Notes and Issues

Developing the 15th Edition of The Appraisal of Real Estate in Challenging Times

by Michael McKinley

Abstract

On September 1, 2020, the Appraisal Institute released the fifteenth edition of The Appraisal of Real Estate. This text is the premier presentation of the Appraisal Institute’s valuation body of knowledge. It is respected internationally for its comprehensive and in-depth treatment of valuation theory and methodology in real property valuation. This article provides a glimpse into the changes in the text and the rigorous process for its development. The Appraisal of Real Estate, fifteenth edition, peer-reviewed by Appraisal Institute members, is at the time of its publication, an authoritative source of recognized methods and techniques for valuation practitioners. Appraisers should consult the text to ensure they are following the body of knowledge.

Introduction

Even in calmer times, developing a new edition of The Appraisal of Real Estate is a long, drawn-out process. In the midst of a pandemic, social upheaval, and a fractious election cycle, the day-to-day task of engaging with the words on paper served as a respite from the uncertainties and confusion of the world outside our home-office windows. In fact, it has been reassuring to read (and reread and reread) The Appraisal of Real Estate and find that, whatever else might be happening in the world, the complicated task of valuing real property still makes sense within the pages of the book.

That is not to say that some readers will not find anything new to argue about. Accepting change is hard, particularly change in a professional resource that has been in print for almost seventy years. Summarizing the multitude of large and small changes throughout an 800-page book is even harder. Readers of the text should keep in mind that it does not change the Appraisal Institute body of knowledge—it clarifies it.

Taking the broadest view, this edition of the textbook retains the organization of the previous edition, with one notable exception, as indicated in the highlighted section of the table of contents in Exhibit 1. There was a complete rewrite of the chapters covering market analysis and highest and best use analysis. The chapters in the previous edition have been split into two separate chapters for each topic in this edition. More precisely, Chapter 15 of the previous edition became Chapters 15 and 16 of the fifteenth edition, and Chapter 16 of the previous edition became Chapters 17 and 18 of the fifteenth edition. The new structure of Chapters 15 through 18 separates the complex topics into more manageable and digestible discussions of (1) theory and (2) application with examples, mirroring the structure of the groups of chapters covering each of the approaches to value. This presentation should improve understanding and application of the market analysis and highest and best use analysis components of valuation.

Many readers will want to know specifically what changes have occurred between editions of the textbook at a more granular level. However, the myriad smaller, spot-weld changes within the textbook are too numerous and diverse to summarize in any meaningful way. Be assured that the small, sometimes seemingly minor changes to wording throughout the book have been parsed...
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**Exhibit 1** Table of Contents, *The Appraisal of Real Estate*, Fifteenth Edition

with as much intensity as the major structural changes in the textbook development process.

**Development Process**
The development process for *The Appraisal of Real Estate* boils down to a simple algorithm:
1. Review
2. Revise
3. Repeat (as needed)

Forty-eight Designated Members of the Appraisal Institute were involved in the development process. There was a complete, detailed review of the text. Inconsistencies and deficiencies in wording were corrected. The body of knowledge has continued to evolve through courses and seminars, and the updated text was harmonized with the current body of knowledge.

Some sections of the textbook (such as the chapters on data collection, land description, and building description) needed only a single pass through the review and revision stages, while others (such as the heavily reorganized discussions of market analysis and highest and best use analysis) underwent a series of iterations that sometimes felt endless.
Since the publication of the fourteenth edition of *The Appraisal of Real Estate*, the Board of Directors of the Appraisal Institute reinstated the Body of Knowledge Committee as part of the organization’s governance structure. This group was charged with oversight of the textbook as well as other publications and educational material that make up the Appraisal Institute's body of knowledge. Its members had an active role in the fifteenth edition’s development process. Never before had a standing committee like the Body of Knowledge Committee been available to arbitrate issues of contention during the development of a new edition of *The Appraisal of Real Estate*.

The development process began in earnest in late 2018, a year after the Appraisal Institute’s Property Rights Symposium, which was organized by the Body of Knowledge Committee to examine certain hot topics in the profession. In that symposium, valuation professionals discussed the nascent (and controversial) “dark store theory,” what we mean when we say “leased fee,” and what other people assume when they refer to “market value.” These discussions influenced the development of *The Appraisal of Real Estate*, fifteenth edition, in a variety of ways.

