2012 Appraisal Institute Annual Meeting

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EXPERIMENTAL AND NON-TRADITIONAL VALUATION METHODS: GUIDELINES FOR APPRAISERS

Appraisal Institute Annual Meeting
San Diego, California | August 2, 2012

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President, Clarion Associates, Inc.
Speaker Qualifications

- Richard J. Roddewig, MAI, CRE
  - President of Clarion Associates
  - More than 30 years appraisal experience
  - Works nationally on appraisal assignments in litigation situations
  - Member of AI Special Task Group for the Development of Standards for Determining the Acceptability of Applications for Statistical and Market Survey Techniques to the Valuation of Real Property
  - Editor of AI book “Valuing Contaminated Properties: An Appraisal Institute Anthology”
  - Developer of four Appraisal Institute seminars and courses
  - Author of many articles in Appraisal Journal and other publications
Topic One: Key Questions Related to Meta-Analysis, Contingent Valuation & Regression Modeling
Topic One: Key Questions

• 1. Are licensed appraisers required to use only “recognized” and “generally accepted” methods?

• 2. If so, how do we know when a method has become “generally accepted”?
Topic One: Key Questions

• 3. When is it appropriate for appraisers to use methods and techniques of non-appraisers, such as economists?

• 4. When and how do techniques of “economists” and real estate professors rise to the level of becoming “recognized” and “generally accepted”? 
5. Are meta-analysis, contingent valuation and regression analysis recognized and generally accepted methods of the appraisal profession?
6. Are there special issues that arise related to use of recognized & generally accepted methods in appraisal assignments in litigation settings?
Topic Two: Sources of Information on Recognized & Generally Accepted Methods
Topic Two

• Sources of Information on Recognized and Generally Accepted Appraisal Techniques
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

• Standards Rule 1-1
  - “In developing a real property appraisal, an appraiser must: (a) be aware of, understand, and correctly employ those RECOGNIZED methods and techniques that are necessary to produce a credible appraisal.”
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

• Scope of Work Rule
  – Scope of Work Acceptability – 2012-13 USPAP
  – “The scope of work must include the research and analyses that are necessary to develop credible assignment results.”
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

• Scope of Work Rule (continued)
  – Scope of Work Acceptability – 2012-13 USPAP
  – Scope of work is “acceptable when it meets or exceeds: . . . what an APPRAISER’S PEERS’ actions would be in performing the same or a similar assignment.”
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

• Definitions
  – Appraiser’s Peers – “other APPRAISERS who have expertise and competency in a similar type of assignment”
    USPAP, 2010-2011 Ed. p. U-14, Lines 408-409 and The Dictionary of Real Estate Appraising
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

• Definitions
  – Appraiser’s Peers – Definition
  – Question: Are economists an appraiser’s peers?
    – Answer: No – unless they are also appraisers!
  – Question: Are academic professors of real estate an appraiser’s peers?
    – Answer: No – unless they are also appraisers!
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

• Frequently Asked Question FAQ 156 (USPAP 2012-2013 Edition)
  – “Question: In the SCOPE OF WORK RULE, one of the two tests regarding the acceptability of an appraiser’s scope of work is what the appraiser’s peers would do. There are many appraisers that do things differently, so how would I know what they would do in an assignment?”
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

- Frequently Asked Question FAQ 156 (USPAP 2012-2013 Edition)
  - Answer –
    - Assignment specific
    - Books, publications, courses, seminars, & discussion groups of THE APPRAISAL PROFESSION
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

What are the sources of information for the recognized & generally accepted methods of the appraisal profession?

- USPAP
- Advisory Opinions
- Frequently Asked Questions
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

– What are the sources of information for the recognized & generally accepted methods of the appraisal profession? (continued)

• Books published by The Appraisal Institute and other professional appraisal organizations such as the IAAO or the American Society of Appraisers
• Articles in the *Appraisal Journal* and other publications of the appraisal profession
• Courses and seminars developed by the Appraisal Institute and other professional appraisal organizations such as the IAAO or the American Society of Appraisers
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

– Comment to Standards Rule 1-1(a) states:
“Changes and developments in the real estate field have a substantial impact on the appraisal profession. . . To keep abreast of these changes and developments, the APPRAISAL PROFESSION is constantly reviewing and revising appraisal methods and techniques and devising new methods and techniques to meet new circumstances.”
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

- Publications of the economics profession are not an appropriate source of information on recognized & generally accepted methods of the real estate appraisal profession.
Topic Two: Sources of Information on Recognized & Generally Accepted Methods

- Publications by real estate professors are also NOT AUTOMATICALLY an appropriate source of information on recognized & generally accepted methods of the appraisal profession UNLESS THEY HAVE ALSO BEEN RECOGNIZED BY THE APPRAISAL PROFESSION
Topic Three: Meta-Analysis, Case Studies & the Real Estate Literature
Topic Three: Meta-Analysis – What Is It?

