

Appraisal Review in a Litigation Support Role

by

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INTRODUCTION

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BRIEF SUMMARY

This article describes how the appraisal review process and review appraiser are used effectively in litigation support. It informs readers of the necessary elements of an appraisal review under the 1999 version of USPAP and offers suggestions to assure compliance. Highlights include dealing with the scope of data available in litigation, assisting attorneys and courts, identifying problems with appraisal reports, and effectively preparing an appraisal review for litigation.

KEYWORD INDEX

Appraisal review, litigation support, market value, opinion, expert witness, USPAP.

Appraisal Review in a Litigation Support Role

When engaged, or rather enmeshed, in litigation, an attorney will often solicit support from a review appraiser. Typical areas of assistance the attorney needs are:

1. To review appraisal(s) prepared at the request of opposing counsel, identifying areas of strength or weakness as an aid to the attorney in preparing the case, and to provide rebuttal testimony.
2. To review appraisal(s) prepared at the attorney's request for the same purpose: to assist the attorney in preparing the case and to offer suggestions as to how the appraiser could make the report or presentation clearer or more effective to the fact finder.
3. To provide other forms of litigation support, such as preparing courtroom exhibits and helping to frame questions to ask appraisal experts on both sides at depositions and during trial testimony.
4. To advise the attorney about standards of practice, professional codes of ethics, sources of information, other experts, and other matters that might impact the pleadings, discovery, dismissals and pretrial judgments, settlement conference or other negotiations, and the actual trial of the case.

While the appraiser who has prepared a report at the attorney's request is often in an excellent position to provide litigation support, that appraiser may be viewed as being so supportive of his or her own report as to lack objectivity. Accordingly, a fresh face—that of the review appraiser—may be helpful to provide a new perspective with greater objectivity. Appraisal reviews are an effective means of assisting the attorney in this process, either in the courtroom or in pretrial settlement discussions.

APPRAISAL REVIEW DEFINED

Appraisal review, as used here, is *not* the approval or constructive criticism that a senior appraiser provides to a subordinate before cosigning a report from within the same firm. By

contrast, *appraisal review* is a process whereby a review appraiser is employed as an independent professional to pass judgment on certain specific elements in another's appraisal report. A review appraiser does not embrace the appraisal's value estimate, nor may the review appraiser provide a substitute value estimate unless the reviewer's research (1) satisfies the requirements of USPAP Standard 1, (2) identifies and states any additional data relied upon and the reasoning and basis for the different opinion of value, and (3) states all assumptions and limitations connected with the different opinion of value to avoid confusion in the marketplace.¹

As put by Max J. Derbes, Jr., "The function of the review appraiser is not to conduct an appraisal of the property; rather it is to analyze the contents of the appraisal report itself."² According to Richard Sorenson, "reviewers 'test' for reasonableness of the logic, assumptions, and value conclusions as well as for compliance with professional standards, the clients' criteria, and regulatory requirements for real estate appraisers."³ Thus, the review appraiser does not take responsibility for the content of the appraisal report or its value estimate. The reviewer does take responsibility for his or her opinion of the appraisal, with emphasis on certain issues, which are:⁴

- Form an opinion as to the completeness of the report under review within the scope of work applicable in the review assignment;
- Form an opinion as to the apparent adequacy and relevance of the data and the propriety of any adjustments to the data;
- Form an opinion as to the appropriateness of the appraisal methods and techniques used and develop the reasons for any disagreement;
- Form an opinion as to whether the analyses, opinions, and conclusions in the report under review are appropriate and reasonable, and develop the reasons for any disagreement.

¹Appraisal Standards Board, *Uniform Standards of Professional Appraisal Practice* (Washington, DC: Appraisal Foundation, 1999), Comment under Standards Rule 3-1(g), p. 27.

²Max J. Derbes, Jr., "Appraisal Review Ethics," *Appraisal Journal* 58 (April 1990): 161.

³Richard Sorenson, "The Art of Reviewing Appraisals," *Appraisal Journal* 59 (July 1991): 353.

⁴1999 USPAP, Standards Rule 3-1(c)–(g).

In essence, the review is a quality control check for an appraisal, with opinions of the appraisal expressed by the reviewer.

Level of Intensity

Appraisal reviews may have various levels of intensity, which are, cumulatively:⁵

1. *Desk review.* The reviewer applies personal knowledge to a careful reading and analysis of the entire report.
2. *Data check.* The reviewer checks the accuracy of data by reference to sources quoted. In some situations the reviewer gathers additional data.
3. *Field review.* The reviewer personally inspects the site and its environs in an effort to confirm (or negate) the appraiser's observations.

A review appraiser may form his own opinion of value when meeting certain requirements. That, however, essentially constitutes an appraisal, which is beyond the scope of an appraisal review.

