification at all)
- Conditions imposed on the hypothetical market under which a sale is presumed to occur

The purpose of this article is to explore some of these definitional differences, the problems they cause, and their practical impact on appraisal practice.

Market Value Concept

Value is generally recognized to be extrinsic rather than intrinsic to the real estate, reflecting the relationship of property to the marketplace. The concept of market value used in modern valuation theory originated with neoclassical economics in the late nineteenth century. This school of economic thought was the first to propose a unified theory of value encompassing both the cost/supply side and the price/demand side. A seminal work was *Principles of Economics* by Alfred Marshall,⁴ introducing what are now

1. See the Scope of Work Rule in Appraisal Standards Board, *Uniform Standards of Professional Appraisal Practice*, 2018–2019 ed. (Washington, DC: The Appraisal Foundation, 2018).
2. *United States v. Miller*, 317 U.S. 369 (1943).
3. Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 6th ed. (Chicago: Appraisal Institute, 2015), s.v. “fair market value.”
4. Alfred Marshall, *Principles of Economics* (London: Macmillan, 1890).

well-known concepts such as the supply/demand curve, equilibrium price and the perfect market. As used in neoclassical economics, a perfectly competitive market is comprised of rational participants, all acting for economic self-interest; characteristics of the perfect market include the following:

- Many buyers and sellers (no one can unduly influence the market)
- Homogenous product
- Perfect information (about product and pricing)
- No barriers to entry/no transaction costs
- Prices that tend towards equilibrium (at least in the long term)

Most markets in the real world do not meet these criteria. Real estate markets are particularly imperfect and inefficient, although some (conforming homes, for example) are more competitive than others (special-purpose or unique properties). As a result, appraisers deal with uncertainty and ranges of value, instead of the equilibrium market price envisioned by the neoclassical model. Along with the variability of the market itself, appraisers also have to contend with subjectivity introduced by commonly used value definitions and conflicts among various definitions that are used for different purposes.

History of Market Value Definitions

One of the first articulated definitions of *market value* is found in an early 1900s eminent domain case decided by the California Supreme Court, *Sacramento Southern Railroad v. Heilbron*, less than twenty years after the first edition of Marshall's economics text was published in 1890. In the *Heilbron* case, the court described market value as

The highest price estimated in terms of money which the land would bring if exposed for sale in the open market, with reasonable time allowed in which to find

a purchaser, buying with knowledge of all of the uses and purposes to which it was adapted and for which it was capable.⁵

The notable things about this definition are the value standard (highest price) and the conditions imposed on the market (money, open market, reasonable time, knowledge). This definition subsequently mutated and replicated many times over the years.

The *Heilbron* definition was incorporated virtually unchanged in the 1950 and 1962 editions of the *Appraisal Terminology and Handbook* published by the American Institute of Real Estate Appraisers (AIREA). However, the *Handbook* included alternative definitions as well:

- The price at which a willing-seller would sell and a willing-buyer would buy, neither being under abnormal pressure.
- The price expectable if a reasonable time is allowed to find a purchaser and if both seller and prospective buyer are fully informed.⁶

The definition of *market value* changed significantly in the 1975 edition of *Real Estate Appraisal Terminology* (published jointly by AIREA and the Society of Real Estate Appraisers). The highest price standard was unchanged, but the conditions imposed on the market became more numerous and specific, resembling those currently included in standard value definitions for mortgage lending.⁷ Also of interest in this text is its succinct definition of *most probable sales price*, a term that was used in appraisal literature addressing this topic during the 1960s and 1970s. *Most probable sales price* is defined as "That price at which a property would most probably sell if exposed to the market for a reasonable time, under market conditions prevailing as of the date of the appraisal."⁸

The 1981 version of the same text contained almost the same definition of *market value*, except that the value standard changed from the "high-

5. *Sacramento Southern Railroad v. Heilbron*, 156 Cal. 408 (1909).

6. American Institute of Real Estate Appraisers, *Appraisal Terminology and Handbook*, 4th ed. (Chicago: American Institute of Real Estate Appraisers, 1962), 121.

7. Byrl N. Boyce, comp. and ed., *Real Estate Appraisal Terminology* (Chicago: American Institute of Real Estate Appraisers and Society of Real Estate Appraisers, 1975), 137.

8. Boyce, *Real Estate Appraisal Terminology*, 145. Note the value standard ("most probably") and the only condition imposed on the market (exposure for "a reasonable time"), which otherwise assumes prevailing conditions.

est price ... a property will bring” to “most probable price ... a property should bring.”⁹ The ninth edition of *The Appraisal of Real Estate*, published six years later, contains relevant and significant commentary about this difference, noting that the concept of market value as the “highest price,” as opposed to market value as a modal or central tendency, is controversial. Of particular interest is the observation that “highest price” was originally rooted in the idea that market value should be the highest price represented by the central tendency, rather than the highest price within an entire data range, and that “a definition that includes the word *highest* is perhaps subject to misinterpretation.”¹⁰

The debate over most probable versus highest price is perhaps best illustrated by a series of changes to eminent domain law in Nevada. Prior to 1993, value for eminent domain was defined as the “highest price,” similar to current law in California and some other states (California also uses the highest price standard for damage to real property and marital dissolution).

