

Guide Notes to the Standards of Professional Appraisal Practice of the Appraisal Institute

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Note about Revision 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, 2011 the Appraisal Institute Board of Directors approved and adopted Guide Note 11: *Comparable Selection in a Declining Market*.

On May 8, 2012 the Appraisal Institute Board of Directors approved and adopted Guide Note 12: *Analyzing Market Trends* and approved the retirement of Guide Note 1: *Valuation of Real Estate Component of Real Estate Limited Partnership Interests*.

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 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 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 with guidance as to how the requirements of the Standards may apply in specific situations.)

Guide Note 5

Appraisals of Real Estate with Related Personal Property, Business Property, or Intangible Assets

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 on-going 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 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 long recognized environmental conditions as major determinants of 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 environmental conditions are readily 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 impact of hazardous substances on the valuation of real property.

The presence of hazardous substances can significantly impact the value of a property. In fact, in some cases the remediation cost may be greater than the property value after any necessary clean-up.

For the purpose of this Guide Note, the term “hazardous substances” covers any material within, around, or near a property that may have a negative impact on its value. Accordingly, the principles discussed in this Guide Note apply equally to hazardous substances that may be contained within the property and external hazardous substances.

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 hazardous substances and, in particular, to the consideration of such hazards 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 requires the appraiser to either 1) properly identify the problem to be addressed and have the knowledge and experience necessary to complete the assignment competently; 2) 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 3) 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 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 of hazardous substances. If an appraiser is qualified to detect or measure hazardous substances, a different standard 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, the appraiser would not require the professional assistance of others. These alternatives are further discussed below.

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 believe that the advice or findings are made by persons who are properly qualified. (See Guide Note 4: Reliance on Reports Prepared by Others and USPAP, the Comment to SR 2-3.) It is suggested that the client, not the appraiser, choose and hire any qualified environmental professionals.

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 for that Rule states:

Comment: 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 hazardous materials that may impact the property, or it may be prepared so that the value opinion does reflect known hazardous substances. 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.

Because the appraiser's value opinion is based on assessment of what a knowledgeable buyer would pay a knowledgeable seller, the appraiser needs to be aware of the steps that knowledgeable buyers and sellers now take in the marketplace. Under federal and most state laws, the owner of a piece of property which is contaminated, and from which there is a release or threatened release, may be held liable for the cost of corrective action. Under federal and state laws, an "innocent purchaser" may avoid this liability. In order for a purchaser to qualify for the "innocent purchaser" defense, the purchaser must establish that it undertook all proper investigation of the property and the investigation indicated that the property was clean. This has come to mean, at a minimum, that the purchaser of commercial, industrial, or vacant property must conduct at least a "Phase I" investigation of the property prior to acquisition. Such an investigation entails a review of the property, its history, and available government records to determine if there is reason to believe that it may contain contamination. If a properly conducted Phase I investigation finds no likelihood of contamination, it should be sufficient to establish the "innocent purchaser" defense. If the potential for contamination is disclosed in the Phase I report, further investigation, often characterized as Phase II or Phase III investigation, should be able to determine with a reasonable degree of scientific certainty whether the property is affected by contamination, and if it is, what the possible remedies and costs may be. Given the accepted practice in the marketplace, the appraiser may wish to qualify his or her appraisal as follows:

If the appraiser has been provided with a Phase I, Phase II, or Phase III report finding no evidence of possible contamination:

The client has provided an environmental assessment for the property performed by XXX. According to the report describing that assessment, dated XXX, no adverse hazardous substances were found on the subject property. The reader of this appraisal report is urged to review the entire environmental assessment for specific detail.

If no Phase I report has been prepared or provided to the appraiser and the appraiser has no reason to suspect the existence of hazardous substances, the appraiser may wish to state specifically that:

The appraiser has not reviewed a Phase I report of examination and such an examination is customary in the transfer of commercial, industrial, or vacant real estate. The appraisal is based on an assumption of a Phase I report indicating no contamination.

Assignments Involving NO Known or Suspected Hazardous Substances

When there are no known or suspected hazardous substances associated with the property, it is recommended, as a matter of standard practice, that the appraiser issue a disclaimer or limiting condition to the effect that the appraisal is predicated on the assumption that hazardous substances do not exist. An example of such a disclaimer might be as follows:

Unless otherwise stated in this report, the existence of hazardous substances, including without limitation asbestos, polychlorinated biphenyl, petroleum leakage, or agricultural chemicals, which may or may not be present on the property, was not called to the attention of nor did the appraiser become aware of such during the appraiser's inspection. The appraiser has no knowledge of the existence of such materials on or in the property unless otherwise stated. The appraiser, however, is not qualified to test for such substances. The presence of such hazardous substances may affect the value of the property. The value opinion developed herein is predicated on the assumption that no such hazardous substances exist on or in the property or in such proximity thereto, which would cause a loss in value. No responsibility is assumed for any such hazardous substances, nor for any expertise or knowledge required to discover them.