**Results**

Unsatisfyingly, a major focus of the review activity over the past two years was the core task of clearly identifying the property rights being appraised. Long-held definitions of terms like *fee simple estate* were examined but ultimately not changed in the textbook. In the interest of clarity, new discussion of the labels applied to property rights by various participants in real property markets has been added (Chapter 7) to help explain certain semantic stumbling blocks and to help appraisers ensure that they are properly communicating what property rights are involved in the assignment at hand to parties that may have different assumptions about what certain terms mean. Throughout development of the new edition of *The Appraisal of Real Estate*, any potential ambiguity about what property rights are being discussed was scrutinized and addressed in the review and revision processes.

Like references to ever-evolving professional standards, certain topics that are covered in the textbook are moving targets. Some of the content areas that are sensitive to changes in the marketplace and the advance of information technology include the following:

- Data standards (e.g., OSCRE, MISMO)
- The use of GIS in valuation
- The programs of Fannie Mae and Freddie Mac (e.g., the new UMBS program)
- Sources of capital, such as opportunity zones and hard money lenders
- The ongoing evolution (and market acceptance) of green building features
- New building measurement standards published by BOMA
- Accounting standards on types of leases and business combinations

Developments in these areas have been covered in the textbook to bring the book up to date. On the other side of the coin, certain topics have outlived their usefulness in the textbook and needed to be weeded out (or deemphasized), such as

- The idea of “scope creep”
- Asbestos as a detrimental building material
- The J factor
- The reviewer’s checklist

Note, however, that the appendices covering professional practice and law, regression analysis and statistical applications, and financial formulas—which have been relatively unchanged over many editions of the textbook—have not been eliminated. Although they no longer appear in the printed book, they are readily available online at www.appraisalinstitute.org/15th-edition-appendices/.

Two areas of focus in recent years, both in Appraisal Institute publications and education, have been market analysis and highest and best use analysis. The most noticeable change in the organization of the textbook, as mentioned previously, is the splitting of the discussions of each topic into an introductory chapter on fundamental concepts and a follow-up chapter on the application of those concepts in valuation practice. In the case of highest and best use, the discussion of the application of that crucial step in the valuation process has been revised significantly to show more explicitly how the six steps of market analysis can be extended to eight steps to derive a credibly supported conclusion of highest and best use, including all three essential components of that conclusion: (1) use,
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(2) timing, and (3) market participants. The revised discussion brings home the point that appraisers are real estate economists who look at supply and demand in the market in which properties operate. Two easy-to-follow graphics in the text illustrate the analytic process (shown in Exhibit 2, above, and Exhibit 3, on page 268). In Exhibit 2, the left column displays each of the eight steps in the highest and best use analysis, the middle column describes the step, and the right column links the eight steps to previous, familiar terminology.

The distinction between the fundamental market of space users and the investment buyer market has been made more explicit in the textbook’s discussion of market analysis and use of data derived from market analysis. That is, estimates of supply and demand need to be made with conscious consideration of which market is being served by the use of the real property. Consistent treatment of market data throughout the valuation process ensures that apples are compared to apples and oranges to oranges.

After publication of the previous edition of *The Appraisal of Real Estate*, the Appraisal Institute established two professional review designations, developed related educational curriculum, and published a handbook on the subject. The discussion of appraisal review, found in Chapter 34 of the new textbook, has been updated significantly to account for changes in this professional discipline such as the evolution of professional standards relating to review, current thinking on precisely what can be reviewed and who can perform reviews, a new more systematic format for structuring review assignments, and a more nuanced discussion of common appraisal issues seen in review assignments.

The valuation of non-realty interests—such as personal property and financial assets involved in the valuation of a business that includes real property—has never been the focus of *The Appraisal of Real Estate*. But increased interest among valuation professionals in this specialized area of practice spurred the development of new material on the subject in the previous edition of the text.