The fair market value of the property is the highest price on the date of valuation that would be agreed to by a seller who is willing to sell, but who is under no particular or urgent necessity for so doing, and who is not obligated to sell, and a buyer who is ready, willing, and able to buy, but who is under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.¹¹

In 1993, however, the Nevada legislature changed the definition of value to the “most probable price,” adopted from the prevailing definition of market value for federally related lending transactions:

Value means the most probable price which a property would bring in a competitive and open market under the conditions of a fair sale, without the price being affected by undue stimulus, whereby the sale is consummated on a specified date and the title of the property is passed from the seller to the buyer under the following conditions:

- a) the buyer and seller are acting prudently and knowledgeably;
- b) the buyer and seller are typically motivated;
- c) the buyer and seller are well informed or well advised and acting in what they consider are their own best interests;
- d) a reasonable time is allowed to expose the property for sale on the open market;
- e) payment is made with United States dollars in cash or pursuant to another financial arrangement comparable thereto; and
- f) the sale price represents the normal consideration for the property and is unaffected by special or creative financing or sales concessions granted by any person associated with the sale.¹²

During a 1996 trial involving a taking by Clark County, Nevada, (County) the trial court nonetheless awarded the “highest price,” accepting the landowner’s argument that the 1993 change in the state’s value definition was unconstitutional. The County appealed, and the Nevada Supreme Court reversed, ruling that the definitional change to “most probable price” was indeed constitutional. In its opinion, the court indicated that the two terms were not synonymous, noting the legislature’s characterization of the “highest price” standard as speculative, and its “misuse and abuse” in the instant case. In a separate concurrence, one justice deviated from his colleagues, reasoning that the terms “highest

9. Byrl N. Boyce, comp. and ed., *Real Estate Appraisal Terminology*, revised ed. (American Institute of Real Estate Appraisers and Society of Real Estate Appraisers, 1981), 160–161.

10. American Institute of Real Estate Appraisers, *The Appraisal of Real Estate*, 9th ed. (Chicago: American Institute of Real Estate Appraisers, 1987), 18.

11. Excerpted from *County of Clark v. Buckwalter*, 115 Nev. 58 (1999).

12. Nev. Rev. Stat. § 37.009 (1993), adopted from 12 C.F.R. § 34.42(g).

price” and “most probable price” were actually synonymous—“a distinction without a difference.”¹³ To complete the saga, the Nevada legislature changed the definition back to “highest price” in 2007,¹⁴ a likely reaction to the *Kelo v. New London* decision by the US Supreme Court in 2005.¹⁵

There are a number of definitions of *market value* and *fair market value* in common use today, all with unique aspects that can differ with respect to the applicable value standard and hypothetical conditions imposed on the market. Appraisers may encounter these definitions in assignments related to

- Mortgage lending
- Eminent domain (state)
- Damage to real property
- Marital dissolution
- Property taxation
- Estate tax
- Casualty losses
- Federal land acquisitions
- Financial reporting
- Global valuation

The table in Exhibit 1 summarizes some of these definitions, illustrating their substantial variation, and the potential for value opinions to be influenced by which definition an appraiser uses.¹⁶

Literature Review

The topic of market value has been addressed sporadically in appraisal literature over the years, typically during times of valuation difficulties—depressed values in the 1970s, creative financing during the 1980s, market decline following the Savings and Loan Crisis in the early 1990s, and most recently, the market collapse in the wake of the subprime mortgage crisis.

Richard U. Ratcliff was one of the pioneering thought leaders on the topic of market value in the 1960s and 1970s, advocating for “most probable price” years before it was finally adopted in some published definitions.¹⁷ Henry A. Babcock in his 1968 text also argued for “most probable buy-sell price” as central to the concept of market value.¹⁸ Ratcliff additionally proposed the idea of expressing value in probabilistic terms (a probability distribution or equivalent), something supported by many subsequent authors, most recently by Max Kummerow¹⁹ and Gale L. Pooley.²⁰ Finally, Ratcliff was critical of attaching hypothetical or idealized perfect market conditions to standard value definitions, instead believing that market value should reflect real, if imperfect, markets without artificial constraints.

Following Ratcliff’s criticism of assuming perfect market conditions, Richard D. Marshall

13. *County of Clark v. Buckwalter*, 115 Nev. 58 (1999).

14. Nev. Rev. Stat. § 37 .009.

15. *Kelo v. City of New London*, 545 U.S. 469 (2005). This seminal 5-4 U.S. Supreme Court decision allowed the transfer of land using eminent domain from one private property owner to another for purposes of economic development, effectively characterizing a “public benefit” as a permissible public use under the Takings Clause of the Fifth Amendment. A significant political and judicial backlash followed, with most states enacting some type of eminent domain reform in the decade following the *Kelo* decision.