INFLUENCE OF FIRREA ON APPRAISAL REVIEW

Although appraisal review is not a new endeavor, its use was greatly broadened as a result of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), also known as the savings and loan bailout bill. FIRREA, which was critical of appraisers for their alleged role in the S&L crisis of the 1980s, arguably was responsible for elevating appraisal standards in the late 1980s and 1990s. Lloyd Hanford, MAI, gives credit to FIRREA for “the rigorous appraisal review process” that it instigated.⁶

In the midst of the crisis of the 1980s, S&L regulator/bureaucrats lacked the education, training, and experience to evaluate property decisions. The decisions in question included setting asking prices and accepting bids. If REO went unsold for too long, regulators were accused of

⁵Seven levels of analysis for an appraisal review are identified in *The Appraisal of Real Estate*, 11th ed. (Chicago: Appraisal Institute, 1996), p. 693.

⁶Lloyd D. Hanford, Jr., “The Reviewer Is Always Right,” *Appraisal Journal* 62 (July 1994): 358.

asking too much; when property sold, they were criticized for selling too cheaply. Suspicious of appraisers for their alleged role, the regulator/bureaucrats became zealous guards of their own actions. To avoid any possible accusation of personal bias or basing their decisions on insufficient data, regulators accelerated their use of appraisers.

In response to the criticisms, regulators required periodic appraisals of REO properties. They adopted appraisal review procedures for further assurance. If there was sufficient disagreement, they ordered another (and still another) appraisal.⁷

FIRREA caused appraisals to be more closely scrutinized. Before FIRREA, many lenders spent little or no time reading or critically evaluating an appraisal—they merely asked for the “bottom line” value amount. Most important, FIRREA mandated state licensing of appraisers in an effort to elevate the minimum standards for appraisers and to instill within appraisers a fear of license revocation for cause.

FIRREA Appraisal Reviews

Now that the S&L crisis is long past, the skills of appraisal review are in demand for other purposes, including institutional equity and loan decisions and litigation support.

Investment Decisions

For institutional investment decisions (acquisitions and dispositions), the institution seeks a value estimate from an independent third party, followed by an independent review of that appraisal. For the relatively small cost of an appraisal review, the loan officer can obtain an objective report by a qualified professional appraisal reviewer. This can save the loan officer considerable time and provide further documentation for the proposed decision.

Often the interests of the parties are consistent (i.e., an investor wants to buy property, and a lender wants the loan to close), so obtaining information from independent third parties is useful

⁷In one case the author reviewed four appraisals on the same sensitive property and later learned that six appraisals had been prepared as of the same date.

because it is free from the bias that the players necessarily bring to the transaction.⁸ The atmosphere is typically friendly, with the review appraiser often encouraged to communicate directly with the appraiser to address any concerns and to correct any errors.

Litigation Support

In litigation, typically each party to a suit obtains one or more appraisal reports, and sometimes the difference in appraised values is an order of magnitude. Litigation includes such matters as condemnation, ad valorem tax appeals, federal gift and estate tax valuations, divorces, and so on, where the interests of the parties are diametrically opposed.

A review appraiser may be employed in litigation to describe the characteristics of the appraisal(s) of either or both side(s). Often, this function is provided in rebuttal testimony to assist a decision maker (commissioner, arbitrator, judge, or jury) in gaining a better understanding of the appraisal.

The review appraiser must reach an understanding with the attorney as to the expert role that will be undertaken. Before the appraiser accepts an assignment, it is important that there be sufficient time and resources to complete the assignment professionally and prepare for trial. Some attorneys wait until the last minute to call on appraisers and review appraisers. Ethics also require that the review appraiser reach an independent judgment, unbiased by the perspective of the attorney, in making review evaluations and forming opinions. One must walk away from assignments where this independent judgment cannot be exercised.

The appraiser can be a “consulting expert” or an “expert witness.” A consulting expert works directly with the attorney, and consultations are generally considered protected within the attorney’s work product privilege. Consulting experts do not testify in court without changing their role and becoming expert witnesses. On the other hand, expert witnesses, if properly qualified, will be expected to testify and must make available during the discovery process all of

⁸Lloyd Hanford (loc. cit.) asserts that the review appraiser has a bias—a desire for future assignments—and can introduce that bias to the detriment of the appraiser.

their work products, notes, databases, and other materials relied upon to reach opinions. This can also include being required to testify on unprotected conversations with lawyers or other parties to the case.

Expert witnesses should be familiar with the rules of civil procedure and rules of evidence applicable to the state or federal court which has jurisdiction over the case in conjunction with which the expert is providing his or her services.

In federal cases, the review appraiser should be familiar with Federal Rule 26, which defines procedures governing discovery and the duty of disclosure. The rule was greatly expanded as of December 1, 1993, and now includes provisions for disclosure of expert testimony, pretrial disclosures, discovery scope and limits, entitlements for reasonable witness fees, and provisions for protective orders.