- An application of statistical techniques to a “review” of the published literature on a particular subject
- Purpose -- explain “study-to-study variation found in empirical literature.” (Stanley, Journal of Economic Perspectives, Summer 2001)
- Used by economists and academics – not by real estate appraisers as an appraisal technique
Topic Three: Meta-Analysis – What Isn’t It?

– Meta-analysis is NOT a “RECOGNIZED” real estate appraisal method or technique
– Meta-analysis is NOT mentioned in
  • *The Dictionary of Real Estate Appraisal* (5th Edition)
  • *The Appraisal of Real Estate* (13th Edition)
  • Any articles in the *Appraisal Journal* or other journals of the appraisal profession
  • Any books, courses, or seminars of the Appraisal Institute or other professional appraisal organizations
– It is NOT an appropriate or generally accepted technique for “review of the real estate literature”
– It is NOT an appropriate application of “case study analysis”
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– Appraisers can appropriately refer to the real estate literature for various purposes including:
  • As a starting point in an appraisal assignment
  • To gain competency
  • To understand how other appraisers have handled similar assignments
  • To gain insights into technical and analytical issues in an appraisal assignment
  • To understand how those outside the appraisal profession have analyzed similar issues
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– Key question related to reviewing and relying on AN OPINION OF VALUE in the published literature:
– Is using the result of a published article a form of “reliance on work performed by appraisers and others”? (USPAP Standard 2-3 Comment)
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

— Comment to USPAP Standard 2-3 certification requirements and reliance on work performed by others:

• Names of those “providing significant real property appraisal assistance” must be stated
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– Comment to USPAP Standard 2-3 certification (continued):

• Signing appraiser “is responsible for the decision to rely on their work”

• Must have “a reasonable basis for believing that those individuals performing the work are competent”

• Must have “no reason to doubt that the work of those individuals is credible”
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– Example of an improper reliance on the published literature:
  - IRS website “Topical Tax Brief” discussion of an IRS market study of sales of historic properties in Philadelphia
  - IRS website article stated “Internal Revenue Service Engineers have concluded that the proper valuation of a façade easement should range from approximately 10% to 15% of the value of the property.”
  - Statement was based upon an IRS market study in Philadelphia
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– Example of an improper reliance on the published literature:
  • Some appraisers – rather than search for and then analyze sales of easement protected properties – simply relied upon that statement to arrive at a 15% conclusion of value of the easement
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

• Example of an improper reliance on the published literature (continued)
  • IRS has challenged dozens of such appraisals

Background - Abusive Transactions Involving Charitable Contributions of Easements

In recognition of our need to preserve our heritage, Congress allowed an income tax deduction for owners of significant property who give up certain rights of ownership to preserve their land or buildings for future generations.

The IRS has seen abuses of this tax provision that compromise the policy Congress intended to promote. We
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

- Example of an improper reliance on the published literature (continued)
  - IRS has challenged dozens of such appraisals
  - U.S. Tax Court and federal district court have ruled it was inappropriate to rely on a percentage in a published article in arriving at an opinion of value

Background - Abusive Transactions Involving Charitable Contributions of Easements

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Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

• Example of an improper reliance on the published literature (continued)
  
  • “the appraisers’ adoption of an arbitrarily determined percentage approach . . . appears to call for careful scrutiny by someone who recognizes when an emperor has no clothes.” Bruzewicz v. U.S.A., U.S. District Court for the Northern District of Illinois
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– Appraisal Institute Guide Note 4

– Query: Is a published article a “report prepared by others” under Guide Note 4?
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– Appraisal Institute Guide Note 4 (continued):

• Four types of reports
  – General Informational Reports
  – Reports Prepared by Licensed or Certified Non-Real Estate Appraisal Professionals
  – Reports Prepared by Other Non-Real Estate Appraisal Professionals
  – Other Reports

• Each type has its own verification requirements
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– Appraisal Institute Guide Note 4 (continued):

- General Informational Reports -- require limited verification
- Reports Prepared by Licensed or Certified Non-Real Estate Appraisal Professionals – require investigation by the appraiser for “observed or apparent material discrepancies” with the appraiser’s investigation
- Reports Prepared by Other Non-Real Estate Appraisal Professionals – can be relied on if preparer is “competent” and the appraiser “has no reason to doubt” that the work is “credible”
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– Appraisal Institute Guide Note 4 (continued):

• Other Reports – “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 appraiser must understand the assumptions on which these reports are based as well as their applicability and validity to the assignment.”