16. The table includes many that are in common use, though it should be understood that the table is not intended to include every definition, nor would it be feasible to do so. The very fact that there are a multiplicity of different value definitions strikes at the heart of the problem addressed in this article.

17. Richard U. Ratcliff, “A Neoteric View of the Appraisal Function,” *The Appraisal Journal* (April 1965): 167–175; Richard U. Ratcliff, “Market Value Can’t be Estimated,” *The Real Estate Appraiser* (January-February, 1970): 16–19; Richard U. Ratcliff, “Appraisal: Is It Measurement or Prediction?” *The Real Estate Appraiser* (November-December, 1972): 4–6.

18. Henry A. Babcock, *Appraisal Principles and Procedures* (Homewood, IL: Ricard D. Irwin, Inc., 1968), 117.

19. Max Kummerow, “Logical Steps in Property Valuation,” *The Appraisal Journal* (January 1997): 25–31; Max Kummerow, “Thinking Statistically about Valuations,” *The Appraisal Journal* (July 2000): 318–325; Max Kummerow, “A Statistical Definition of Value,” *The Appraisal Journal* (October 2002): 407–416.

20. Gale L. Pooley, “Adding Value to Valuation with Confidence,” *The Appraisal Journal* (Summer 2015): 218–225.

Exhibit 1 Summary of Definitions of Value

Source	Value Definition
Federal Mortgage Lending (Comptroller of the Currency) 12 C.F.R. § 34.42(g)	<i>Market value</i> means 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: <ol style="list-style-type: none"> (1) buyer and seller are typically motivated; (2) both parties are well informed or well advised, and acting in what they consider their own best interests; (3) a reasonable time is allowed for exposure in the open market; (4) payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and (5) 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.
Same definition for FDIC, NCUA, FNMA Selling Guide	
California Code of Civil Procedure, Eminent Domain C.C.P. § 1263.320(a)	The fair market value of the property taken is the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, not obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.
California Real Property Damage Civil Jury Instructions § 3903F	“Fair market value” is the highest price for the property that a willing buyer would have paid to a willing seller, assuming: <ol style="list-style-type: none"> (1) that there is no pressure on either one to buy or sell; and (2) that the buyer and seller know all the uses and purposes which the property is reasonably capable of being used.
California Marital Dissolution <i>In re Marriage of Cream</i> 13 Cal.App.4th 81 (1993)	The fair market value of a marketable asset in marital dissolution cases is the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no obligation or urgent necessity to do so, and a buyer, being ready, willing and able to buy but under no particular necessity for so doing.
IAAO Glossary for Property Appraisal and Assessment, 2nd ed. (2013)	Market value is the major focus of most real property appraisal assignments. Both economic and legal definitions of market value have been developed and refined. A current economic definition agreed upon by agencies that regulate federal financial institutions in the United States is: [see above]
California Property Taxation R.T.C. § 110(a)	“Full cash value” or “fair market value” means the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and both the buyer and the seller have knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes.
Federal Estate Tax 26 C.F.R. § 20.2031-1(b)	The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.

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Exhibit 1 Summary of Definitions of Value (*continued*)

Source	Value Definition
Federal Casualty Loss 26 C.F.R. § 1.165-7 Instructions for Form 4684	Fair market value (FMV) is the price at which the property would be sold between a willing buyer and willing seller, each having knowledge of the relevant facts. The difference between the FMV immediately before the casualty or theft and the FMV immediately after represents the decrease in FMV because of the casualty or theft.
Uniform Appraisal Standards for Federal Land Acquisitions (2016) § 1.2.4	Market value is the amount in cash, or on terms reasonably equivalent to cash, for which in all probability the property would have sold on the effective date of value, after a reasonable exposure time on the open competitive market, from a willing and reasonably knowledgeable seller to a willing and reasonably knowledgeable buyer, with neither acting under any compulsion to buy or sell, giving due consideration to all available economic uses of the property.
Legal (general) <i>Black's Law Dictionary</i> 2nd pocket edition (2016)	The price that a seller is willing to accept and a buyer is willing to pay on the open market and in an arm's length transaction; the point at which supply and demand intersect. (fair market value)
Financial Reporting FASB 157 ¶ 5-14 [excerpts]	<p>Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.</p> <p>The measurement should consider attributes specific to the asset or liability.</p> <p>A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date.</p> <p>A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability.</p> <p>Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that are:</p> <ol style="list-style-type: none"> Independent of the reporting entity; that is, they are not related parties Knowledgeable, having a reasonable understanding about the asset or liability and the transaction based on all available information Able to transact for the asset or liability Willing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so. <p>A fair value measurement assumes the highest and best use of the asset by market participants.</p>
Global Valuation International Valuation Standards (2017) ¶ 30.1	Market Value is the estimated amount for which an asset or liability <i>should</i> exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

notes that “what actually takes place in a transaction does not meet the criteria of the definitions that have been developed to guide the determination of market value,” while further stating that “participants in real estate transactions cannot avail themselves of the kind of efficient market ... that serves investors in the stock market.”²¹ Kerry D. Vandell suggests that market value definitions based on formal economic theory “are of limited usefulness because they assume a perfectly competitive market and complete certainty about present and future conditions ... [while] the real estate market is neither perfectly competitive nor certain.”²² Vandell argues that “market value and HBU should be associated with what actually is expected to happen to the subject property under current market conditions.”²³ Peter N. Thomson is another who indicates “an appraiser faces an apparent dichotomy between assumptions that underpin market value and the current market realities,”²⁴ arguing for use of alternative value definitions such as liquidation price to deal with speculative or troubled markets.