The issue of who may be an expert witness in the federal court is currently undergoing change. Rule 702 of the Federal Rules of Evidence states: “If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education may testify thereto in the form of an opinion or otherwise.” In the 1993 *Daubert* case, the U.S. Supreme Court established a “gatekeeper” role and created a set of tests on federal courts to exclude inappropriate expert testimony on science matters that failed to be “not only relevant, but reliable.”⁹ Until the 1999 U.S. Supreme Court *Kumho Tire* case, there was mixed opinion in the Federal Circuit Courts as to whether other technical expert opinions were subject to this gatekeeper scrutiny. Although most circuits applied the *Daubert* tests only to hard science cases, several of the Circuits applied these tests more broadly. Of particular interest to appraisers is the Seventh Circuit’s decision in *Frymire-Brinati v. KPMG Peat Marwick*, 2 F. 3d 183 (7th Cir. 1993). A Circuit Court panel ruled that the trial judge failed to conduct preliminary assessment of a CPA who was giving evidence on appraisal of real estate; the testimony of this accountant was

⁹*Daubert v. Merrell Dow Pharmaceuticals, Inc.* 509 US 579 (1993) at 589.

therefore not properly admitted. Ironically, the trial court in that case refused to allow testimony of a real estate appraiser with 28 years of experience to rebut the accountant's testimony. To resolve the differences among the Circuits on non-science expert witnesses, on March 23, 1999, the U.S. Supreme Court reached its decision in *Kumho Tire Co. v. Carmichael*, 97-1709 (1999). Writing for the majority, Mr. Justice Breyer writes that the trial court's gatekeeper role applies not only to testimony based on "scientific" knowledge but also to "all expert testimony." The 8-1 majority opinion specifically agrees with the U.S. Solicitor General's *amicus curiae* brief, which lists "land valuation" as one of the areas of expert opinion that are subject to the Rule 702 gatekeeper's role of a trial court. Trial courts are required to determine whether the expert's testimony has a reliable basis in the knowledge and experience in the relevant discipline with respect to "factual basis, data, principles, methods, or their application." Factors that trial courts can consider include testimony based on professional studies and experience. As a result of the *Kumho Tire* case, review appraisers can expect more scrutiny of their credentials and their reports by courts in the future.

Atmosphere. The atmosphere in litigation is quite different than in the investment decision situation. The reviewer in litigation is discouraged from communicating with the opposing appraiser. If errors are discovered in the opposing appraiser's report, the reviewer highlights them. The reviewer does not offer an easy way out by suggesting and encouraging corrections to improve a report.

Juries. In many cases, juries lack the time and training to sort the wheat from the chaff, so they often split the difference between divergent appraisals. This expectation causes the advocates for both sides to pressure appraisers to agree with their point of view.

Information Available. The discovery process often more than compensates in litigation for the inability to confer with the appraiser. Here the review appraiser can take an active role in gaining information about the appraisal by:

1. Preparing questions for the attorney to be answered by the appraiser at the appraiser's deposition (and later at trial).
2. Being present at the appraiser's deposition and/or reading the transcript of it.
3. Reviewing data and documents the appraiser relied on, supplied pursuant to a *duces tecum* request.
4. Reviewing affidavits and answers to interrogatories.
5. Reading other appraisals of the same property, whether prepared by the same appraiser or by another.
6. Reading appraisal reports of other properties by the same appraiser to check for consistency of methodology. Also reading the depositions and any books or articles that appraisers on both sides of the case have written for offensive or defensive strategies applied to *Daubert*-type issues.
7. Reading published articles or appraisals the appraiser has prepared on other, similar properties, if available.
8. Reading transcripts of depositions and court testimony of the appraiser in other trials.
9. Listening to trial testimony. (If "the rule" to exclude experts from listening to the testimony of other experts is not invoked, the review appraiser can also gain valuable information and provide suggestions to counsel during the trial.)

These steps can more than compensate for the lack of direct appraiser-to-review appraiser contact because the review appraiser should have access to all the information that the appraiser relied on. Also, the review appraiser should encourage the attorney to request and share information, though some attorneys do not want to because of cost considerations. If an attorney withholds information, received from the other side in discovery, that a review appraiser needs to complete an assignment, the review appraiser must weigh his options and may withdraw from the engagement if vital information is being withheld.

Level of Investigation. Nonlitigation assignments typically limit the reviewer to a desk review. The reviewer is expected to apply his market knowledge and experience to what is written within the report. This does not preclude the reviewer from seeking readily available market data or initiating a well-placed phone call to a fellow appraiser who is active in the given market. These investigations may be used whether or not the data appears free of bias.

A review in litigation also begins with a desk review and perhaps confirmation with publicly available market data and phone calls to data sources, all of which are documented in the reviewer's work papers. If the appraisal's facts are borne out by these investigations, and the appraisal otherwise passes muster, the investigation phase of the review may end there. A report will follow.

If, however, more than minor problems surface at the desk level of review, then it would be appropriate to check a large portion of the appraisal data and possibly to determine whether other data is available, then gather it. The purpose of gathering the data is not necessarily to form an independent opinion of value; it may be only to discredit the appraiser by showing that readily available information was disregarded, whether willfully or inadvertently.

A property visit might also be appropriate depending on the review appraiser's and the attorney's expected benefit from such a visit, versus the cost. If the property is in a distant city, this step might be postponed pending a possible settlement of the case. If the case proceeds to trial, a site visit can be useful to let the jury know that the reviewer did see the property; and if that visit changed the reviewer's mind about something in the written review report, it can be addressed in an addendum to supplement the review report with new material.