Assignments Involving SUSPECTED Hazardous Substances

If in the course of completing an appraisal assignment, the appraiser discovers reason to believe there may be hazardous substances associated with the property, the appraiser should immediately notify the client to address the situation. The appraisal may be completed based on the extraordinary assumption that there are no hazardous substances affecting the property's value. However, the client may at this time wish to investigate further by requesting the services of an environmental professional before the appraisal is completed.

USPAP defines an "extraordinary assumption" as "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." The Comment to this definition states: "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."

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...”

An example of the disclosure of such an extraordinary assumption would be:

During the course of completing this assignment, the appraiser became aware that [give reason for suspecting the presence of hazardous substances]. Unless otherwise stated in this report, the existence of hazardous substances, including without limitation asbestos, polychlorinated biphenyl, petroleum leakage, or agricultural chemicals, which may or may not be present on the property, was not called to the attention of nor did the appraiser become aware of such during the appraiser’s inspection. The appraiser is not qualified to test for such substances. The presence of such hazardous substances may affect the value of the property. The value opinion developed herein is predicated on the extraordinary assumption that no such hazardous substances exist on or in the property or in such proximity thereto which would cause a loss in value. No responsibility is assumed for any such hazardous substances, nor for any expertise or knowledge required to discover them.

The foregoing disclosure may be placed in the letter of transmittal, scope of work description, or general comment section, depending on the type and length of report prepared. In an oral report, the appraiser should present the same information, if possible.

Assignments Involving KNOWN Hazardous Substances: Appraised Value DOES NOT Account for Their Effect

If a property is known to be affected by hazardous substances, it may serve a valid and useful purpose to develop a value opinion for the property that excludes the consideration of known hazardous substances. Such an appraisal would be based on a hypothetical condition; i.e., that the property is not impacted by known hazardous substances. Such an appraisal could be required as the logical starting point in a study of the impact of hazardous substances or in connection with legal proceedings.

USPAP defines a “hypothetical condition” as “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.” The Comment states: “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 requires the report to “clearly and accurately disclose all ... hypothetical conditions ... used in the assignment.” This Standards Rule does 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. A brief discussion of the likely impact on value is all that is required.

An example of the disclosure of such a hypothetical condition would be as follows:

It is reported that asbestos is present within the subject property. In accordance with the client’s instructions and consistent with the intended use of this appraisal, the value opinion is based on the hypothetical condition that the subject property is not impacted by asbestos. The presence of asbestos may have a negative influence on the value of the subject property, but the consideration of the effects of asbestos on the value of the subject property is beyond the scope of this assignment. The appraiser cautions against the use of this appraisal for any use other than the intended use stated herein.

The foregoing disclosure may be placed in the letter of transmittal, scope-of-work section, 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.

If the appraiser is provided with a Phase I, Phase II, or Phase III report that indicates the possibility of contamination, that must be noted together with the amount of further investigation that is required by customary business practice as well as necessary to establish the “innocent purchaser” defense (such further investigation must reveal the absence of contamination to establish the “innocent purchaser” defense). A statement similar to the following is suggested:

The client has provided a Phase XX environmental assessment for the property performed by XXXX. According to the report describing that assessment, dated XXX, the following hazardous substances are found on the subject property. The reader of this appraisal report is urged to review the entire environmental assessment for specific detail.

Assignments Involving KNOWN Hazardous Substances: Appraised Value Accounts for Their Effect

In developing an appraisal based in part on the findings of others with respect to the existence and effects of known hazardous substances, the appraiser must correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal. The loss of value attributable to hazardous substances is sometimes measurable using the same methods and techniques that are used to measure depreciation from other causes. In other cases, more specialized techniques are indicated. However, in some cases even environmental professionals cannot agree on the level of clean-up required, the appropriate method of that clean-up, or the cost of clean-up.

The appraiser is cautioned that the value of a property impacted by hazardous substances may not be measurable simply by deducting the typical remediation cost, or discovery cost from the total value, as if “clean.” The possibility of other changes affecting value, such as a change in highest and best use, marketability, and stigma, should be considered. In any analysis the appraiser should concentrate on developing an opinion of the hazardous substances’ effect on value.