In advocating for a statistically oriented definition of market value, Peter F. Colwell observed that “different definitions yield different estimates of market value.”²⁵ Harold D. Albritton, noting differing opinions regarding the meaning of *highest price*, suggested that it should not be interpreted literally, but rather as “the most probable price at the highest and best use.”²⁶ In an earlier article, Robert N. Frissell commented on the then-prevailing definition of market value using “highest price,” indicating that the appraiser must therefore “look for the highest price that the market will justify, ... not the price at which the transaction would ‘probably’ occur,” and further suggesting that “the average sale must be adjusted

upward” to conform to the highest price definition.²⁷ Richard Marchitelli and Peter F. Korpacz proposed a single concise definition that could be applied to all real estate activity, using the term “likely” instead of “most probable,” and with few explicit assumptions about the market:

The price in cash and/or other identified terms for which the specified real property interest is likely to sell as of the effective date of appraisal in the real estate marketplace under all conditions requisite to a fair sale.²⁸

A number of articles in the mid-1980s discuss price as it relates to value. Writing about the debate between “most probable selling price” (a term likely first used by Ratcliff to distinguish a value unencumbered by idealized or unreal market conditions) and traditional market value, Kenneth M. Lusht proposes that these are really equal, where traditional value definitions assume market efficiency explicitly (via conditions attached to a hypothetical market), and most probable selling price does so implicitly based on the use of historical data. He argues that appraisers must use a working assumption of market efficiency to produce a credible value estimate. Lusht also distinguishes between a “prediction” (relative certainty quantified by a probability distribution) and a more judgmental “estimate,” a topic also addressed by Ratcliff in some of his writings.²⁹

Jared Shlaes suggests that “*highest price* and *typical price* are clearly at odds with one another,” with “highest price” reflecting an atypical purchaser, and perhaps an atypical seller willing to wait for the best available offer,³⁰ noting that “the fool in the market teaches us nothing about value, only about foolishness.”³¹ Joseph Williams posits that fair market value rarely represents an

21. Richard D. Marshall, “Market Value: What Does It Mean in Real Estate Today?” *The Real Estate Appraiser* (January-February 1978): 32.

22. Kerry D. Vandell, “Toward Analytically Precise Definitions of Market Value and Highest and Best Use,” *The Appraisal Journal* (April 1982): 256.

23. Vandell, “Toward Analytically Precise Definitions,” 261.

24. Peter N. Thomson, “Market Value: Does One Size Really Fit All?” *The Appraisal Journal* (October 1993): 566.

25. Peter F. Colwell, “A Statistically Oriented Definition of Market Value,” *The Appraisal Journal* (January 1979): 58.

26. Harold D. Albritton, “Market Value: Highest Price or Most Probable Price?” *The Appraisal Journal* (July 1979): 453; Harold D. Albritton, “A Critique of the Prevailing Definition of Market Value,” *The Appraisal Journal* (April 1980): 201.

27. Robert N. Frissell, “The Professional Appraisal and Market Value,” *The Appraisal Journal* (October 1966): 582.

28. Richard Marchitelli and Peter F. Korpacz, “Market Value: The Elusive Standard,” *The Appraisal Journal* (July 1992): 318.

29. Kenneth M. Lusht, “Most Probable Selling Price,” *The Appraisal Journal* (July 1983): 346–354.

30. Jared Shlaes, “The Market in Market Value,” *The Appraisal Journal* (October 1984): 501.

31. Shlaes, “The Market in Market Value,” 513.

optimal price, but rather a compromise price arrived at by buyers and sellers through negotiation, noting also that fair market value definitions presume ideal conditions and efficient markets that rarely exist.³²

Terry V. Grissom addressed the quest for more consistent and descriptive definitions of market value by using symbolic logic, first identifying two schools of appraisal thought, characterized as the traditional and the contemporary. The traditional perspective uses “fair market value” and is rooted in formal neoclassical economics at the intersection of supply and demand, incorporating the assumptions of a perfectly competitive market. He reasons that insights gained from this approach more than offset the loss in concrete reality based on representative conditions. The contemporary argument, on the other hand, emphasizes “most probable selling price,” rejecting the premise that actual real estate markets comply with the perfect competition model. In an attempt to reconcile the two schools of thought, Grissom describes a third perspective, identified as neotraditional. In his view, this is not so much a school of thought as a gray area where semantic differences between the concepts of market value and most probable selling price are debated, with some arguing for quantitative equivalence between the two, while others try to modify definitions to fit a strictly empirical perception of the real estate market.³³

In 1992, the Appraisal Institute Special Task Force on Value Definitions published a report addressing problems associated with distressed market conditions and limited sales activity, suggesting that transactions differing substantially from assumed conditions in a value definition fail as evidence of market value, which may imply a price that cannot occur until some future time.³⁴ This is reminiscent of fictional intrinsic values assumed during the Great Depression in the 1930s, and clearly contrary to the position taken by Rattcliff and others, that “market value” should reflect the market as it is, however imperfect it might be.

