1 **Best Practices**
Techniques for Creating Credibility

2 **Course Inspired by Joel's Appraisal Board Experience**

- Joel has served on the State of Illinois Appraisal Disciplinary and Advisory Board since February, 2014
- This presentation is a one-hour summary of Joel's 7-Hour CE "Best Practices" course and, like all licensed courses in Illinois, the content was approved by the Board.
- Important to note that Joel DOES NOT SPEAK FOR THE BOARD. The content of this presentation contains only Joel's opinions and advice.

3 **Epic Failures**

- Throughout the course, several scenarios will be discussed which are taken from appraisal reports which have been the subject of complaints to IDFPR, or have been submitted by appraisers seeking up upgrade their licenses from trainee to certified residential status.

4 **Learning Objectives**

- Understand the "Prime Directives" of USPAP SR 1 and SR 2.
- Understand how to identify assignments when "Credibility" cannot reasonably be achieved.
- Understand some methods to enhance appraisal credibility

5 **USPAP's Two Prime Directives**

- Standard One: Produce a credible appraisal. In USPAP, "credible" means "worthy of belief."
- Credibility needs to be judged relative to the intended use and the intended user.
- Standard Two: The results of an appraisal must be communicated in a manner that is not misleading.

6 **When Can Credibility Not Be Achieved?**

- Unlicensed practice for Cert Res appraisers
- Assignments where sufficient data isn't available to produce a credible appraisal
- Assignments where the appraiser lacks competence

7 **Unlicensed Practice Can't Be Credible**

- Epic Fail: A Certified Residential Appraiser appraisers a subject property containing a farmhouse and 60 acres of land, where 40 acres are in production. He says that buyers will only pay for the house and 5 acres of land, and that the remaining land has no value.

8 **AQB Criteria for a Certified Residential Appraiser (Effective 1/1/2015)**

- A. The Certified Residential Real Property Appraiser classification qualifies the appraiser to appraise one-to-four residential units without regard to value or complexity.
- 1. The classification includes the appraisal of vacant or unimproved land that is utilized for one-to-four residential unit purposes or for which the highest and best use is for one-to-four residential

units.

- 2. The classification does not include the appraisal of subdivisions for which a development analysis/appraisal is necessary.
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9 **Unlicensed Practice for Cert Res: No Farmland.**

- Certified Residential Appraisers are NOT LICENSED to appraise farmland or land for which the highest and best use is something other than 1-4 family residential.
- By "farmland" I mean "…income-producing land that will be used principally for income producing purposes." USDA RD Handbook-1- 3555, Section 12.12 Site Requirements (7 CFR 3555.201(b))

10 **"Best Practices" for Subjects with Farmland for Cert Res Appraisers**

- If the secondary market IS NOT involved, suggest to the client that the subject be appraised subject to the hypothetical condition that it is situated on a site not containing farmland, and then describe that site. Make sure it would be a saleable parcel on the smaller site.
- If the secondary market IS involved, let the client know that part of the site is in agricultural production. The secondary market doesn't make loans on farms or ranches.
- If the client still wants the appraisal, with the farmland included, and if you are a cert res, my advise is to decline the assignment.
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11 **"Best Practices" for Subjects with Farmland**

- Some appraisers argue that "just a little bit" of productive farmland isn't going to matter. I disagree.
- However, in the May meeting the Appraisal Board discussed this topic and formed a committee to address it with a view to potentially providing additional clarification for appraisers. Stay tuned.

12 **Cert Res Appraisers: No "Mixed Use"**

- Certified Residential Appraisers are NOT LICENSED to appraise a "Mixed Use" building such as a building with a retail store on the first floor and an apartment on the second floor.
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13 **"Questionable" Appraisal Assignments**

- Sometimes, certified residential appraisers are asked to appraise properties where it is not clear that the highest and best use of the property is 1-4 family residential.
- For example, a single-family home located on a site at the corner of two arterial streets, zoned commercial and surrounded by commercial land uses, may very well have a commercial highest and best use.
- Best Advice for Cert Res: Decline the assignment. Certified Residential appraisers MAY NOT be competent to evaluate a commercial highest and best use, especially if it is a "Close Call."