If at all possible, a physical inspection of the property by the review appraiser should be undertaken. Physical inspection may often disclose facts that are very effective when presented at trial. For example, in one case involving a dispute over the value of land at the edge of a cliff, the question was raised whether the land was accessible from the valley floor, which was several hundred feet below. An examination of topographical maps, land use plans, and aerial photographs suggested that accessibility was a major problem. The review appraiser had

physically inspected the property and was able to testify at trial that he had personally walked up an abandoned road, overgrown by young trees and bush, that led directly from the valley floor to the disputed land.

REVIEWER CONSIDERATIONS

The reviewer must be concerned with more dimensions of USPAP than the appraiser. The current version of USPAP is applicable to a reviewer forming an opinion and reporting it. This includes USPAP's Preamble, Ethics and Competency Rules, Definitions, and any Supplemental Standards. Perhaps there are circumstances where a reviewer must observe the Departure Rule and/or Jurisdictional Exception Rule. Standard 3 mandates specific requirements for appraisal reviewers.

USPAP Review Requirements

In addition to meeting USPAP's universal requirements for review (principally stated in the Preamble and in the Ethics and Competency Rules), a review appraiser must meet Standard 3. Meeting USPAP is a minimum. The reviewer may comment on any element of the appraisal to explain the nature of the review or consideration of the appraisal, whether or not called for by Standard 3.

USPAP Research for Reviews

USPAP requires that the reviewer identify the client and intended users, the intended use of the appraiser's opinions and conclusions, and the purpose of the review assignment. In addition, the reviewer must identify the report being reviewed, the property being appraised, the effective date of the appraisal, the date of the review, and the extent of the review process. Figure 1 shows the matters the reviewer must consider and form an opinion about in studying the report under review.

USPAP Reporting for Review

Standards Rule 3-2 applies to reporting the results of a review. See Figure 2 for details of review reporting requirements.

USPAP Appraisal Requirements

Equally important to a reviewer are the USPAP requirements for the appraisal. Universal requirements include observing the Preamble and the Ethics and Competency Rules. The research requirements for an appraisal are listed in Standard 1 and the reporting requirements in Standard 2. The reviewer should be mindful of provisions where a departure from USPAP is permitted, as contrasted with the nondeparture rules, commenting accordingly in the review report. A nondeparture rule is mandatory—the appraiser must address the matter in every report—whereas a departure rule allows the topic to be avoided with an appropriate explanation of why the departure was acceptable. To be acceptable, the departure must not result in a value opinion that is not credible.¹⁰

In addition to USPAP Standards, its Preamble, its Ethics, Competency, and Departure Rules, and its Jurisdictional Exception Rule are to be observed. USPAP Statements (SMT) and Advisory Opinions (AO) should be respected by the appraiser.

The standards in effect when the appraisal report was prepared are controlling in consideration of whether a report meets USPAP and/or other professional standards. An appraisal report prepared in 1995 should be expected to meet 1995 standards even though it is being reviewed in 1999. However, if an appraisal was performed in 1999 to provide a value estimate retrospective to 1995, it should meet 1999 standards.¹¹ The review itself should observe the standards in effect when it is prepared.

¹⁰Advisory Opinion 15, in 1999 USPAP, p. 116.

¹¹The 1999 USPAP became effective on March 31, 1999.

Other Regulations

Appraisers who are members or candidates for designation in a professional association are required to follow their association's Code of Ethics and its standards. The reviewer/member must follow those of his or her own association(s) in performing the review and should point out whether or not the appraiser did so in preparation and communication of the appraisal if he or she is a member or candidate of the association.

Respect for the Appraiser

A review appraiser must adequately respect the opinion(s) of the appraiser. If there is disagreement, the reviewer should state the issue and reasons for the disagreement rather than presume superior knowledge simply as a result of being in the review position. (This is one of the principal points made by Hanford¹² and Oetzel.¹³ This respect, however, does not imply a reviewer's acceptance of the report or its value estimate. If the reviewer refutes the compliance of the appraisal with Standard 1 and wishes to express a different value, the review should comply with Standard 1, cite adequate data to support the reviewer's position, and state all assumptions and limitations connected with the differing opinion. This requirement was adopted by USPAP in 1999 (see Standards Rule 3-1(h)(2)).

Appraisal Not on Trial

The appraisal itself is rarely the trial issue. The issue is the property value. The appraisal may become the issue in rare cases when the appraiser is being sued for malpractice. Still, the professional integrity and reputation of both the appraiser and the review appraiser are typically not the principal matter under siege in a courtroom situation, so the issues should be addressed coolly, in reliance on the data. Sometimes, unfortunately, it is the appraisers who come under attack with efforts to impugn their integrity or competence.

¹²Hanford, 358.