Standard Practices referenced in Guide Note 4

“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.”
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

— Case Study Analysis

— Query: Is reliance on a published article an example of “case study analysis”?
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– What is Case Study Analysis?

– Case study analysis involves collecting and analyzing sales prices, appreciation rates, cap rates, discount rates, etc. IN ANOTHER MARKETPLACE that is affected by a market influence or market factor at work in the location where your property or assignment is located.

– Recognized as appropriate in appraisal assignments in which there is a only limited sales data in the market in which your property is located.
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– What is Case Study Analysis?

– “Case study analysis involves situations where similar properties have been impacted by similar conditions. Thus, the analysis of case studies is an extension of the sales comparison approach . . .” (Bell, et al., *Real Estate Damages: Applied Economics and Detrimental Conditions*, 2nd Edition, 2008)
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

- Examples of appraisal assignments in which case study analysis may be necessary:

- Special-purpose properties
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

- Examples of appraisal assignments in which case study analysis may be necessary:

- Trophy ranches with conservation easements
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

– Examples of appraisal assignments in which case study analysis may be necessary:

– Some types of contaminated properties
Topic Three: Meta-Analysis & Proper Reference to the Real Estate Literature

- Examples of assignments in which case study analysis may be necessary:

- Properties impacted by “disamenities” (e.g., power lines, windfarms, cell towers, etc.)
What is Case Study Analysis? (continued)

- Case study data is typically collected and analyzed by the appraiser signing the appraisal report.
- If relying on data collected and analyzed by others, must comply with
  - Standard 1 requirements concerning credible appraisal results
  - USPAP Standard 2-3 certification requirements
  - Guide Note 4 requirements related to reliance on reports prepared by others
- Test the accuracy of the data, analysis and conclusions in published articles before relying on them as support for an opinion of value.
Topic Four: Contingent Valuation Analysis
Topic Four: Contingent Valuation

• Types of surveys

  – Informal surveys – interviews with market participants, buyers & sellers, public officials, other appraisers, etc. – typically done by real estate appraisers

  – Formal statistical surveys – random or statistical sampling of a population – typically not part of the appraisal process
Topic Four: Contingent Valuation

• Contingent valuation is a “stated preference” technique rather than a “revealed preference” technique such as the analysis of actual sale prices

• CV typically structured to provides the respondents’ “willingness to pay” for the specific benefit, good or service – can also involve “willingness to accept”

• BUT the survey results are “contingent” because they are based upon the survey’s hypothetical facts or set of conditions read to or given to the survey respondents
Topic Four: Contingent Valuation

• Contingent valuation is NOT a recognized or generally accepted real estate appraisal technique

• Real estate trades in active markets where sales data can be directly analyzed

• When sales data is limited, case study analysis has been recognized as appropriate – CV is not a form of case study analysis since it is not based on actual sales prices
Topic Four: Contingent Valuation

• Even the economics profession recognizes that CV analysis is ONLY appropriate as a primary valuation tool for “noneconomic goods”, that is, goods that do not trade in an active marketplace of buyers or sellers
Topic Four: Contingent Valuation

– Contingent Valuation is NOT a “RECOGNIZED” real estate appraisal method or technique when there is actual sales data that can be analyzed

– CV is NOT mentioned in

  • *The Dictionary of Real Estate Appraisal* (5th Edition)
  • *The Appraisal of Real Estate* (13th Edition)

– It is NOT an appropriate application of “case study analysis” since it does not involve analysis of actual sales prices
Topic Four: Contingent Valuation

– Articles in the *Appraisal Journal* have discussed contingent valuation as an alternative to the three traditional approaches to value and have summarized/critiqued the method itself and the results of CV surveys involving real estate
Topic Four: Contingent Valuation