In response to these difficulties, Shlaes offered what he called the concept of subjunctive value defined as “That value which the relevant parties, hope, wish, fear, or suspect might be equal to market value, but which all recognize is not necessarily so.”³⁵ In the same article, Shlaes (tongue in cheek) suggests another definition to be used in the absence of a market, called “nu value,” certainly an antithesis to the equilibrium price of the perfect market. He describes this as “value as determined by a committee of experts sitting at a round table with all pertinent facts at hand in a locked room from which they will not be released until they have reached agreement.”³⁶

An Appraisal Institute white paper in 1999 lamented “a proliferation of Market Value definitions, dilution of the Market Value concept, and great confusion in the marketplace.”³⁷ A suggestion that USPAP clarify market value for appraisers and users of appraisal services resulted in a quasi (but not citable) definition of market value added to USPAP in 2001, which does little more than note that market value “presumes the transfer of a property, as of a certain date, under specific conditions,” cautioning appraisers to identify the exact definition applicable in each appraisal assignment.

Market Price

While value is commonly perceived to be an opinion of worth, price is what is actually paid. Prices are used as a proxy for value in the sales comparison approach, though it is recognized that price and value are not the same, and that prices are not infrequently different from estimated or perceived value. Because the term “market price” has been used and discussed occasionally in appraisal literature, often in different contexts, an examination of this term is warranted in connection with the larger discussion of market value.

Writing in the mid-1930s, George Schmutz and Loring McCormick argue against *market price*

32. Joseph Williams, “An Examination of Fair Market Value Concepts for Oil and Gas Properties,” *The Appraisal Journal* (July 1991): 402–414.

33. Terry V. Grissom, “Value Debates: The Argument Forms and Market Structure,” *The Appraisal Journal* (January 1986): 124–135.

34. Appraisal Institute, *Special Task Force on Value Definitions* (Chicago: Appraisal Institute, June 1992).

35. Jared Shlaes, “Value: More Than Ever, in Your Eye,” *The Appraisal Journal* (January 1993): 76.

36. Shlaes, “Value,” 77.

37. Appraisal Institute, *Market Value Initiative White Paper* (Chicago: Appraisal Institute, revised December 7, 1999), 5.

measured in dollars, in favor of *market value* measured in commodity units, based on the present worth of future benefits. They observe that prices can change dramatically because of changes in the value of money, while the value of underlying commodities (including real estate) experience little change.³⁸ This position is not necessarily surprising given the volatility of prices following the sharp market decline in 1929–1932, and the notion that real estate had intrinsic value not properly reflected in prevailing prices during the Great Depression. M. J. Slonim subsequently suggested that courts do not distinguish between *market price* and *market value*; i.e., that market value is established by the prices buyers actually pay.³⁹ This might tend to support the notion that courts are inclined to favor sales comparison over alternative approaches to value.

Fred E. Case distinguishes among the terms *normal value*, *market value*, and *market price*, with *normal value* relating primarily to proposed prices during the bidding process, while the latter two are reflective of actual completed transactions. Ultimately, however, market price is what is actually paid, consistent with most subsequent definitions containing the word “price.” Importantly, Case points out that common market assumptions (voluntary participation, fully informed, etc.) often do not exist in the real world, noting further that some circumstances (no market, forced or speculative markets) can result in erroneous market indicators.⁴⁰

In more-recently published articles, Kevin Clarke uses *market price* as a solution to providing prospective (future) values, although his proposed definition of market price is quite similar in concept to prevailing definitions of market value.⁴¹ The premise of an article by Stephen F. Fanning, et al. is that there are really two real estate markets—the transaction (buy/sell) mar-

ket, and the fundamental market (measured by economic potential). In a stable market, there may be little difference between the two, but during boom or bust conditions, market prices may deviate significantly from fundamentals. Thus, actual prices over time might fluctuate substantially, while underlying economic value exhibits more moderate and sustainable movement; this harkens back to the position of Schmutz during the 1930s, suggesting that value might be somewhat independent of prices actually paid in some circumstances. Fanning acknowledges the appraiser’s dilemma between these two schools of thought, indicating that reconciliation of valuation approaches becomes more important in unstable markets.⁴²

The term *market price* has been specifically defined occasionally by the Appraisal Institute and its predecessor organizations, with a pre-1945 version of *Appraisal Terminology* including a footnote to the definition of market value stating that “at any given moment in time, market value connotes what a property is actually worth, and market price what it may be sold for.”⁴³ The term was not defined in the 1950 and 1962 editions of *Appraisal Terminology and Handbook*, but later appeared in the 1975 and 1981 editions of *Real Estate Appraisal Terminology* as “the amount actually paid, or to be paid, for a property in a particular transaction,” with the clarification that it “differs from market value in that it is an accomplished or historic fact, whereas market value is and remains an estimate until proved [and] involves no assumption of prudent conduct by the parties, or absence of undue stimulus or of any other conditions basic to the market value concept.”⁴⁴

Standards and guidelines for broker price opinions include the term *fair market price* defined as follows:

38. George L. Schmutz and Loring O. McCormick, “The Factors Affecting Market Price,” *The Journal of the American Institute of Real Estate Appraisers* (April 1934): 181–188.

