



Evaluating Appraisals

Which Type of Report Best Suits Your Client's Needs?

by John A. Simpson, CCIM, MAI, and Eileen Simpson

During most commercial real estate sale transactions, an appraiser is required to value the property and issue a report. However, both experienced and new users of appraisal services often are not aware of the type of report they need and the choices they have. Commercial real estate professionals who understand the terminology can help their clients obtain the product that best serves their situations.

Appraisal History

In 1987, the Appraisal Foundation, a nonprofit educational organization based in Washington, D.C., was established to promote professional standards and qualifications in the appraisal industry. The Appraisal Standards Board, an independent arm of the Appraisal Foundation, currently maintains the *Uniform Standards of Professional Appraisal Practice*, which comprises the generally accepted standards for professional appraisers in North America.

A number of professional associations, such as the Appraisal Institute, offer advanced education and designations to licensed appraisers. All licensed appraisers are required to adhere to *USPAP*, which is enforced by state regulatory agencies, professional appraisal associations, and client groups.

Is a Valuation an Appraisal?

Confusion between the terms *appraisal* and *valuation* began in the early 1990s when lenders started using the term *evaluations*, implying that they were not appraisals. Soon, the “e” in evaluations was omitted. The appraisal community and the Appraisal Foundation have addressed this issue at length, and a valuation now is considered equivalent to an appraisal. Thus, the words are used interchangeably, with no difference in meaning.

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The Appraiser's Role

Appraisers perform valuations of commercial properties for many reasons. As independent third parties, appraisers many times are the only party in a transaction that doesn't have a vested interest in the outcome.

Appraisers also are in the best position to tell clients what type of valuation report is necessary. They are required by *USPAP* to determine the scope of the assignment, the function of the appraisal, and the use of the report.

The client — often the lender — issues an engagement letter to hire the appraiser. Only clients and those they specifically authorize receive copies of

appraisals and three types of reports for a total of six possible combinations.

The two types of appraisals are complete and limited use. These terms apply to the development of the report and the extent of the valuation assignment.

Complete Appraisal. Technically, a complete appraisal is one that does not invoke one of *USPAP*'s departure provisions. Departure is the tool that allows appraisers to perform assignments that are something less than or different from work that otherwise would be performed for a complete appraisal. In addition to no departures, a complete appraisal has all the materials necessary to prepare a credible analysis and has not excluded any approaches to

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the appraiser's report. Appraisers must have verbal or written permission from clients to release reports to other parties.

Informal vs. Formal

Those outside the appraisal industry often refer to the old letter of opinion report as an informal report, although terms such as *update appraisal*, *recertification of value*, and *evaluation of real property collateral* also have been used.

Appraisers no longer use these terms because the formats violate multiple *USPAP* regulations. Today, the shortest format is the restricted report; however, its use is limited and it requires substantially more work of the appraiser.

For formal reports, *USPAP* dictates that appraisers can issue two types of

value, such as cost, sales comparison, and income approaches, that a typical appraiser would use in that situation.

For example, to value vacant land, a typical appraiser would perform a sales comparison approach, rarely perform an income approach due to insufficient land lease transactions, and never perform a cost approach because it does not apply. This would be a complete appraisal because applicable approaches were used, even though the cost approach was excluded.

Another example of a complete appraisal is a 30-year-old office building where the appraiser uses an income approach and a sales comparison approach but does not use the cost approach because of a lack of land sales in the market and/or the imprecision in estimating depreciation.

Complete appraisals are needed for most loan transactions and court cases.

Limited-Use Appraisal. Limited-use appraisals invoke one or more USPAP departure provisions. They most frequently are used to exclude one or more applicable approaches.

To use the office building example, if the appraiser did not perform the income approach, even though sufficient information was available to do so and a typical appraiser would do it, excluding it changes the report from a complete appraisal to a limited-use appraisal.