14 **Are You Competent for the Assignment?**

- Epic Fail: A certified residential appraiser accepts an assignment to appraiser an older 3-unit building located on Chicago's "Gold Coast." This neighborhood has been undergoing a transformation where older buildings are being torn down and replaced with upscale townhomes. There are no comps in the subject's neighborhood. The appraiser explains all this, then uses comps from other neighborhoods, making a $100,000, across the board adjustment for "Location." There is no support for the adjustment. The appraiser reports highest and best use as the present use. The appraiser is fined and publically reprimanded for violations of Standard 1, Scope of Work

Rule and Competency Rule. What should the appraiser have done?

15 **Turn It Down!**

- Often, the best decision for an appraiser to make is to decline the assignment, especially if there is some question as to whether the appraiser has sufficient competency.
- The same is true for other "impossible" assignments: Geodesic domes, earth-berm homes, homes which are significant over-improvements for the neighborhood or market area, homes subject to environmental hazards, etc.
- Many of these assignments could be completed in accordance with USPAP, assuming the appraiser has competency, but the research involved might take several days or weeks. If you are not willing or able to devote that time and effort, or if the client isn't willing to pay for it, the best decision is to decline the assignment.

16 **Preview of Some Common Problems with Credibility**

- Subject's listing history and appraised value are inconsistent.
- Subject's sales history and appraised value are inconsistent.
- Analysis of the subject's market segment is absent, or conclusions are drawn without support.
- Lack of sales comparison reconciliation comments and/or lack of comments for the approaches to value developed or comments which fail to provide support for the appraised value by the sales comparison approach.

17 **Preview of Some Common Problems with Credibility**

- In the sales comparison approach, failure to make necessary and reasonable adjustments to comparable sales. Failure to support adjustments that need to be supported.
- In the cost approach, failure to value the land as if vacant by an appropriate valuation technique.

18 **Creating Credibility: Becoming "Worthy of Belief"**

- An appraisal is like the "persuasive speeches" many of us were asked to give in high school.
- The goal is to *convince* the reader of the report that the value of the property is the value we are reporting.

19 **Non-Epic Failures Can Destroy Credibility**

- On way many appraisals fail to be credible is that they contain so many "little" mistakes that, by the time the reader has gotten to the end of the report, they conclude that the appraiser must be incompetent.
- Examples of "little" mistakes: "Typos," incorrect zoning, neighborhood boundaries which don't define an enclosed area, incorrect spelling, etc.
- Other examples include "boilerplate" comments that are not applicable to the current assignment.
- USPAP recognizes the seriousness of lots of "little" errors when it says, in SR 1-1 (c) the following:

20 **SR 1-1 (c)**

- "An appraiser must…not render appraisal services in a careless or negligent manner, such as by making a series of errors that, although individually might not significantly affect the results of an appraisal, in the aggregate affects the credibility of those results."

21 **Creating Credibility**

- USPAP S.R. 1 requires us to produce a "credible appraisal" which means "an appraisal worthy of belief."

- In the first place, this means that the appraiser's opinions and conclusions are "worthy of belief."
- In particular, most clients and intended users are going to focus on the appraiser's opinion of value—it is worthy of belief?
- So, let's look at our definition of value.

22 **Key Points of the Definition of Value**

- The most likely sale price for the subject property on the effective date of the appraisal assuming reasonable exposure time prior to that date.
- The "most likely sale price"
  - Not the highest price any buyer could possibly pay
  - Not the lowest price any seller could possibly accept
- "Assuming reasonable exposure time"
  - Without this assumption, the definition of value doesn't make sense.
  - "Most likely sale price" must be linked to an estimate of reasonable exposure time.

23 **Reasonable Exposure Time**

- For every market value appraisal, USPAP requires the appraiser to estimate reasonable exposure time.
- USPAP defines reasonable exposure time as: "Estimated length of time that the property interest being appraised would have been offered on the market prior to the hypothetical consummation of a sale at market value on the effective date of the appraisal."
- Simply put, when would the subject need to have been listed at a reasonable list price, and assuming normal marketing efforts, to have sold on the effective date of the appraisal at the appraised value?