– Testing of the results of CV surveys by comparison to actual sale prices paid by buyers with as much or more information as those in CV surveys has demonstrated its unreliability as a predictor of prices that will be actually paid

– See, for example, Roddewig and Frey, *Appraisal Journal*, Summer 2006
Topic Four: Contingent Valuation

- See also, Wilson, *Appraisal Journal*, Winter 2006
- Discusses NOAA’s blue ribbon panel limited endorsement (with reservations) of CV studies for some types of non-market goods

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Continental Valuation:
Not an Appropriate Valuation Tool
by Albert R. Wilson

There are essentially two types of market surveys. The first type of survey is a survey of past actions taken by market participants. An appraiser’s sales confirmation process is an informal and limited example of this type of survey. The second is to collect information as to what action was taken and why the
Topic Four: Contingent Valuation

• “The CV technique is the subject of great controversy.”

Report of the NOAA Panel on Contingent Valuation

January 11, 1993

Kenneth Arrow
Robert Solow
Paul R. Portney
Edward E. Leamer
Roy Radner
Howard Schuman
Topic Four: Contingent Valuation

• “The contingent valuation method has been criticized for many reasons and the Panel believes that a number of these criticisms are particularly compelling.”
Topic Four: Contingent Valuation

- “Its detractors argue that respondents give answers that are inconsistent with the tenets of rational choice, that these respondents do not understand what it is they are being asked to value (and, thus, that stated values reflect more than that which they are being asked to value), that respondents fail to take CV questions seriously because the results of the surveys are not binding, and raise other objections as well.”

- Report of the NOAA Panel on Contingent Valuation, January 11, 1993
Contingent valuation analysis was used in the wake of the Exxon Valdez spill in Alaska to value seabirds and wildlife – non-market goods.

It was not used in the Exxon Valdez litigation over the spill’s impact on real estate prices and values – market goods.

Topic Four: Contingent Valuation

• “Unlike losses to commercial fishermen or recreational property owners, there are no market transactions that can be observed to provide information on which estimates can be based.”
Topic Five: Regression Analysis and Automated Valuation Models (AVMs)
Topic Five: Regression Analysis & AVMs

– Automated valuation modeling and regression analysis are recognized and generally accepted appraisal techniques – in specific & limited circumstances and when properly used!
However, when using regression & AVMs appraisers need to:

• Comply with USPAP Standard 6 in mass appraisal assignments
• Follow guidance in AO-18 on “Use of an Automated Valuation Model (AVM)”
• Follow guidance in AO-32 in mass appraisal assignments
• Review and understand AII and IAAO courses, seminars and textbooks on proper application of regression modeling, mass appraisal, and other AVM techniques
• Recognize the limitations of regression modeling and AVMs in the appraisal process
• Test the accuracy of the results of their modeling
Topic Five: Regression Analysis & AVMs

- Most widely applied applications of regression modeling & AVMs

  * Sale price to date, rent to area, price to size, etc. relationships
  * Ad valorem taxation (mass appraisal)
  * Underwriting of single-family home mortgage portfolios & internal review appraising at financial institutions
  * Valuation and pricing websites like www.zillow.com
  * Determining contribution of an attribute, component, amenity or disamenity to a price/value
Topic Five: Regression Analysis & AVMs

- Regression modeling to determine price trends
  - Simple linear regression modeling combined with scatter plot diagrams
Topic Five: Regression Analysis & AVMs

- Simple linear regression modeling to show central tendency of price trends
Topic Five: Regression Analysis & AVMs

– AO-32 definition of “mass appraisal”
– “The keys to distinguishing a mass appraisal are:
  1) the subject of the appraisal is a ‘universe’ of properties, meaning more than one property; and
  2) the assignment involves standard methodology employing common data that allows for statistical testing.”
Topic Five: Regression Analysis & AVMs

– AVMs and regression models used to arrive at value conclusions are often inaccurate – even when used in the ad valorem taxation process

• Boards of Tax Appeals – submit individual appraisal reports by licensed appraisers as a “check” on inaccuracy

• State reviews & assessment/sales ratio studies
Topic Five: Regression Analysis & AVMs

- Examples of inaccuracy of tax assessment regression models

  - Montgomery County, MD in 2004 -- almost 5,000, or 5% of roughly 96,000 property owners submitted appeals claiming high assessed values. At least 30% of those appeals resulted in lowered assessments.
– Examples of inaccuracy of tax assessment regression models (continued)