¹³Terry Oetzel, "Opinion," *The Appraiser* 44, no. 5 (1988): 2

PROBLEMS WITH APPRAISAL REPORTS

Sorenson correctly identified the problems reviewers find in appraisal reports as related to “issues of competency; data research, support, analysis and reasoning; report inconsistencies; ineffective quality control; misunderstanding of the assignment; standards issues; vagueness; and the failure to use a reasonableness test before finalizing the appraisal.”¹⁴

Cause and Effect of Appraisal Deficiencies

Although Standard 3 review requirements do not describe or prescribe this, a conscientious reviewer could make the connection between an appraisal’s apparent USPAP compliance (or violations) and the resulting quality (or inadequacy) of the report. That is, if a USPAP provision was violated in an appraisal, the review appraiser could indicate how this (possibly) led to an inaccuracy in the appraisal report. Although not all USPAP violations result in a value misstatement, those that materially affect the value should be identified. This can often be conveniently summarized in a two-column table, with USPAP violations in one column and the effect on the appraised property value in the other, thus:

Column A	Column B
USPAP Violation	Property Value Effect

However, not all USPAP violations are apparent, and not all violations result in a value misstatement. Those errors that do not cause a value misstatement are less serious (i.e., to use a sports analogy, “no harm, no foul”).

Clues to Appraisal Problems

Clues to possible appraisal problems include those described in the following sections.

¹⁴Sorenson, 353.

Different Values—Different Appraisers

In condemnation and other disputes in litigation, appraisals are often supplied by both sides of the issue. The review appraiser can evaluate both reports at the same time and focus on areas of significant difference, or on known key elements that affect the property's appraised value.

For example, for income property the focus can be on rental rates, vacancy, operating expenses, forecast growth of income and expenses, capitalization rates, and discount rates. The data and their support from both appraisal reports can be compared as to timeliness, reliability of their source, and apparent relevance.

For land, whether a comparison approach or a development approach is principally relied on can make a huge difference. The characteristics of the sales data for comparables can be evaluated, as well as the assumptions used in the development approach.

If the cost approach is used by the appraisals, the source of reproduction or replacement cost data may be useful, and the reviewer must carefully consider whether all forms of depreciation were evaluated in the appraisals.

Wherever subjectivity can be introduced by an appraiser, the review appraiser must evaluate how the subjectivity was applied. Was it applied in a manner that appears to result in a credible appraisal? This may be difficult to assess for a single variable but may become apparent if a series of subjective judgments all cause the value to be biased in the same direction. The result is likely to be an appraisal that violates Standard 1 because it is not credible.

Different Values—Same Appraisers

A property owner may have a favorite appraiser who may have lost his independence. In the discovery process, it may come out that the appraiser performed a prior appraisal on the same property. The review appraiser should read any previous appraisal carefully and investigate similarities and differences. There can be valid reasons for divergent values, such as changes over time in rental market conditions or capitalization rates. However, these changes must be supported by the narrative. If the narrative in the more recent report describes stable rent and

capitalization rates for the period between the reports, yet the numbers applied in the valuation section show significant increases or decreases, the two reports are clearly inconsistent. One or both likely contain erroneous values. The appraiser's credibility can be shattered by this comparison.

In some cases, it may be possible to obtain inconsistent appraisals from the public record or through discovery. For example, in some jurisdictions it is possible, through state freedom of information laws, to obtain appraisals used for property tax appeals or in land use permit applications involving environmental impact statements. In one case, attorneys gained access to an opposing appraiser's report for tax appeal purposes and another report for mortgage underwriting purposes for the same property for the same year. There was significant variance in the "fair market" values in the two reports. The inconsistency of values could not be defended by the other appraiser.

In another case the owner donated to a charitable organization property for which he had not been able to find a buyer. He claimed a large income tax deduction supported by an appraisal. Just prior to that, however, the owner had appealed the ad valorem tax assessment, stating a market value for the property that was one-fifth the amount he later claimed as an income tax deduction. The ad valorem tax appeal, which described building deficiencies, came back to haunt the income tax deduction.

In yet another case an appraisal firm appraised an office building at \$1.25x million to support a purchase at \$x million. Six months later the same firm appraised the same property at \$1.5x million, principally by changing the capitalization rate. Yet no changes had occurred in the market, the building, or capitalization rates generally to justify the increased valuation. The firm's malpractice insurer paid dearly. The multimillion-dollar inconsistency between appraisals was not supportable or defensible. Other errors in both reports were also exposed in the review process.

*Different Values for Different Purposes
Given Same Market Value Definition*

Different definitions of value are likely to cause differences in property valuation.¹⁵ However, when the same definition of market value is used by the same appraiser, applied to the same property for the same date of value, then the same value conclusion should be reached regardless of the intended use of the appraisal. Thus, the market value provided by an appraiser should be the same whether the intended use of the appraisal is by the purchaser in acquisition negotiations or for a loan application.

Failure of the “Now Therefore” Test

When the text of an appraisal report says one thing and the valuation section applies the opposite, an appraiser’s explanation in litigation is suspect. If the text describes a weakening economy—oversupply of the given product type, with additional supply coming on the market and no demand increase in sight—a reader expects falling rent and rising vacancy rates. If the valuation section shows the opposite, it has failed the “now therefore” test. (Items such as this are why it is crucial for the reviewer to read the entire report, even though some sections may be soporific.)