24 **Reasonable Exposure Time**

- Epic Fail: In five of their appraisal reports, in diverse market segments, the appraiser states: "Exposure time for the subject is estimated at 30-360 days." Do you think this appraiser actually performed an analysis of exposure time?
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25 **Listing History Epic Fail**

- Epic Fail (From a Formal Hearing): An appraiser reports the subject listed 10/13/14 at $714,000 with the price reduced to $664,900. It was placed under contract 5/29/15 at $625,000. Actual marketing time was 226 days. The appraiser reports reasonable exposure time as 83 days. The appraiser values the subject at $745,000. Is this worthy of belief?
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26 **Listing History**

- USPAP requires the appraiser to report all listings of the subject which are current as of the effective date.
- Fannie/Freddie require the appraiser to report all listings of the subject within the year prior to the effective date.
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27 **Listing History: Principle of Substitution**

- According to the Principle of Substitution, no buyer will pay more for one property than for another which is equally desirable. It follows that no buyer will pay more for a property than they are required to pay to purchase it—unless something unusual is happening.

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28 **Listing History**

- In many cases, when properties sell above list price, the sale price is NOT "the most probable price" especially when the subject has been exposed to the market for a reasonable time.
- In some cases when properties sell above list price actual exposure time is significantly below reasonable exposure time In these cases, "the most probable price" MAY be above list price.
- In these cases, additional research is likely necessary.

29 **Listing History Best Practice**

- Best Practice: The listing history of the subject property and the appraised value, taken together, need to make sense. If the appraised value is above the list price, then it is critically important for the appraiser to explain why it makes sense to think that the most likely sale price is greater than the list price.
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30 **Sales History**

- USPAP requires that the appraiser "analyze all sales of the subject property that occurred within the three years prior to the effective date of the appraisal."
- Epic Fail: In a refinance transaction, the appraiser reports on page one that values are "stable." The appraiser reports a prior sale of the subject at $150,000 three months before the effective date of the appraisal. The appraised value of the subject is $225,000. There are no comments concerning the circumstances of the prior sale. There are no comments concerning any change in condition of the subject since the date of the prior sale. Is this worthy of belief?

31 **Sales History Reconciliation**

- While most appraisers report the sales history of the subject, most do not "analyze" the prior sales of the subject as USPAP requires.
- In many circumstances, I think a better verb is "reconcile."
- Best Practice: Whenever a prior sale of the subject is reported, the appraiser need to reconcile that sale price with the current appraised value.
- Here is an example:

32 **Sales History Reconciliation Example**

- The subject sold a year ago at $200,000 and is now is being appraised at $250,000 in a purchase transaction. The appraiser states "Since the date of the prior sale, the condition of the subject has improved significantly, with the following work having been completed: A new roof, new HVAC and a remodeled kitchen. In spite of values in the subject's market segment being stable over this time, the change in condition of the subject is consistent with its value increasing since the date of the prior sale."
- But without the explanation, we are left with an unexplained increase in value of $50,000.

33 **Good Market Analysis Adds Credibility**

- In SR 1-3, USPAP says that, "...when it is necessary for credible assignment results in developing a market value opinion, an appraiser must identify and analyze the effect on value of ...economic supply and demand...area market trends...."
- We would all agree that an analysis of area market trends and supply and demand are always necessary for credible assignment results. It would be difficult to find an appraisal "worthy of belief" which failed to address the conditions of the marketplace, given that such conditions can

have such huge effects upon market value.

34 **Market Analysis**

- Market analysis is important because it provides the context for the appraiser's understanding of the behavior of buyers and sellers.
- Major elements of market analysis for residential appraisers:
  - Supply vs. demand
  - Trends in sale prices
  - Trends in list prices
  - Trends in sale price/list price ratio
  - Trends in marketing time
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35 **Market Analysis**

- Critical for determining whether "time of sale" adjustments are required in the sales comparison approach
- Critical for providing guidance in reconciling an appraised value

36 **Market Analysis Epic Fail**

- Epic Fail: On page one of the URAR, in the "Market Conditions" field, the appraiser states "Market conditions within the subject market mirror general conditions that exist throughout the Midwest region." A review of several appraisals performed by the appraiser revealed that this comment was part of the "boilerplate." There are no comments concerning what those general conditions are. When asked, the appraiser said "I don't know—probably stable."
- A failure to understand, analyze and report the conditions in the market which affect the subject property is one of the most common appraisal defects I see.