• 2010 -- A township in Adams County, Pennsylvania filed a lawsuit against the county due to the high number of appeals in 2010. The lawsuit claimed that a mass appraisal system utilized by a company retained by the county to perform property tax assessments was “flawed.” See, “Adams County township sues to undo property reassessment,” The Patriot-News (Harrisburg, Pennsylvania), October 25, 2010.
Topic Five: Regression Analysis & AVMs

Examples of inaccuracy of tax assessment regression models (continued)

- Cook County, Illinois (Chicago) -- The number of residential parcel appeals to the Board of Review increased 107% between 2000 and 2006. A full 65% of the residential parcels appealing to the Board of Review in 2006 had a successful outcome.

### Tax Break

In 2010, most people who appealed their property tax assessment were successful. But owners of higher-valued properties typically received a higher reduction.

<table>
<thead>
<tr>
<th>Estimated property value</th>
<th>Success rate</th>
<th>Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $500,000</td>
<td>71%</td>
<td>11%</td>
</tr>
<tr>
<td>$500,000 or more</td>
<td>63%</td>
<td>19%</td>
</tr>
<tr>
<td>Citywide average</td>
<td>69%</td>
<td>17%</td>
</tr>
</tbody>
</table>

Source: Cook County Board of Review; analyzed by The Chicago Reporter.
Topic Five: Regression Analysis & AVMs

- Sample problems with inaccuracies in mass appraisal regression modeling property taxation all across the country
Inaccuracies of AVMs and regression models used to arrive at value conclusions (continued)

- The purpose of regression analysis used in ad valorem taxation is “fairness” and “uniformity” not accuracy

- The ad valorem process relies on individual appraisal reports in tax appeals to assure property-by-property accuracy
Inaccuracies of AVMs and regression models are widely recognized.

- Standard 6 -- "It is implicit in mass appraisal that, even when properly specified and calibrated mass appraisal models are used, some individual value estimates will not meet standards of reasonableness, consistency, and accuracy."
Inaccuracies of AVMs and regression models as an appraisal tool has long been recognized by real estate economists.

"The Real Problem. One of the most serious problems involved with the application of the regression method to appraisals has yet to be adequately addressed in the literature: the large standard error of the regression estimate. The high standard error of estimates reported in most hedonic studies might render the fitted values useless..."
Indeed, when the standard error of estimate is normally 10% to 30% of the estimated value of residential properties, we fail to see that the appraisal can contribute very much to the underwriting process.”

Inaccuracies of AVMs and regression models (cont.)

“AVMs’ accuracy tends to suffer in areas where local housing is highly heterogeneous or where there is a lack of sufficient long-term data. . .”

Inaccuracies of AVMs and regression models (cont.)

- “AVMs cannot observe the subject, its condition, safety hazards, lot utility, view, traffic conditions, adjacent negative land uses. They cannot tell if it is really a house (a highest-and-best-use issue). They work poorly for unique properties and for mixed neighborhoods. They can err greatly in either direction.”

- Dell, “AVMs: The Myth and the Reality; the Problem and the Solution,” Valuation Insights & Perspectives, 2004
AVMs were demonstrated to be highly inaccurate in New Orleans in the wake of Hurricane Katrina

- “The problems (with AVMs) seem most acute in Orleans Parish, where neighborhoods with checkerboard demographics and home values aren’t well-suited to ‘average’ calculations of value used in the automatic assessments.”
Topic Five: Regression Analysis & AVMs

– AVMs problems in New Orleans following Hurricane Katrina
  • By January of 2007, the Road Home program to assist returning residents had decided to commission individual property appraisals using local New Orleans appraisers “for as many properties as necessary to get the values right.” *The Times-Picayune*, May 1, 2007
Topic Five: Regression Analysis & AVMs

– Zillow and other regression-based AVM websites are routinely criticized for their inaccuracies.

been added since the data for this study was collected.

The key issue regarding Zillow’s Zestimates is whether they reflect transaction prices. Zillow has been described both as “a useful site” and as “categorically wrong.” There have been many instances of praise and many instances of complaints by homeowners using the Web site to estimate the value of their homes. Realtors in general have also been critical of the values produced by Zillow. The objective of this research and article is to examine the relationship between Zillow’s Zestimates and actual transaction prices, while also examining how the Zillow model compares to a standard hedonic model of sale prices.
Topic Five: Regression Analysis & AVMs

– Inaccuracies of AVMs and regression models (cont.)