Such slips sometimes result from an appraiser’s use of “boilerplate,” using the same text in introductory sections for every property appraised. The apparent manipulation in the valuation section would go unnoticed without the careful reading that would show up the inconsistency of the text.

Omission of Essential or Required Statements

An omitted statement may be a clue that something is being hidden. For example, USPAP Standards Rule 1-5(b) requires the appraiser to analyze any sale of the property within three years (one year for one-to-four-family residential property). In some appraisals the absence of

¹⁵Jack P. Friedman, “Market Value of Inventory: Different Definitions Equal Different Values,” *Journal of Property Tax Management* 10 (Summer 1998): 1–10.

comment is perfectly harmless: the appraiser learned that there was no sale in the requisite period and chose to say nothing. I recommend, however, that the appraiser provide a positive statement to that effect. When the statement is omitted, alarm bells should ring for the reviewer: the appraiser may have omitted mention of a recent sale of the subject, thereby arguably providing a report that lacks credibility or is deceptive. When reviewing an appraisal performed under the 1999 USPAP, S.R. 2-2 (a, b) ix applies. It states:

When the purpose of an assignment is to develop an opinion of market value, a summary of the results of analyzing the information required in Standards Rule 1-5 is required. If such information was unobtainable, a statement on the efforts undertaken by the appraiser to obtain the information is required. If such information is irrelevant, a statement acknowledging the existence of the information and citing its lack of relevance is required.

Although this wording is new to the 1999 edition of USPAP, the concept really was there all along in the old S.R. 2-2 (a, b, c) xi, where one had to “show compliance” with Standard 1.

In one case, raw land was under contract for \$ x and appraised at \$ $4x$. A loan for \$ $3x$ in cash was originated based on the appraisal. The appraiser did not provide a three-year sales history of the property or existing known contracts, as required by USPAP. The appraiser used as comparable sales parcels of 5–10 acres or less, whereas the subject was about 200 acres. The appraiser wrote that property in the control of a developer was worth far more than in the hands of a passive landowner. Therefore he selected as comparables tracts owned or purchased by developers, implicitly justifying the fourfold markup. The officers and directors of the S&L that provided the loan paid for their failure to exercise due diligence by settling with the regulatory agency for a large amount. The officers and directors were upset because they felt that ordering an appraisal to support the loan amount *was* exercising due diligence. Apparently the appraiser was considered judgment-proof. Subsequent events indicate that the appraiser’s judgment about the land’s development potential was faulty. Now, 10 years later, the land remains raw land.

Carelessness and Inconsistencies

A report exhibiting poor grammar, misspellings, and math that doesn't add up may be evidence of sloppy or careless research and analysis. An appraiser may admit to being a poor speller or typist, yet argue that the appraised value is correct. But such errors are an indication of an appraiser's lack of attention to detail, the same carelessness that may have led to reuse of boilerplate text without necessary revision.

The report may also be replete with inconsistencies—transpositions of numbers, varying values for amounts that should be identical, and so on. In these days of spell check utilities and computer-assisted math, such errors should be minimal. If the appraiser is careless or inconsistent in these matters, there is a presumption that he is careless or inconsistent in fundamental matters.

Unsupported or Questionable Assumptions

Key assumptions should be supported by market data. When support is absent, this is a clue that the value estimate is without validity.

In some instances the reviewer, from his own experience, may recognize an assumption as being questionable; where the reviewer lacks personal market knowledge to challenge a crucial assumption, he may seek confirming data.

Unexpected Limiting Conditions

The reviewer should read critically the statement of limiting conditions included in the appraisal. If the statement is excessively lengthy or includes items other than the usual "boilerplate," the reviewer may ponder each (as well as the boilerplate) in an effort to understand a valid reason for its mention. If the appraiser encountered an obstacle that prevented him from performing adequate research, it may raise a significant question for the reviewer to consider.

Selection of Data at the Margins

When a range of data is presented and the appraiser consistently selects a data point from one end of the range, with the result that the value estimate is biased in one direction, the reviewer

must consider the apparent bias. This is a clue to a misleading value estimate. Although a single data point selection does not prove this contention, a pattern of such selection could.

The reviewer should also be aware of the appraiser who selects from the midrange of the data but offers a biased sample of comparable sales data. A biased sample is more insidious and often goes undetected unless the scope of review work includes a search for additional data.

Rare or Excessive Use of Hedging Words into Type

Some appraisers have a writing style that is rarely unequivocal. They always modify descriptions with words such as “seems” or “appears” rather than flatly stating “This is...” Perhaps they feel that definite and positive statements are more easily proven wrong. Certainly a modicum of caution is advisable in stating any subjective conclusion, but excessive use of such words as *possibly, presumably, arguably*, and the like, and conditional statements using “might” or “could,” suggest a lack of conviction. On the other hand, some appraisers rarely use such words and are perhaps too forceful, expressing a confidence that the reviewer may come to discover is unjustified. If the reviewer can get a feel for the appraiser’s writing style, it may be possible to identify whether the hedging words are appropriate.