39. M. J. Slonim, “Market Value or Market Price,” *The Appraisal Journal* (October 1945): 390–391.

40. Fred E. Case, “Value, Market Value, and Market Price,” *The Appraisal Journal* (April 1953): 217–223.

41. Kevin Clarke, “Market Price: A Practical Solution,” *The Appraisal Journal* (July 1993): 437–438.

42. Stephen F. Fanning, John A. Blazejack, and George R. Mann, “Price versus Fundamentals—From Bubbles to Distressed Markets,” *The Appraisal Journal* (Spring 2011): 143–154.

43. Slonim, “Market Value or Market Price,” 390; nearly identical verbiage was included following the definition of *market value* in the 1962 edition of AIREA’s *Appraisal Terminology and Handbook*, although the term *market price* was not specifically defined.

44. Boyce, *Real Estate Appraisal Terminology*, 136; Boyce, *Real Estate Appraisal Terminology*, revised ed., 160.

The most probable price, as of the date of inspection or other specifically defined date, in terms equivalent to cash, unaffected by special or creative financing or sales concessions, for which the property should sell after reasonable exposure in a competitive market under all conditions requisite to a fair sale with buyer and seller each acting prudently and for self-interest and assuming neither is under undue duress. Also known as Market Price.⁴⁵

Market price has also been defined in the IAAO Glossary for Property Appraisal and Assessment as “the price a particular buyer and seller agree to in a particular transaction; the amount actually paid.”⁴⁶

Market price has not been defined in *The Dictionary of Real Estate Appraisal*, including only a definition of *price*, initially defined as “the amount a particular purchaser agrees to pay and a particular seller agrees to accept under the circumstances surrounding their transaction.”⁴⁷ *Price* is currently defined in *The Dictionary of Real Estate Appraisal*, sixth edition, as “the amount paid in exchange for a good or commodity.” It notes that price is a fact when a transaction is consummated, while value is an estimate, further stating that “the price paid for a property may or may not have any relation to the *value* that might be ascribed to that property by others.”⁴⁸

In general, *market price* and *price* are more or less synonymous, although lack of a consistent definition for market price has allowed authors some flexibility in their interpretation of the term. Real estate brokers and sales agents preparing broker price opinions (BPO) use market price somewhat synonymously with our understanding of market value, although this is clearly an exception.

The distinction between price and value is perhaps best summarized by Warren Buffet, who sagely observed that “price is what you pay, value is what you get.”

Value Standard

The *market value* definition for mortgage lending is the most widely used, and conspicuously defines *value* as the “most probable price,” closely resembling the definition of *market value* in the 1981 edition of *Real Estate Appraisal Terminology*. The *market value* definition in the Uniform Appraisal Standards for Federal Land Acquisitions is somewhat similar, defining *market value* as “the amount in cash ... for which in all probability the property would have sold.”⁴⁹ Many other standard definitions instead use the *highest price* standard, including California definitions for eminent domain,⁵⁰ damage to real property⁵¹ and marital dissolution.⁵² Still other definitions do not specify any particular standard, simply an amount or price at which a property would be sold, including federal definitions for estate taxation⁵³ and casualty losses.⁵⁴

The definition of *fair market value* from *Black’s Law Dictionary* similarly provides no definitive standard, while also paying homage to the neoclassical model by referencing the intersection of supply and demand: “The price that a seller is willing to accept and a buyer is willing to pay on the open market and in an arm’s length transaction; the point at which supply and demand intersect.”⁵⁵

After decades of debate, the practical difference between *highest price* and *most probable price*, if any, remains unclear. “Most probable price”—

45. National Association of Broker Price Opinion Professionals, *Broker Price Opinion Standards & Guidelines*, version 5.0, 16.

46. International Association of Assessing Officers, *Glossary for Property Appraisal and Assessment*, second ed. (Kansas City: International Association of Assessing Officers, 2013), 100.

47. American Institute of Real Estate Appraisers, *The Dictionary of Real Estate Appraisal*, ed. (Chicago: American Institute of Real Estate Appraisers of the National Association of Realtors, 1984), 237.

48. Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 6th ed. (Chicago: Appraisal Institute, 2015), s.v. “price.”

49. Interagency Land Acquisition Conference, *Uniform Appraisal Standards for Federal Land Acquisitions* (Appraisal Foundation, 2016), 10; <http://bit.ly/UASFLA>.

