

A simple idea – Opinions, Appraisals and USPAP

By William H. Miller

The Exposure Draft for the Proposed Revisions to USPAP were issued by the ASB on December 22, 1997. The comment period extends through March 20, 1998.

Mr. W. David Snook, the 1997 ASB Chair, stated in the Fall 1997 Foundation News

ASB concluded that professional appraisers would benefit greatly if USPAP were more streamlined and the language was clarified...

The revisions fail to accomplish this objective. The language was changed, not clarified. We, as appraisers, are entering a new era. Now is the time for open debate.

To a large degree, USPAP works. For most appraisers, the ten years with USPAP has improved our profession. Our future regulations however, must be consistent with the needs of the marketplace.

The core problem is that we are regulating buggy-whips. Time and again, I hear from knowledgeable, intelligent and sophisticated clients that appraisers are not willing to listen to and answer the questions being asked by the market. As a student of the marketplace, I find this appalling.

Clients have said *“We already have a market value report, now we need an appraisal.”* Another client will call and say *“You guys are experts. We’re thinking about building a high-rise apartment and have a few questions. Can you give me your opinion if this building could be worth \$x.xx PSF? Because, if it not worth this much, then it doesn’t make sense to build.”*

Is it consulting or is it an appraisal (or, under the proposed definitions *“Appraisal Consulting”*). Well, the prospective client is doing a feasibility analysis. The costs are already known. The remaining question is what will it be worth? Even if we were being asked to do a feasibility analysis (which we are not), this sounds like *“a separate valuation opinion is required.”* Therefore, our response is that an appraisal is necessary. The client, as the telephone is being hung up, says *“when I need an appraisal, maybe I’ll call back.”* The client then proceeds to call someone with less market and valuation expertise to assist in making a reasonable, everyday business decision.

The Solution

The marketplace requires our services for two reasons – (1) our opinions and (2) appraisals.

Appraisals are typically needed to fulfill a regulatory requirement. In fact, it is difficult to think of an appraisal assignment where the request was not regulatory driven. Sure, clients call with other questions. But, these calls invariably begin with phrases like *“I need to know what this property is worth,”* and *“We need to respond to an unsolicited offer,”* and *“An idea was raised at a recent board meeting, what do you think?”*

Appraisers (and USPAP) define appraisals as *an estimate of value*. This definition is broad enough to encompass virtually

everything. So, we invent ideas such as *numbers* (i.e., the answer from an Automated Valuation Model is a *number*; 11/21/97 USPAP Instructors Forum). Or, we stretch the definition of consulting – even though the conclusion is dependent upon valuation. These are, quite simply, tricks of the trade to get around core problems. These will no longer work in a litigious society where our rules are codified. The attorneys will tell us that if it looks like an appraisal and was performed by an appraiser, it is an appraisal. Therefore, it better be to standards.

I believe that the marketplace defines appraisals as follows:

An Appraisal is a defensible value opinion with supporting backup. An appraisal is always prepared:

- By an unbiased third party;
- with no present or prospective interest in the property;
- with no personal interest or bias with respect to the parties involved;
- with compensation that is not contingent upon any present or future circumstances involving the client, the property or any parties involved with the property;
- with the requisite competency;
- based on true, correct and verifiable facts;
- based upon local market knowledge, judgement, and experience;
- in conformance with generally accepted appraisal principles as defined by USPAP;
- and, is individually certified by the appraisal professional(s).

The marketplace is intelligent. The market understands that *broker opinions, DCF runs, consulting reports and intelligent conversations with an appraiser are not appraisals*. We are the only ones who do not understand.

Accountants have a solution. The AICPA says that a CPA may provide a client with three distinct services involving financial statements.

Three products are – Compilation, Review and Audit.

The ***Audit*** is similar to our appraisal. A ***Review*** is similar to our limited appraisal. A ***Compilation*** is similar to our ***Opinion***. AICPA states that:

“A compilation is useful to small, privately held entities that need help in preparing their financial statements.”

“A compilation is preparing financial statements of private entities based on information provided by the entity’s management. ... He or she offers no assurances as to whether material, or significant, changes are necessary for the statements to be in conformity with generally accepted accounting principles. ... No probing is conducted beneath the surface unless the CPA becomes aware that the data provided is in error or is incomplete.”