37 **Defining the Subject's Market Segment**

- While some market characteristics may be consistent in all segments of the overall market, other market characteristics may not be.
- For example, one could easily image an overall market with a stable median sale price of $150,000 (year over year), but where prices in the $500,000-$800,000 price range had declined by 5% (year over year) due to an oversupply of homes in that price range.
- In this example, it would be misleading (and flat out incorrect) to report, for a $600,000 subject property, that values in the market were stable.

38 **Defining the Subject's Market Segment**

- The first step must therefore be to define the subject's market segment—that portion of the overall market which reflects conditions relevant to the subject property.
- The very best guidance for this tasks is found in the instructions to the 1004 MC.

39 **Defining Subject's Market Segment**

- "Sales and listings must be properties that complete with the subject property, determined by applying the criteria that would be used by a prospective buyer of the subject property." Instructions to 1004MC
- This set of properties is what is being referred to as "the subject's market segment."
- Note that this segment is defined from the point of view of a prospective buyer of the subject property.

40 **Defining the Subject's Market Segment**

- Those of you who are also real estate brokers have gone through this process with buyers many times, often starting out by asking the buyer, "What are you looking for in your new home?"
- After price (we'll get to that later), the single most common response has to do with location.

41 **Defining Market Segment**

- Certainly, a prospective buyer for the subject property will look for properties within in the subject's neighborhood.
- However, they would also look for properties within neighborhoods which compete with the subject's neighborhood.
- Other defining characteristics (search parameters) for the subject's market segment may be a range of
  - Square footages
  - Age
  - Number of bedrooms
  - Lot size (for rural properties)

42 **Defining Market Segment**

- I think it is necessary to use price to define market segment, since that's what buyers do.
- Try to avoid using narrow price ranges to define the subject's market segment, since some of the analysis is intended to identify changes in sale and list prices in the subject's market segment. Defining a market segment using excessively narrow price ranges could easily distort the later analysis—not to mention failing to find the right comparable sales.
- Be careful not to define the market segment too narrowly, resulting in too few homes. Up to a point, the larger the number of homes in the market segment, the more meaningful any statistical analysis will be.

43 **Best Practice: Neighborhood & Market Segment**

- Define the neighborhood with meaningful neighborhood boundaries.
- Define the market segment in accordance with the guideline to include "Sales and listings must be properties that compete with the subject property, determined by applying the criteria that would be used by a prospective buyer of the subject property"—Instructions to 1004MC

44 **Market Segment Analysis**

- The "bottom line:" Whether an appraiser uses the approach just explained or not, what is critical in creating credibility is to provide clear and convincing support for the appraiser's conclusions concerning market trends and supply/demand relationships.
- In all cases, the support for the appraiser's conclusions must include reporting the "search criteria" used for the data from which those conclusions are drawn.

45 **Selecting Good Comps Creates Credibility**

- We have already discussed the importance of the buyer's perspective in defining the subject's market segment or those properties which would be directly competing with the subject property based upon the behavior of a typical buyer of the subject property, if all properties were on the market at the same time.
- So, comparable sales must be as similar to the subject as possible, <u>based upon how a typical buyer for the subject would view them</u>.

46 **Comparable Selection: Bracketing**

- Secondly, it is important to select one comp which is clearly inferior overall, and one which is clearly superior overall. This choice at the outset of the process, will define a range of values for the subject. This is a form of “bracketing” and, in the case of a purchase transaction, will typically (but not always) result in one comp having sold for less than the subject, and one for more.

47 **Comparable Selection**

- It is helpful to have at least one sale which is smaller than the subject, and one which is larger. With this array, if your adjustment for square footage is not reflective of the market, the error will not affect every sale in the same way (as it would if all sales were smaller or all were larger).
- Choose sales which do not require the same adjustment to each sale, e.g. with a subject having a typical residential view, and the comps all having lake views. If the adjustment for view is in error, it will affect all of the comps in the same way.
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48 **Comparable Selection**

- DO NOT select comparables simply with a view to secondary market guidelines or the client’s assignment conditions.
- DO select comparables which require the fewest and smallest adjustments, then add additional comparables to meet secondary market requirements or the client’s assignment conditions.