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 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)(viii), 2-2(b)(viii), and 2-2(c)(viii)).
4. Identify in the appraisal process any known hazardous substances affecting the property (SR 1-2(e)(i)).
5. Identify the scope of work necessary to complete the assignment, including the manner and degree to which hazardous substances will be addressed (Scope of Work Rule).

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

Guide Note 7

Consideration of the Americans with Disabilities Act in the Appraisal Process

Introduction

The Americans with Disabilities Act of 1990 became effective as to the removal of barriers to entry and use by disabled persons in existing public accommodations as of January 26, 1992. It applies to alterations of existing public accommodations or commercial facilities as of the same effective date and new construction of commercial facilities or places of public accommodation designed for first occupancy after January 26, 1993.

In appraisals involving real estate that is covered by the Act, appraisers should address the question of whether or not the requirements of the Act could have an effect on the value opinion.

The need to comply with the Accessibility Guidelines set forth in the Regulations for existing facilities where compliance is readily achievable and on alterations or new facilities may be a substantial expense to be paid by the tenant or owner. This, in turn, can have an impact on the value of the property.

Competency

The Competency Rule of the Uniform Standards of Professional Appraisal Practice requires the appraiser to either 1) properly identify the problem to be addressed and have the knowledge and experience necessary to complete the assignment competently or 2) 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.

The Competency Rule is of particular importance in the appraisal of real property that comes under the provisions of the ADA Regulations. The typical appraiser does not have the knowledge or experience required to determine whether physical changes have to be made to existing facilities to conform to the ADA Regulations or whether alterations or new construction meets the requirements. The appraiser in most cases will have to rely on those with special expertise.

An appraiser is not prevented from developing expertise in the area of ADA requirements, but a real estate appraiser is not required to become an expert in the field of ADA requirements. This Guide Note addresses the area of ADA requirements from the viewpoint of the real estate appraiser who is not an expert in this area.

An appraiser may accept an assignment involving the considerations of ADA requirements without the required knowledge and experience in this area provided the appraiser discloses such lack of knowledge and experience to the client prior to acceptance of the assignment and arranges to complete the assignment competently. 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 relies on the

advice or findings of others, the appraiser must believe that the advice or findings are made by persons who are properly qualified. (See Guide Note 4: Reliance on Reports Prepared by Others.) It is suggested that the client hire qualified ADA experts.

In addition to an appropriate limiting condition, there should be an appropriate statement of purpose, and the conclusion should be properly qualified, as illustrated below.

The purpose of this appraisal is to develop an opinion of the market value of the subject property, as if unaffected by the elevator requirements of the ADA Regulations, as of July 1, XXXX.

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 how compliance or lack of compliance with the ADA might impact the property. The Comment in the Scope of Work Acceptability section of the SCOPE OF WORK 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.

The appraiser must be prepared to demonstrate that the scope of work is sufficient to produce credible assignment results.

An appraiser must not allow assignment conditions or other factors to limit the extent of research or analysis to such a degree that the resulting opinions and conclusions developed in an assignment are not credible in the context of the intended use of the appraisal.

SR 2-2(a), (b) and (c)(x) require that the scope of work be disclosed in the appraisal report.

Depending on the intended use, the appraisal may be prepared so that the value opinion reflects no known lack of compliance with ADA requirements, or it may be prepared so that the value opinion does reflect lack of compliance. 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.

Assignments Involving NO Known or Suspected Lack of Compliance with ADA

When there is no known or suspected lack of compliance with the ADA, it is recommended, as a matter of standard practice, that the appraiser include a general assumption in the appraisal report to the effect that the appraisal is predicated on the assumption that readily achievable barrier removals do not exist. Since the law is written on the basis that the final determination of whether or not readily achievable changes have been made will be determined by the courts, it can never be assumed that any property has met all the requirements.

The following example is offered for illustration only.

The Americans with Disabilities Act (ADA) became effective January 26, 1992. The appraiser has not made a specific compliance survey and analysis of this property to determine whether or not it is in conformity with the various detailed requirements of the ADA. It is possible that a compliance survey of the property together with a detailed analysis of the requirements of the ADA could reveal that the property is not in compliance with one or more of the requirements of the Act. If so, this fact could have a negative effect upon the value of the property. Since the appraiser has no direct evidence relating to this issue, possible noncompliance with the requirements of ADA was not considered in developing an opinion of the value of the property.