50. Cal. Civ. Proc. Code § 1263.320.

51. Judicial Council of California Civil Jury Instructions (2018) § 3903(f).

52. *In re Marriage of Cream*, 13 Cal. App. 4th 81; 16 Cal. Rptr. 2d 575 (1993).

53. 26 C.F.R. § 20.2031-1(b).

54. IRS Instructions for Form 4684; see also 26 C.F.R. § 1.165-7.

55. Bryan A. Garner, ed., *Black’s Law Dictionary*, 5th pocket ed. (St. Paul, MN: Thomson Reuters, 2016), s.v. “fair market value.”

whether defined statistically as the mean, median, or mode, or an expected value or range of values—is a fairly objective standard, at least in comparison to highest price, which conceivably might encompass any number above the mid-point of a possible value distribution. It has even been argued that a literal interpretation of highest price ignores the impact of uncertainty in the market.

Thinking of value as a transaction zone where the low end of the seller's expectation meets the high end of what a buyer is willing to pay is helpful, but still leaves room for considerable variation depending on the characteristics and efficiency of the market, negotiating position of the parties and/or random price variation. Nor does it necessarily account for high (or low) sales that seemingly defy the market, or situations where market imperfection results in a wide value range. Only in the perfectly competitive market does a true equilibrium price exist, where most probable and highest price are the same number.

The graphic in Exhibit 2 helps to visualize the potential difference between most probable and highest price (a normal distribution is used as an exemplar, although value distributions can exhibit different characteristics).

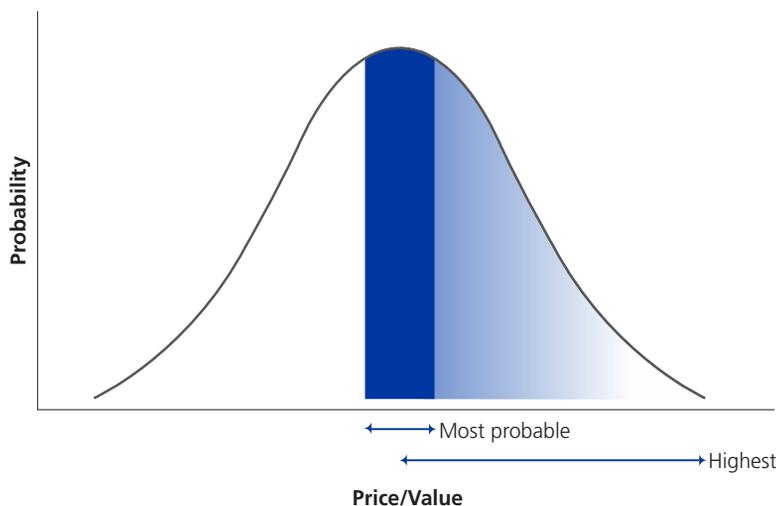
Whether expressed as a specific number or a range, most probable price represents the portion of a value distribution that is most likely to occur, based on analysis of market data. Highest price, on the other hand, is much more subjective, as

evidenced by its varied interpretations in appraisal literature and court decisions over the years:

- Synonymous with most probable price
- Most probable price at highest and best use
- Highest price represented by the central tendency
- Highest price that the market will justify (average sale adjusted upward)
- Reflective of an atypical purchaser
- Highest price as speculative, subject to misuse and abuse

It is clear that a literal interpretation of highest price could result in a value limited only by the extreme upper limit of a data range (and perhaps the creativity of the appraiser). But values in this rarefied area are probably not likely and certainly not “fair.” In fact, one might argue in more general terms that *highest price* is not fair and equitable. The rationale for highest price is perhaps understandable in eminent domain, where a property owner is involuntarily forced to cede property to a condemning agency, but an award of compensation higher than prevailing values (most probable price) is certainly not fair to the taxpayers. And in other types of civil litigation or family law, basing market value on the highest price could easily favor one party over another, resulting in something less than a fair and equitable outcome. And what about definitions that have no value standard? There might be an implication that an expected or likely (most probable) value would be appropriate, but without some qualification, an appraiser is free to interpret the definition as he or she sees fit.

Exhibit 2 Normal Distribution: Market Value



Assumptions about the Market

Whether we call it market value or fair market value, virtually all definitions include assumptions about the hypothetical market where a transaction is to take place, with conditions that may or may not comport with actual transactions in the marketplace. A number of authors, including Case, Ratcliff, Marshall, Vandell, and Thomson, have noted the disconnect between hypothetical or idealized perfect market conditions and the real world. Douglas Lovell suggests that “sales which violate the basic terms and conditions of the type of value being estimated are excluded from consideration because they intro-

duce bias into the analytic process,”⁵⁶ an idea that was reinforced by the Appraisal Institute Special Task Force on Value Definitions in 1992.

While some definitions are more restrictive than others, USPAP identifies three categories of conditions included in market value definitions:

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).