Limited-use appraisals generally are used internally by owners or for quick purchase decisions. The level of reliability of limited-use appraisals varies, but most users believe them to be less reliable than complete appraisals; however, they can be very appropriate in certain situations. For instance, a client familiar with a property may order a limited-use appraisal to get a lower fee and a faster turnaround time. Appraisers justifiably are hesitant to provide a limited-use appraisal for third parties such as banks that have not lent on the property, but for internal valuations for the property owner, limited-use appraisals are very appropriate.

Online Resources

Following is a list of online resources for information on appraisal standards and laws, educational opportunities, and valuation issues.

The Appraisal Foundation
<http://www.appraisalfoundation.org/>

Appraisal Subcommittee of the Federal
Financial Institutions Examination Council
<http://www.asc.gov/>

Appraisal Institute
<http://www.appraisalinstitute.org/>

National Association of Independent
Fee Appraisers
<http://www.naifa.com/>

American Society of Appraisers
<http://www.appraisers.org/>

In addition to these two types of appraisals, there are three types of report formats: self-contained, summary, and restricted.

Self-Contained Report. In this option, the appraiser provides all of the data and the rationale used in the development of the appraisal. All conclusions and data sources are fully disclosed and discussed.

Two practical tests can determine if a report is self-contained:

- the content of the report fully describes the data, reasoning, and each conclusion to such a degree that the client does not need to consult other data sources or inquire how the appraiser reached a conclusion, and
- information sources cited within the report are included in the document, within reason. Citing a book does not require the inclusion of the book in the addendum, but market studies or other articles cited in a report should be included, especially if the appraiser relied upon them to support important conclusions.

Self-contained reports most often are needed for commercial property lending.

Summary Report. As the name indicates, the appraiser summarizes the findings rather than fully describing them. Summary reports are much shorter than self-contained reports and are accepted by many lenders. Appraisers may summarize their data and conclusions without explaining the full reasoning behind them. Summary reports most often are used for simple commercial real estate transactions.

Restricted Report. The shortest format, restricted reports state only the appraiser's conclusions with no explanation on how they were derived. Restricted reports generally are used internally or when a value must be reported quickly. Many clients order restricted reports when time is of the essence and then have them upgraded to summary or self-contained reports in the future.

USPAP does not allow a restricted report to be used by anyone other than the client or someone intimately familiar with the property, so a summary or a self-contained report must be prepared if other parties will view the appraisal. Appraisers cannot recertify this type of report to other lenders.

Are Verbal Reports Valid?

USPAP makes some provision for verbal reports, but the disclosure requirements are just as complex as for written reports and generally are not practical for appraisers to employ. Appraisers may state values verbally, but since they are required to document appraisals fully, they must write the equivalent of a report. To provide a verbal value without writing the report is misleading, highly unethical, and in violation of all appraisal licensing laws.

Appraisers can act as consultants and provide raw data to clients who then determine their own value; however, data provider licensing agreements usually prohibit this.

Generally, clients ask for verbal reports when time is short or they need a quick decision. A good solution is a limited-use appraisal in a restricted report format that would provide information quickly and legally. Appraisers can use data sources as part of their appraisals and thus would not violate data subscriber agreements.

Objectivity Requirements

Appraisers must maintain a third-party position to a transaction, and no appraiser can accept an assignment where bias could be interpreted.

USPAP is very clear on this issue: Appraisers cannot be advocates for any client. Although it may seem unusual for a client to pay for a report that does not provide a favorable outcome, appraisers governed by appraisal licensing laws must remain objective.

Clients uncertain about their property's value first should have the appraiser prepare a restricted report and then upgrade to a summary or self-contained report if the value is satisfactory. This is acceptable appraisal practice and one not often suggested by appraisers.

An appraiser's third-party status is essential to maintaining the high standards put forth by USPAP. These standards and the value they bring to sales transactions make appraisers a valuable commodity for commercial real estate professionals. ❖