49 **Adjustments must be “worthy of belief”**

- This is my suggestion for the acceptability of adjustments—they need to be reasonable and “worthy of belief.”
- In order to be “worthy of belief,” some adjustments need to be clearly supported (more on that later), while others may not need such robust support.
- Here is an example of adjustments lacking credibility:

50 **Square Footage Adjustment-Fannie Mae Analysis**

- Fannie Mae has identified and shared some very interesting results of their analysis of 700,000 appraisals with more than 2.5 million comps submitted in the first quarter of 2014.
- Fannie Mae discovered that square footage adjustments remain much the same no matter what the overall price/GLA of the home is.
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51 **Fannie Mae GLA Adjustment Analysis**

52 **GLA Adjustment “Cost Related Analysis” Example**

- What follows is one way to make or support GLA adjustments based upon Marshall-Swift Cost Service data. Keep in mind that this data is based upon surveys of building costs and is updated each quarter. It is generally regarded as a reliable indicator of construction costs as of the published effective date.

53 **Cost Related GLA Adjustment Example**

- Let’s compare a 1500sf ranch of average quality situated on a $40,000 site with a 2000sf ranch of similar quality also on a $40,000 site.
- Marshall Swift shows a cost for the 1500sf ranch at $122,640 and $154,940 for the 2000sf ranch. The difference is $32,300 or $64.60/sf for the additional 500sf.

- So the adjustment for square footage would be $64.60/sf.
- Many appraisers think of square footage adjustments as a percentage of the overall price per square foot of the subject or comparable.
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54 **Cost Related GLA Adjustment Example**

- If we compare the adjustment rate of $64.60/sf to the overall price/sf for the (larger) property on its site of $97.47, it represents 66% of the overall price/sf.
- Keep in mind that this is for new construction—the rate of adjustment would be lower for homes with more physical depreciation.
- Instead of being new, if it were a 15 year old home with a 60 year life it would be 25% depreciated. The adjustment rate on this analysis would be $64.60 x 75% or $48.45. This represents 49.7% of the overall price/sf of the larger property.

55 **GLA Adjustment Example-Higher Quality**

- A 1600sf brick ranch of very good quality on a $50,000 site has a cost of $215,312; the 2000sf version has a cost of $255,920 for a difference of $40,608 or $101.52/sf.
- This rate of adjustment represents 66% of the overall price/sf of the larger home. Again, this rate would be less for older homes.

56 **Cost Related GLA Adjustment Example**

- Note that the rate of adjustment differs significantly in these two examples: $64.60 for the average quality home and $101.52 for the very good quality home.
- This makes sense, but is clearly inconsistent with the practices of the appraisers who produced the 700,000 reports Fannie analyzed in the first quarter of 2014.

57 **Cost Related GLA Adjustment Example**

- Keep in mind that GLA adjustments must reflect the behavior of buyers in the marketplace, and we are not saying that this is the ONLY way to derive or support GLA adjustment, or even that it is the best way.
- But this analysis is ONE WAY to derive GLA adjustments (especially applicable to new construction) and does support the view that the rate of adjustment should vary with the overall quality and price of the home.
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58 **Cost Related Analysis for a Bath Adjustment**

- In a 15-year old home appraised at $120,000, an appraiser makes an adjustment of $3,000 for a second full bathroom. How could this be supported? Let's look at some possibilities:
- Marshall Swift reports the cost of a plumbing fixture at $1,360. Three fixtures would be $4,080. The home is 25% depreciated (15/60), so the depreciated cost of three fixtures is $3060. Is that credible?

59 **Monthly Payment Analysis**

- While buyers rarely make "quantitative adjustments," they are very aware of their monthly payment for their new home.
- Comparing the change in monthly payment is one way reflect how many buyers might think about specific characteristics of the property.

- For example, mortgage money costs about $5.00 per thousand at current rates. Is it reasonable to think that a typical buyer of our $120,000 home would pay $15/month more for a two bathroom home as opposed to a one bathroom home? ($3,000 x $5/thousand)

60 **Statistical Analysis Example-Ashland Park in Champaign**

- In a subdivision with ranch style homes built by the same contractor and virtually identical in quality of construction, condition, age and amenities, the appraiser wanted to extract and support an adjustment for a three bedroom floorplan as opposed to a two bedroom floorplan.
- In a recent 12 month period, 17 three-bedroom homes sold with an average sale price of $141 ,871. In the same time period, 11 two-bedroom homes sold with an average sale price of $119,900. The difference is $21,971—attributable to square footage and a third bedroom together.
- However, the average square footage of the three-bedroom homes was 1,433 sf and only 1,116 sf for the two-bedroom homes.