Ideally, terms that describe historical facts should not be qualified. If an independent data source indicates that a certain number of new homes were completed within a certain period, hedging is inappropriate. By contrast, in expressing expectations of the future, hedging is expected. A typical opinion might read: “Based on historical trends and current economic conditions, in my opinion it is highly likely (i.e., greater than a 75% probability) that x number of units will be absorbed in the latter half of 1999.”

Absence of Documentation or False Documentation

It is often worthwhile to check on some or part of the documentation offered in the appraisal report. Follow up on deed recordings, individuals who confirmed sales, third-party data providers, etc. A spot check of three to four items from different sources may be adequate to

confirm the appraisal report, but if documentation cannot be confirmed, is refuted, or is missing, the reviewer should check further and retain documentation of having so tested the data. When the reviewer has clear evidence that the appraiser misstated facts, such as having seen and made copies of courthouse records that differ from statements in the appraisal report, the appraiser is easily discredited in the matter being litigated.

Value Estimates That Don't Make Sense

An example of value estimates that don't make sense was a case where three appraisals, all submitted by the condemnee, were in a relatively narrow range of \$2–\$2.5 million. The subject property was the sewer pipes in a 30-year-old 200-unit subdivision of modestly priced homes. All the appraisals used the cost approach because the appraisers stated that sewer pipes were special-purpose property that could be appraised only using that approach. To a reviewer, it didn't make sense that the sewer pipes were worth \$10,000 per home, or more than 10% of the typical home value. This is especially noteworthy considering that the rate-making authority of that state allowed the owner of the sewer pipes to earn net income of only \$7,000 per year for all 200 homes combined. This income would have provided a return of one-third of one percent on the \$2–\$2.5 million purported value, much lower than the return on Treasury bills, which are riskless.

The attorneys in the case needed a review appraiser to identify the appraisals' flaws: (1) that both income and market approaches were available and both had greater validity than the cost approach, and (2) that the cost approach had the least validity but, if applied, must reflect a huge amount of external obsolescence caused by the state's public utility regulatory authority. State public utility regulations that limit the rate structure in an effort to also limit cash returns to the owner-operator serve as a substitute for competition in a natural monopoly.

In a pretrial hearing, the judge perfectly understood the review appraiser's opinion and ordered the three appraisers to correct their reports. Note that other parties knew, from the value estimates alone, that something in the appraisals smelled bad, but they needed a qualified review appraiser to explain the cause of the stench.

CHECKLISTS FOR APPRAISAL REVIEW

A checklist is a useful tool in evaluating an appraisal. One such list, comprising 100 questions, may be found in *Reviewing Appraisals*.¹⁶ Other, more extensive checklists are used by institutional lenders. As each individual appraiser gains experience and confidence, the need for such a checklist is reduced. When supervising appraisal reviewers, a checklist is a must to assure uniformity, consistency, and completeness.

USPAP

USPAP is a useful device for educating an attorney as well as for your personal review. For example, you can go down each Standards Rule and ask: “How did this appraisal measure up to this standard?” Where the appraisal you are reviewing is deficient, you can make a note and bring it to the attorney’s attention.

One of the most damaging things that can happen to an appraiser on cross-examination is for the attorney to go over each of the Standards Rules, one at a time, armed with violations of each standards rule that were identified by a review appraiser.

Writing an Appraisal Review

All Technical Reviews should comply with USPAP Standard 3; Administrative Reviews are described in USPAP under Advisory Opinion AO-6. Under USPAP Standard 3, an appraisal review must cover certain essential elements. Many appraisal reviews are written in narrative text, although a detailed checklist would also be acceptable.

Disclosure

An appraisal review must disclose the matters shown in Figure 2.

¹⁶American Institute of Real Estate Appraisers, *Reviewing Appraisals*, a continuing education seminar developed by Kenneth G. Foltz, MAI (Chicago: National Association of Realtors, January 1990).

Format

A reviewer who begins with an outline and format that considers the minimum USPAP requirements will be assured of USPAP compliance for reporting. That is, begin page 1 of the review with a list of the items in USPAP 3-1(a)–(h) and 3-2(a)–(f). The same items may then be dealt with in greater detail as major sections within the text of the review. The certification page can be placed near the beginning of the review (page 2) or near the end. This format or outline will assure that no major requirement of a review under USPAP is omitted.

Style

Each review appraiser may adopt his or her own style of reporting. One style that is useful uses roman text to describe the appraisal factually and italics when commenting or offering an opinion on it. Boldfacing and underlining can be used for headings and/or emphasis. For example:

Appraiser's Description. On page 4 of the appraisal, the appraiser describes the property as being located at...

Reviewer's Comment. The appraiser's description of the property location is adequate.

Reading the Draft Review

After drafting an appraisal review, the reviewer should reread it for accuracy by comparing the review to (1) USPAP Standard 3 and (2) the appraisal report. When a good format is used to report the review, compliance with USPAP's reporting requirement (Standards Rule 3-2) is virtually certain.