Assignments Involving SUSPECTED Lack of Compliance with ADA

If in the course of completing an appraisal assignment the appraiser becomes aware of information indicating the property may lack compliance with the ADA, the appraiser should immediately notify the client of the situation. The appraisal may be completed based on the extraordinary assumption that there is no lack of compliance with the ADA that might affect the property's value. However, the client may at this time wish to investigate further by requesting the services of an ADA expert before the appraisal is completed.

USPAP defines an "extraordinary assumption" as "an assumption, directly related to a specific assignment, which, if found to be false, could alter the appraiser's opinions or conclusions." The Comment states: "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."

Standards Rule 1-2(f) requires that in developing an opinion of value the appraiser identify "any extraordinary assumption 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.

Standards Rule 2-1 requires the report to "clearly and accurately disclose any extraordinary assumption ... that directly affects the appraisal and indicate its impact on value." This Standards Rule does not require that the appraiser quantify the impact on value, such as by both valuing the property subject to the extraordinary assumption and valuing it not subject to the extraordinary

assumption. A statement that the use of any extraordinary assumptions might have affected the assignment results is required.

An example of the disclosure of such an extraordinary assumption would be as follows:

During the course of completing this assignment, the appraiser became aware that [give reason for suspecting the lack of ADA compliance]. The Americans with Disabilities Act (ADA) became effective January 26, 1992. The appraiser has not made a specific compliance survey and analysis of this property to determine whether or not it is in conformity with the various detailed requirements of the ADA. It is possible that a compliance survey of the property together with a detailed analysis of the requirements of the ADA could reveal that the property is not in compliance with one or more of the requirements of the Act. If so, this fact could have a negative effect upon the value of the property. Since the appraiser has no direct evidence relating to this issue, this appraisal was made based on the extraordinary assumption that the property is not impacted by lack of compliance with the ADA.

The foregoing disclosure may be placed in the letter of transmittal, scope-of-work section, or general comment section, depending on the type and length of report prepared. In an oral report, the appraiser should present the same information, if possible.

Further, as discussed above, the extraordinary assumption must be clearly and conspicuously reported. For example:

The appraiser's final opinion of the market value of the subject property as of January 1, 2XXX, is therefore \$XXX,XXX. This opinion is made based on the extraordinary assumption that the subject property is not impacted by lack of compliance with the Americans with Disabilities Act. The use of this assumption might have affected the assignment results.

Assignments Involving KNOWN Lack of ADA Compliance: Appraised Value DOES NOT Account for Its Impact

If a property is known to be out of compliance with the ADA Regulations, it may serve a valid or useful purpose to appraise the property as though ADA compliance were not at issue. Such an appraisal could be required as the logical starting point in a study of the impact of the ADA Regulations. Whatever the purpose, such an appraisal must be properly qualified to prevent its misuse. The valuation of property that has known readily achievable changes required to meet the ADA Regulations would be based on the hypothetical condition that the property is not impacted by lack of ADA compliance.

USPAP defines a "hypothetical condition" as "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." The Comment to this definition states: "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 an 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 state in the appraisal report all hypothetical conditions upon which the value opinion is premised.

Standards Rule 2-1 requires the report to “clearly and accurately disclose all ... hypothetical conditions ... used in the assignment.” This Standards Rule does not require that the appraiser quantify the impact on value, such as by valuing the property both subject to the hypothetical condition and valuing it not subject to the hypothetical condition. A statement that the use of the hypothetical condition may have affected assignment results is all that is required.

An example of the disclosure of such a hypothetical condition would be as follows:

In accordance with the client’s instructions, and consistent with the intended use of the appraisal, the opinion of value is based on the hypothetical condition that the subject property is unaffected by the elevator requirements of ADA. It is known that the elevators do not meet the requirements of ADA and if they are required to be brought in line with the Regulation it would have a negative effect on the value of the subject property. The consideration of the negative effect on value that would occur if the elevators are required to be brought into compliance is beyond the scope of this assignment. The appraiser cautions against the use of this appraisal for any use other than the intended use stated herein.

The foregoing disclosure may be placed in the letter of transmittal, scope-of-work section, 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.

Assignments Involving KNOWN Lack of ADA Compliance: Appraised Value Accounts for Its Impact

In developing an appraisal based in part on the findings of others with respect to changes that are required to meet the ADA Regulations, the appraiser must correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal. The loss of value attributable to required changes is generally measurable using the same methods and techniques that are used to measure curable depreciation from other causes. However, it must be recognized that experts will disagree on what are readily achievable barrier removals.

The appraiser is cautioned that the value of a property which has physical barriers to the disabled may not be measurable simply by deducting the cost to cure from the value opinion developed before the required changes. The possibility of using auxiliary aids, changing the use of the property so it is not a public accommodation, or making the changes over time should be considered.