61 **Statistical Analysis Example-Ashland Park in Champaign**

- Marshall-Swift reports a base cost for the 1,116 sf home at $76,725 and $93,202 for the 1,433 sf home. These homes are about 25% depreciated, resulting in depreciated costs of $57,544 and $69,902.
- The difference in depreciated cost due to increased square footage is $12,358 (or about $39/sf for the 317 sf difference).
- The total difference in price was $21,971 less the difference as a result of square footage of $12,358 leaves $9,613 for the third bedroom.
- This is about 6.7% of the average price of the three bedroom home.

62 **Paired Sale Example: Ashland Park**

63 **Paired Sale Example: Ashford Park**

- The statistical analysis shows support for a $9,600 (6.7%) adjustment (rounded) as opposed to this particular paired sale showing support for a $8,200 (5.8%) adjustment—not identical but a case could be made that they are in the same "ballpark."
- Remember that in using individual pairs, it is important to replicate the process several times with different properties so as to reduce the probability of being misled by anecdotal differences either in the properties or in the transactions. The more pairs analyzed, the more confident we can be in the results—especially if they are consistent with each other.

64 **Making Quantitative Adjustments-General Guidelines**

- Remembering that the adjustment process is intended to reflect the behavior of buyers, we should not make adjustments for differences between the subject and the comps which a typical buyer would not notice, or not care about if they did notice. E.g., small differences in square footage are not discernable to most buyers; even relatively large differences in site size may not be discernable to many buyers.
- Closely related to this is the practice of rounding adjustments to the nearest thousand or the nearest hundred. While a buyer just might say that one house is superior to the other in condition by $10,000, he certainly would not say that it is superior by $10,256.
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65 **Making Quantitative Adjustments-General Guidelines**

- Appraisers should avoid making very large adjustments, e.g. 10% of the comparable sale price or more. Large adjustments have the potential to drastically skew the results of the sales comparison approach. The larger the adjustment, the more important it is for it to be supported.

- Appraisers should avoid making adjustments "across the board." For example, if the subject has a lake view and all of the comps have standard residential views, a $30,000 positive adjustment to all the comps would require convincing support. If the appraiser was wrong, and the adjustment was only $10,000, then the entire approach would be overstating value by $20,000.

66 **In Conclusion…**

- The adjustment process needs to be "worthy of belief."
- Traditional techniques, especially paired-sale and cost-related analysis, are important tools for discovering what the real adjustment should be in the marketplace, and then for supporting it in the appraisal.
- It is especially important to research and support adjustments which are very large, subjective (e.g. quality or view), or unusual.

67 **Reconciling the Sales Comparison Approach**

- EPIC FAIL: The appraiser reconciles on a number which is significantly above the list price of the subject, where the subject had been exposed to the market for a reasonable time. When asked why he reconciled that way, he responded: "It's what the software told me to do." When asked if, as a matter of practice, he always chose to reconcile on the number suggested by his software, he said: "Oh, yes, I always use that number."
- Sometimes, I meet appraisers who think that an appraisal is like a crossword puzzle—just fill in the blanks and all will be well.
- It's not: The appraisal needs to reflect the REAL WORLD.

68 **Reconciling the Sales Comparison Approach**

- A very common defect in appraisals is a failure to make any comments whatsoever which explain why the appraiser chose a particular value within the range of values indicated in the sales comparison approach. The reconciled value just "appears."
- Given our view that the quantitative adjustment process is subject to error, it is all the more important for the appraiser to explain just what supports the final value.
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69 **Sales Comparison Reconciliation**

- What is the best comp? Many times, one of the comparables is much more similar to the subject than the others, requiring little or no adjustment. It makes good sense to rely more upon the indicated value based upon this comp.
- What is the worst comp? In some cases, you just don't have much confidence in one of your comparable sales—it's just too different from the subject. It makes sense, then, to explain that you have given this sale less weight in the final consideration.