Consider the motivation of the parties. Under most value definitions, distress sales are generally not reflective of market value. In a 2012 article, William G. Steinke addressed this issue, noting the inherent conflict between distressed markets and conditions attributed to standard value definitions. Even if real estate owned and short-sale transactions in distressed markets reflect typical motivation, Steinke opines that they still reflect undue stimulus, and are therefore not reflective of market value.⁵⁷ But if distressed sales comprise all or most market activity, isn't it more realistic to accept the market as it is, rather than impose unrealistic conditions associated with a non-existent semi-perfect market? Ratcliff and others argue strongly that idealized conditions sometimes bear little resemblance to the real world, and appraisers generally ignore the literal implication of value definitions in actual practice.

What about legitimate sales that are not consistent with conditions and limitations in many value definitions? Some definitions, for example, assume reasonable exposure on the open market; would this disqualify an off-market but otherwise legitimate arm's-length transaction? If typical buyers are not particularly knowledgeable or well-informed, are these sales somehow not indicative of market value? Do appraisers have an obligation to forecast normal market prices during a

boom or bust? If prevailing terms are not cash or equivalent, is it appropriate to discount to cash equivalence and call the result market value?

In essence, should market value be positive (objective; what is) or normative (subjective; what should be)? Every normative condition imposed on a market value definition has the potential to make the definition less representative of the actual market, and in extreme cases, might result in a situation where market value simply cannot occur at the effective date.⁵⁸

Conclusion

“A proliferation of Market Value definitions ... and great uncertainty in the marketplace” is as much of a problem today as when it was identified by the Appraisal Institute's *Market Value Initiative White Paper* in 1999, debated in appraisal literature for decades prior and since.

The two primary differences among various definitions of market value and fair market value are the value standard (most probable versus highest price versus no standard) and conditions imposed on the hypothetical market. The use of “highest price” in many legal definitions is especially problematic, given its inherent subjectivity and potential for “misuse and abuse.” Confining opinions of market value to an expected or likely range would eliminate much uncertainty, and would arguably be more “fair” than a literal interpretation of *highest price*.

Assumptions about the market generally impose certain normative conditions that might disqualify legitimate sales, or in extreme circumstances might make it virtually impossible to estimate market value at the effective date. Ratcliff's suggestion that literal implications of value definitions are often ignored in actual practice probably has some truth, but differences between an idealized semi-perfect market and the real world shouldn't require appraisers to make this choice, even subconsciously.

56. Douglas D. Lovell, “Does Your Client Really Need a Market Value Estimate?” *The Real Estate Appraiser* (May 1991): 6.

57. William G. Steinke, “Price, Value, and Comparable Distinctions in Distressed Markets,” *The Appraisal Journal* (Spring 2012): 140[1/n]-148.

58. As an example, consider a market where all transactions are distressed sales, a not uncommon occurrence during the years following the subprime mortgage crisis. Under conditions imposed by the standard lending definition of *market value* (e.g., lack of undue stimulus, typical motivation, reasonable exposure time), these transactions fail as evidence of market value, suggesting that some level of market stabilization would be necessary to provide sufficient transaction data matching the operative definition of market value.

Market value and fair market value definitions are embedded in a plethora of codes, regulations, and court decisions across the country. Thus, a real solution to the problem of multiple market value definitions used for varied purposes across different jurisdictions is elusive. The simplicity of a single market value definition based on expected or likely price, without artificial constraints, that could be used for all purposes, is definitely appealing. When it comes to something as basic and important as defining “market value,” it is unfortunate that the role of the appraisal profession has been usurped by the courts, regulators, and others.

While it is unrealistic to presume that myriad definitions in current use could actually be changed to conform to a single standard, the valuation profession should seek to clarify how the

terms *market value* and *fair market value* can be consistently applied, particularly with respect to the value standard (highest versus most probable). This would also be an opportunity to carefully review what conditions (if any) should be imposed on the market; i.e., should we really seek to impose conditions of the semi-perfect market on what all would agree to be imperfect and inefficient real estate markets?

Quoting Richard Ratcliff yet again, “appraisal is largely the predicting of human behavior under given market conditions.”⁵⁹ In an ideal world, appraisers would apply market value definitions using a relatively consistent and objective standard, and reflect conditions in the market as they exist, rather than how others might wish them to be.

About the Author

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Additional Resources

Suggested by the Y. T. and Louise Lee Lum Library

Appraisal Institute

- **Guide Notes to the Standards of Professional Appraisal Practice**
<https://www.appraisalinstitute.org/professional-practice/ethics-and-standards/guide-notes-to-the-standards-of-professional-practice-of-the-appraisal-institute/>
- **Lum Library External Resources [Login Required]**
Information Files—Value

Appraisal Standards Board—Uniform Standards of Professional Appraisal Practice

<http://www.uspap.org/files/assets/basic-html/page-1.html#>

Financial Accounting Standards Board—Fair Value Measurements

https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1218220130001&acceptedDisclaimer=true

59. Richard U. Ratcliff, “Appraisal Is Market Analysis,” *The Appraisal Journal* (October 1975): 486.