Reviewer's Support

The reviewer must be prepared to support every word in the review report, especially in litigation. In litigation the opposing side will take issue with any overzealous remarks the reviewer has made and remind the reviewer that any false statement in the review is subject to sanctions. If the

reviewer cannot fully support a statement in a draft of the review, it is advisable to revise or delete it.

Take care, therefore, in the review to articulate the exact content of the appraisal report and specify the exact USPAP violation, if any. For example, if the appraisal report does not provide a three-year sales history of the subject, the reviewer should state precisely that, drawing no conclusions from it. The absence of mention of the three-year sales history is not, *per se*, an appraisal violation. If there was no sale of the subject within three years, that fact need not be mentioned in the appraisal, though it is spelled out in most appraisals to demonstrate compliance with USPAP. If, on the other hand, the reviewer has discovered that there was a sale within the three-year period, which the appraiser failed to disclose, this should be pointed out as a USPAP violation.

Use of Hindsight

A review appraiser may know what happened in the market subsequent to the appraisal and be tempted to comment. This would be unfair to the appraiser. An appraisal review may follow the guidelines for retrospective appraisals offered in USPAP SMT-3, including the use of subsequent events to confirm trends but applying a logical cutoff date. Essentially, however, the reviewer should see the market based on the market conditions existing at the effective date of value and not expect the appraiser to have been a seer. Confirmation of trends can be helpful, especially where an appraisal depends on the appraiser's expectation of changing market conditions.

Objective and Critical

The review appraiser must review the appraisal objectively, yet also be critical. While Max Derbes argues that an appraisal review should objectively report on every section of the appraisal, heaping praise where deserved,¹⁷ such treatment would not be efficient, especially in litigation. The appraisal review must be succinct. Little or nothing need be said about points where the

¹⁷Derbes, 161.

appraisal is adequate. In places where it is inadequate, however, the review appraiser must state in what way it is deficient and give reasons for disagreement with the appraiser's conclusions. Accordingly, more space will be devoted to criticism, which requires explanation and support, than to agreement or praise.

Documentation, Meaningful Matters

Criticism of another's work should be well founded, well documented, and meaningful. It would be improper to take a quote out of context, to point out an obviously unimportant typographical error, or to highlight an inconsequential mathematical transposition. By contrast, repeated misstatements that significantly affect the value conclusion are clearly the stuff that a review appraiser would have no trouble criticizing.

CONCLUSION

Appraisal review in litigation can be an effective tool for evaluating the appraisals under consideration. To perform appropriately, the reviewer should be objective and apply a disciplined, systematic approach to studying the appraisal(s), such as using a checklist. In this way, the strengths and weaknesses of the appraisal(s) and value estimate(s) can be brought to light.

Some reviewers are sticklers about an appraisal's meeting regulatory requirements, especially USPAP; other are concerned with the appraiser's support for the market value estimate. An effective technique is for a reviewer to demonstrate, by an appropriate analysis of data and conclusions, how well the regulatory requirements have been met. Specifically, if there is a USPAP violation (or compliance failure), the reviewer may show how that deficiency led to a defective overall report or value conclusion.

When a reviewer can point to the appraiser's regulatory violation that caused a value estimate problem, this illustrates the purpose of the regulation. (Similarly, if a motorist runs a stop sign or

red light and in so doing causes an accident, the patrolman on duty can report the violation and show that the violation resulted in the mishap.)

An appraisal review can be a valuable tool for evaluating an appraisal because it often takes expert knowledge of appraisal to evaluate the report properly.

Figure 1
USPAP Requirements of Standards Rule 3-1

In reviewing a real property appraisal, an appraiser must:

- (a) identify the client and intended users, the intended use of the appraiser's opinions and conclusions, and the purpose of the review assignment;
- (b) identify the report under review, the real estate and real property interest appraised, the effective date of the opinion in the report under review, and the date of the review;
- (c) identify the extent of the review process to be conducted;
- (d) form an opinion as to the completeness of the report under review within the scope of work applicable in the review assignment;
- (e) form an opinion as to the apparent adequacy and relevance of the data and the propriety of any adjustments to the data;
- (f) form an opinion as to the appropriateness of the appraisal methods and techniques used and develop the reasons for any disagreement;
- (g) form an opinion as to whether the analyses, opinions, and conclusions in the report under review are appropriate and reasonable, and develop the reasons for any disagreement.

Figure 2
Reporting for an Appraisal Review: Elements Required by Standards Rule 3-2

In reporting the results of an appraisal review, an appraiser must:

- (a) state the identity of the client, by name or type, and intended user; the intended use of the assignment results; and the purpose of the assignment;
- (b) state the information that must be identified in accordance with Standards Rule 3-1(b);
- (c) state the nature, extent, and detail of the review process undertaken;
- (d) state the opinions, reasons, and conclusions required in Standards Rule 3-1(d–g);
- (e) include all known pertinent information; and
- (f) include a signed certification.

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