70 **Sales Comparison Reconciliation**

- Take into consideration the characteristics of the subject's market segment. What is the supply/demand relationship? Are values declining, stable or increasing? Is the sale/list price ratio declining, stable or increasing? Are marketing times increasing, stable or decreasing?
- For example: If the subject's market segment is showing a shortage, increasing values and declining marketing times, a reconciled value nearer the upper end of the indicated range could be supported.

71 **Sales Comparison Reconciliation**

- Appraisers might also want to take into consideration relevant economic or demographic data

from the subject's market area. For example, a large company move out of the area is likely to result in a market where lower values are becoming more frequent.
- The Bottom Line: In order to make the appraisal more worthy of belief, it is important to explain to the reader why a particular value was selected as the reconciled value of the sales comparison approach. A failure to do so will seriously undermine the credibility of the appraisal.
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72 **The Cost Approach**
- Epic Fail: The appraiser states that he used "local builders" as the source of cost data. The cost approach indicated a value for the subject of $225,730. The sales comparison approach indicated a value of $225,000. What would you think the appraiser did?
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73 **The Cost Approach**
- The second most common Cost Approach USPAP violation: Many appraisers "back into" the cost approach: They take a guess at site value, then fudge the cost data until the cost approach produces a value similar to the one produced by the sales comparison approach.
- This is not only a violation of Standard 1 and Standard 2, it is also committing fraud: Performing an act which *is intended to deceive*.
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74 **Credibility in the Cost Approach-Site Valuation**
- Epic Fail: The appraiser reports that "Site value was determined by the extraction method." There was no discussion in the appraisal. There was no analysis in the appraiser's workfile. The appraiser was unable to explain how to determine site value by the extraction method.

75 **Site Valuation**
- The most common Cost Approach USPAP violation: Stating in the report that the site has been valued by a particular technique, when that technique has not been employed. (An example, in many cases, of "bad boilerplate.")

76 **Site Valuation: Best Practices**
- Whatever technique you employ for determining a site value, place support or analysis for that technique in the appraisal report.
  - For sales comparison, a brief summary of comparable land sales and the analysis of those sales.
  - For extraction, a summary of the methodology, the sales used, and the results.
  - For allocation, a summary of the methodology and the data used to derive the allocation of land to value.

77 **Reconciling Sales Comparison & Cost Approaches**
- It is not unusual for the cost approach to indicate a value significantly different from the sales comparison approach. In order to preserve the credibility of the appraisal, this difference needs to be explained.
- One very major source of potential error in the Cost Approach is estimating the quality level of the subject property. Marshall Swift, for example, has six quality levels.
- For example, the difference in base square footage cost between an "Average" 2000sf ranch and a "Good" 2000sf ranch is 31%--a really big difference!

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78 **Reconciling Sales Comparison & Cost Approaches**

- A comment similar to the following can be helpful in explaining this difference: "The quality level of the subject is most similar to Marshall Swift 'Average,' and this is the level which has been used. However, most properties do not perfectly fit any particular quality level, and this is a major source of error in the cost approach. The sales comparison approach is considered a more reliable approach to value for the subject property."

79 **The Importance of Narrative**

- When the goal is to produce an appraisal which is worthy of belief, it is important to explain the appraiser's reasoning at every important step of the process, especially the following:
  - The definition of the subject's market segment
  - Analysis of market data supporting conclusions for median sale price and marketing time trends, and for supply/demand relationships.
  - Description of the subject property, with particular attention to the characteristics of value most relevant to the subject.
  - Explanation and support for adjustments in the sales comparison approach.
  - Reconciliation of each individual approach to value.
  - Reconciliation of all the approaches to value.
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80 **In Conclusion…**

- In reviewing a completed appraisal report prior to communicating it to the client, try to pretend that you are an intended user instead of the author of the report.
- Reading the report carefully, see if any questions arise. Perhaps an adjustment for quality isn't explained or the reconciliation comments don't really explain how the final value was reached.
- After finishing the report, ask yourself the three key questions:
- Have I communicated everything clearly, without contradictions, and in a way which is not misleading?
- Do my assignment results reflect the real world?
- And, the critical question, is this appraisal worthy of belief?