Summary of Standard Practices

1. Disclose to the client the appraiser's lack of knowledge and experience with the ADA Regulations and their requirements (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 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 ADA requirements (SR 1-2(h) and/or (g), SR 2-1(c), and SR 2-2(a), (b) and (c)(x)).
4. Identify in the appraisal process any known lack of ADA compliance (SR 1-2(e)(i)).

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members 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 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.

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, 2XXX

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 with guidance as to how the requirements of the Standards may apply in specific situations.)

Guide Note 9

Use and Applicability of Engagement Letters

Introduction

An engagement letter means a written or electronically transmitted agreement between the appraiser and the client setting forth the terms and conditions of an appraisal assignment. Neither the Uniform Standards of Professional Appraisal Practice nor the Code of Professional Ethics requires that engagement letters be used. However, use of an engagement letter is generally a sound business practice, as it serves to clarify the terms of the assignment and provides written evidence of the client's and appraiser's agreement to those terms.

Basis for Appropriate Use

The engagement letter can be written by either the appraiser or the client, as long as both parties understand and agree to its entire content. In most cases the engagement letter should be drafted after the client and the appraiser have discussed the assignment and have orally agreed to the scope of the assignment, timing of completion by the appraiser, fee, and other parameters. The engagement letter then serves as an affirmation of this conversation.

If the appraiser and the client have an on-going relationship, the client (or trading partner) might initiate a new assignment by sending the appraiser (often via fax or electronic transmission) an appraisal request or order form. This procedure serves the same purpose as an engagement letter as long as it adequately addresses the requisite issues and the appraiser can agree to the terms of the assignment established by the client. Upon receipt it would be advisable for the appraiser to sign and date the request or otherwise document its acceptance.

The format and content of the engagement letter may vary depending on the nature of the assignment. Items that should be addressed include the following:

- Date of the engagement.
- Scope of work to be used in the assignment; if the Jurisdictional Exception applies, the applicable law or public policy should be referenced or a copy should accompany the engagement letter.
- Any laws or regulations that apply to the assignment or the appraiser (e.g., FNMA guidelines or Uniform Appraisal Standards for Federal Land Acquisitions appraisal requirements) or special requirements of the client (e.g., photos, maps, data sheets, etc.).
- Reference to compliance with the Code of Professional Ethics and Standards of Professional Practice of the Appraisal Institute (which include USPAP).
- Identification of the subject property.
- Identification of the interest to be valued.

- Intended use of the appraisal.
- Intended user(s) of the appraisal.
- Type of value opinion(s) to be developed.
- Definition(s) of value opinion(s) to be developed.
- Number of copies of the appraisal report.
- Due date.
- To whom delivered and where, and method of delivery, if appropriate.
- Amount of agreed upon fee (and method of payment, if appropriate).
- Contact(s) for access to and information about the subject property.
- Client's name, company name, and contact information.
- Appraiser's name, company name, and contact information.

It is advisable for the engagement letter to be signed and dated by both the appraiser and the client, and both parties should retain a signed and dated copy. If it is not possible for both parties to sign and date the engagement letter, the appraiser should document its mutual acceptance.

When the terms and conditions of the assignment are set forth in a written engagement letter, any subsequent modifications to the original agreement should also be in writing (or transmitted in the same manner as the original engagement letter). The documented modifications should be retained with the original engagement letter by both the appraiser and the client.

If the engagement letter or appraisal request is transmitted electronically via a standard or proprietary transaction set, all necessary items must be addressed. If fields for the necessary information are not specifically provided, the information should be input as text.

Summary of Standard Practices

1. Client requirements must be consistent with USPAP, unless a Jurisdictional Exception applies.
2. The agreed upon fee must not be contingent upon the outcome of an assignment.
3. The engagement letter must be consistent with any oral agreement with the client regarding the assignment.
4. Subsequent modifications to a written engagement letter should be in writing or otherwise properly documented.

GUIDE NOTE 9

(Please Note: The purpose of the Guide Notes to the Standards of Professional Appraisal Practice is to provide Members 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's *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 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’s *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's *The 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's *The 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.

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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 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.”¹

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.)²

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

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.

¹ Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 5th ed. (Chicago: Appraisal Institute, 2010).

² Stephen F. Fanning, *Market Analysis for Real Estate: Concepts and Applications in Valuation and Highest and Best Use*. (Chicago: Appraisal Institute, 2005.), p. 5

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.
10. Job growth declining.
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 with guidance as to how the requirements of the Standards may apply in specific situations.)