“However, before agreeing to perform a compilation, a CPA will take a “common sense” look at the entity to decide whether the client needs other accounting services. ...”

“A compilation is useful when limited in-house capabilities for preparing financial statements exist.”

For decades, the appraisal profession has recognized that appraisers may work in-house for large development and

investment companies, and in the course of their work, may professionally engage in the day-to-day business process of “what if” questions dealing with real estate value.

Many firms either cannot afford or do not desire to retain a staff appraiser for these functions. They should however, be able to call a third-party appraisal expert and request a professional opinion. This is no different than if you have an accounting question, call a CPA for good advice. In an era of Wall Street paced decisions, internet bidding, alliances, co-branding and franchises, even large firms with in-house expertise may desire to engage a third-party appraisal expert for questions dealing with real estate value. It is in the public interest for us to be able to offer them more than a buggy-whip designed to fulfill specific regulatory purposes.

The solution is an Opinion.

An Opinion reflects an appraiser's viewpoint. An Opinion is always prepared:

- By an unbiased third party;
- with no present or prospective interest in the property;
- with no personal interest or bias with respect to the parties involved;
- with compensation that is not contingent upon any present or future circumstances involving the client, the property or any parties involved with the property;
- by an individual with the requisite competency;
- based on local market knowledge, judgement and experience;
- with the degree of competency and local market knowledge conveyed to the client;
- with the extent of the valuation or consulting process, no matter how limited, disclosed;
- in conformance with generally accepted appraisal principles as defined by USPAP;
- with a clear statement that the opinion is not an appraisal, specific facts underlying the opinion were provided, and limited (or no) effort was made to uncover material errors;
- with a clear statement that the underlying facts and the resulting opinion are reasonable;
- and, although signed, is ***not*** individually certified by the appraisal professional(s).

If this solution is implemented, I believe that the majority of the wrangling and disagreements over USPAP and the business problems of increased competition from persons without the requisite foundation in real estate valuation will be solved.

This idea is not new and we will not be reinventing the wheel. We will be mirroring a respected professional organization – the AICPA. I am also quite confident that the descriptions outlined herein are consistent with FASB and GAAP.

In summary, the proposal is that the definition of ***Appraisal*** be narrowed. This is consistent with the general usage of the word in the marketplace. One of the best analogies is an ***Audit***. No business person or regulator views an unaudited financial statement, a compilation, or a review with the esteem reserved for an ***Audited Financial Statement***. An appraisal should be elevated to the same plateau.

All else should be properly described for what it is – an ***Opinion***. The opinion may be good or bad, it may be based on a wealth of facts, or the sketchiest of information. It must always however, be prepared by an appraiser with competency and market knowledge, without personal or financial bias, and in accordance with USPAP (this last part will obviously require USPAP revisions).

The ***Opinion*** can be reported orally, in one page or in one hundred pages. Report size will not convert an opinion into an appraisal. ***The decision of whether it is an opinion or an appraisal is properly left to the author – the professional appraiser!***

If people or entities want to rely on the ***Opinion***, no problem. The ***Opinion***, however, will not be suitable for situations requiring an appraisal. ***All current regulations use the word appraisal.*** Therefore, regulations, laws, ordinances would have to be changed before a person or entity could even think about using an Opinion to replace a regulatory appraisal requirement. With the appraisal elevated to a higher plateau, I doubt that this will happen.

The purpose of the ***Opinion*** is to provide a simple vehicle to answer all other valuation questions.

Two final thoughts. First, as with the AICPA, a mid-level product is necessary. The term ***Limited Appraisal*** can serve the middle-ground. Therefore, three levels of service – ***Opinion, Limited Appraisal and Appraisal*** are appropriate.

Second, the written format of the ***Opinion*** should have minimal regulation beyond that cited. It could literally fit on one page. The written formats of ***Summary and Self-Contained*** reports work well for the appraisal product. The Restricted Report option could likely disappear; thus, the existing six options would be reduced to five.

Valuation Process

Opinion

Limited Appraisal

Complete Appraisal

Written Report Formats

Any written format OK,
subject to minimum standards
Summary or Self-Contained
Summary or Self-Contained

I believe that implementation of the ideas expressed will simplify the debate, provide understandable explanations to our clients and the business community, and best serve the public interest. I also believe that these changes can be straightforward to implement, allowing the ASB to better concentrate on the mission of streamlining and clarification.

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