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**Exhibit 2  Eight Steps of the Highest and Best Use Analysis Process**

| Step 1. Property productivity analysis | Analyze property productivity attributes (site, legal, and location) to eliminate uses and determine most probable uses | Physical possibility  
|                                          | • Physical possibility  
|                                          | • Legal permissibility |
| Step 2. Delineate the market            | Perform market studies to determine the economic demand and timing for probable alternative uses | Data required for analysis of financial feasibility |
| Step 3. Demand analysis                 | Perform marketability analysis |
| Step 4. Supply analysis                 | Perform financial analysis of alternative land uses to determine which use has the highest residual land value | Financial feasibility |
| Step 5. Residual demand analysis        | Perform highest and best use reconciliation and draw conclusions:  
|                                          | • Use  
|                                          | • Timing  
|                                          | • Market participants  
|                                          | • Users of space  
|                                          | • Most probable buyer type | Maximum productivity |
| Step 6. Subject capture analysis        | Perform marketability analysis |
| Step 7. Financial analysis of alternative uses | Complete a financial analysis of alternative land uses to determine which use has the highest residual land value |
| Step 8. Highest and best use conclusions | Perform highest and best use reconciliation and draw conclusions:  
|                                          | • Use  
|                                          | • Timing  
|                                          | • Market participants  
|                                          | • Users of space  
|                                          | • Most probable buyer type |

Source: Figure 18.1 in *The Appraisal of Real Estate*, 15th ed.
Exhibit 3 The Iterative Analysis of Alternative Uses

Problem Definition of Highest and Best Use Analysis
The reasonably probable use of property that results in the highest value. The four criteria that the highest and best use must meet are legal permissibility, physical possibility, financial feasibility, and maximum productivity.

Economic Overview and Alternative Use Scoping
Site, improvement, legal, and locational determinants of most probable uses

Alternative Use 1  
Alternative Use 2  
...  
Alternative Use n

Market Analysis and Marketability Analysis
Step 2. Delineate the market  
Step 3. Demand analysis  
Step 4. Supply analysis  
Step 5. Residual demand analysis  
Step 6. Subject capture analysis

Market Analysis and Marketability Analysis
Step 2. Delineate the market  
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Market Analysis and Marketability Analysis
Step 2. Delineate the market  
Step 3. Demand analysis  
Step 4. Supply analysis  
Step 5. Residual demand analysis  
Step 6. Subject capture analysis

Financial Analysis of Alternative Use 1  
Financial Analysis of Alternative Use 2  
Financial Analysis of Alternative Uses  
Financial Analysis of Alternative Use n

Highest and Best Use Conclusions
Specified in terms of  
- Use  
- Timing  
- Market participants  
  - Users of space  
  - Most probable buyer type

Source: Figure 18.2 in The Appraisal of Real Estate, 15th ed.
book. The fifteenth edition moves forward the discussion of techniques for the valuation of non-realty interests. Chapter 37 provides clarification of the application of the management fee approach and the parsing income method, a description of the overall capitalization without allocation to asset classes technique, and concrete examples of the various techniques covered.

Looking Ahead

The care and feeding of The Appraisal of Real Estate is an ongoing effort, like looking after the sourdough starter that we’ve all acquired in the recent stay-at-home months. This maintenance process involves more than just the individuals listed in the Acknowledgments section of the new edition of the textbook. Work on the next edition starts on the day that the current edition is published. User feedback is collected continuously over the lifespan of each edition of The Appraisal of Real Estate and serves as the jumping off point for the development of the next edition. With uncertainty about how real estate markets—and, really, all markets—will behave once the coronavirus pandemic has passed, ongoing vigilance will be essential to the continuing improvement of the textbook as a tool for valuation professionals at all points in their careers.

The publication of the fifteenth edition of The Appraisal of Real Estate is a step forward worthy of celebration. For obvious reasons, we are not able to convene all the contributors to the development of the new edition for a book launch party. We’ll have to make do with the more modest comfort of a slice of sourdough bread and the reassuring heft of the completed book in our hands.

About the Author

Michael McKinley is a senior book editor and technical writer with the Appraisal Institute. He has worked in the Publications area of the Appraisal Institute since 1998. He has been the developmental editor for four editions of The Appraisal of Real Estate, and he has worked on development of the fourth, fifth, and sixth editions of The Dictionary of Real Estate Appraisal as well as numerous other Appraisal Institute texts, monographs, and handbooks. Contact: mmckinley@appraisalinstitute.org