– As a result, AVMs are almost never utilized to value non-residential properties, and even for single-family homes, have been recognized as “reliable without human interaction for only 30%-35% of the market.”

Topic Six:
Concluding Points & the Litigation Setting
Topic Six: Concluding Points

• *Query*: How likely are real estate appraisers to have to use meta-analysis, contingent valuation and regression modeling/AVMs in their every day appraisal practice in coming years?
Topic Six: Concluding Points

• *Answer as to meta-analysis*

• NEVER because it is not now nor in reasonably foreseeable future is it likely to be a recognized and generally accepted appraisal method
Topic Six: Concluding Points

• Answer as to contingent valuation analysis:

• NEVER because not now nor in reasonably foreseeable future is it likely to be a recognized and generally accepted real estate appraisal method because:
  – real estate is an economic good trading in an active market
  – there are actual sale prices that can be analyzed
  – comparison to actual prices paid demonstrates its unreliability
  – when sales prices are limited, case study analysis is the recognized & generally accepted technique
Topic Six: Concluding Points

• **Answer as to contingent valuation analysis (cont.):**

• IF an appraiser uses it, must do so as a tool to understand or interpret the results of the recognized and generally accepted approaches to value


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A Survey Approach for Demonstrating Stigma Effects in Property Value Litigation

by James Flynn, PhD, Donald G. MacGregor, PhD, Wayne Hunsperger, MAI, SRA, C.K. Mertz, and Stephen M. Johnson, PhD

The values of individual properties are determined to some degree by the reputation of the area where they are located. The association of properties with a stigma or with a succession of owners has resulted in lower property values than the market generally would bear. This study demonstrates a survey approach to measuring the relative effect of stigma on property values.
Topic Six: Concluding Points

- *Answer as to regression analysis & AVMs:*
- Yes, especially if in following specialized appraisal practice areas
  - Staff appraisers in ad valorem taxation agencies & state equalization review agencies
  - Staff appraisers in financial institutions involved in mortgage underwriting
  - Appraisers working for on-line websites such as Zillow
  - Litigation support
Topic Six: Concluding Points

- **Answer as to regression analysis (continued):**
- Simple linear regression analysis – likely to become more common in everyday appraising in analyzing price trends or other simple relationships such as price to size relationships, etc., or, in limited cases in homogeneous markets to support adjustments to comps
Topic Six: Concluding Points

• Query: Have meta-analysis, contingent valuation analysis, and regression analysis/AVMs been recognized and accepted by courts of law in cases involving issues related to the market value of real property?
Topic Six: Concluding Points

- Answer as to regression analysis:
- Regression analysis has long been recognized by the courts as appropriate to use in many – BUT NOT ALL – types of litigation involving real estate prices & market values
  - Exception – some types of class actions involving claims for damages to large number of properties, e.g., Hurricane Katrina class action against levee districts & Army Corps
Topic Six: Concluding Points

- **Answer as to contingent valuation:**
  - Only seen it used by one or two real estate appraisers across the country in real estate litigation settings involving market value issues
  - Only seen it used by one or two real estate economists in real estate litigation settings involving market value issues
Topic Six: Concluding Points

• Answer as to contingent valuation:
  – Has been the subject of a number of *Daubert* challenges in federal court and *Frye* challenges in state courts in recent years
    • Not allowed as a technique in a Louisiana case in 2012
    • Allowed as a technique to be presented to the jury in a Maryland case in 2011 – decision now on appeal in Maryland
  – Other cases pending
Topic Six: Concluding Points

• Answer as to meta-analysis:
  – Only seen it used by one real estate appraiser and one real estate economist in real estate litigation settings involving market value
  – There are one or two pending cases challenging the appropriateness of meta-analysis as a technique in measuring market value impacts
Topic Six: Concluding Points

In summary:

- Analysis of actual sale prices remains central to the integrity and objectivity of the appraisal process.
- We must respect the requirement that we use recognized and generally accepted techniques & methods.
- It is fine for economists and academic real estate professors to “experiment” with various statistical techniques – BUT that does not make the techniques “recognized” and generally accepted by the appraisal profession.
- History of consideration and eventual adoption of regression analysis indicates the manner in which experimental statistical techniques can eventually become part of the recognized appraisal profession toolkit -- only after long and careful consideration by the appraisal profession.