

Reviewing Appraisals—Art and Science

To those occasionally dependent on appraisals, “mystifying” sometimes describes the process. Whether appraisals are the product of tried and true academic methods or some vague art form has long been debated in real estate venues. The simple answer to this cliché is that it is both. The same is true of the appraisal review function, which has grown in importance in this “sea changed” economy. Appraising complex assets with meager transaction data in a persistently challenging real estate market has raised the bar for “appraisers” and “review appraisers” in the provision of reliable valuation services.

In my career as an appraiser, review appraiser and counselor, several observations come to mind about the contribution of review appraisers. This article summarizes some of the obvious and also less obvious functions and benefits of the process beyond peer review, quality control and regulatory compliance. The reader is directed to an excellent Appraisal Institute publication titled *Appraising the Appraisal*, by Richard Sorenson, MAI, for a thorough presentation of the technical and practical nature of the review process. Some reader knowledge of the appraisal process is presumed in this article.

The 1980’s recession again revealed inconsistency in the quality and reliability of appraisals. This time it led to the creation of the Uniform Standards of Professional Appraisal Practice (“USPAP”) in 1987; FIRREA in 1989 with Interagency Guidelines; and the formalizing of additional appraisal guidelines by IRS, transportation authorities, the U.S. government for federal land acquisitions, and others. USPAP Standards 1 and 2 relate to appraisals and Standard 3 relates to appraisal reviews, explaining the detailed requirements of each.

How does appraisal review contribute to the real estate investment process and what do reviewers actually do? The extent of an appraisal review can be limited or broad depending on the nature of the assignment and complexity of subject property appraisal issues. There are several terms used to describe the different functions and level of detail available in that process. These terms are not clearly defined or consistently used by appraisers or clients. For example, an abbreviated "desk" or "administrative" review can mean a limited check for compliance with client or USPAP requirements, and does not penetrate far into appraisal "issues". A "technical" review of an appraisal report, with or without a reviewer field inspection, usually involves a thorough and constructive critique of the appraiser's description of the subject property, market data selected for analysis, highest and best use analysis, appropriate use of valuation methods, and the value conclusion. A reviewer can also evaluate an oral appraisal report, file memoranda, or portions of an appraisal. Individual or portfolio assets can be reviewed in different geographical locations far from the reviewer's base.

Since there are so many types and levels of an appraisal review, the review appraiser and client must agree in advance on a USPAP required "Scope of Work". It discloses the nature, extent, and detail of the review process for the subject appraisal and must lead to a credible reviewer conclusion that is not misleading. An appraisal review can be required as a simple bureaucratic compliance checklist, at one extreme, or as a critical part of a financial transaction, asset management, disposition or litigation, at the other. The technical methods, analytical requirements and judgment required in an appraisal review contribute obvious value to the process by completing due diligence and supporting clients or employers in carrying out their fiduciary responsibilities. To most investors, a competent appraisal is a welcome part of a prudent asset management process. An evaluation of that work

product by an appropriately experienced review appraiser mitigates risk, provides effective communication between appraiser, reviewer and client, and adds confidence in the decision making process.

So, a reliable appraisal or appraisal review requires a skillful combination of "science and art". The "science" part is the gathering of appropriate market information and use of time tested and often complex valuation methods developed by the appraisal industry. The "art" part is the judgment that is required at many steps along the way, from appropriately characterizing a more complex subject property; researching comparable transaction data; selecting and using correct valuation methods in an ambiguous or distressed market; and reconciling often conflicting results and inconsistent market information into a reliable value conclusion. The increasing use of automated valuation models risks marginalizing the important role that judgment plays. The reviewer provides a common sense "safety net" for quality control and support for sound, confident financial decisions.

What are some of the characteristics of the best reviewers, beyond education, experience and competence? In an industry with tight deadlines, a paucity of transaction data and the large amount of detail in the appraisal process, mistakes are inevitable. Perfection is not the goal. A good reviewer does not dally over trivialities or make the mundane momentous, but instead focuses on key issues in an appraisal that lead to either a credible, reasonable conclusion or require a "leap of faith" to a questionable one. A good reviewer communicates effectively and empathetically with the appraiser. He or she recognizes the strong parts of an appraisal and provides constructive criticism where warranted. This is done in a cooperative spirit, when possible, to reach a reasonable, well-supported appraisal conclusion. An experienced, professional reviewer wants to be part of an appraisal problem's solution.

What types of clients do review appraisers serve? Given the high percentage of appraisal work that is driven by debt and equity finance, the appraisal review process has a crucial role in evaluating the quality and value of funded assets. Financial institution appraisal review staff are usually appropriately educated, very experienced, salaried professionals with high standards and ethics. They carry out an important function in the selection of fee appraisers and management of the appraisal process with the primary goals of quality control and compliance.

Well-seasoned, independent review appraisers also play an important role serving financial institutions and a wide range of clients like attorneys, municipalities, government agencies, corporations and individuals. Beyond assessing compliance and competence, the review appraiser can provide additional service by discussion with the appraiser; completion of an independent appraisal; focus on contentious appraisal "facts" or use of valuation methods; and many other ad hoc needs.

In a litigation support role, an appraiser can objectively and without bias critique another's appraisal; complete a new independent appraisal; explain valuation methods, concepts and semantics; assist in the preparation of interrogatories; evaluate depositions; interpret oral testimony; provide additional market research and analysis; and testify as an expert witness. A real estate consultant with appraisal review expertise can provide strategic counseling and support for attorneys and influence litigation outcomes.

Appraisal Institute professional designations, MAI for commercial and SRA for residential, signify excellence in appraisal education, experience, and professional conduct. The Appraisal Institute's mission is to provide premier real estate education, publications, peer review, maintenance of exceptional standards and ethics, and advocacy for the profession. In this challenging and uncertain economic and

political environment, performing appraisals and reviews has become more of an “adventure”.

A qualified and experienced review appraiser provides a very useful, timely and cost effective evaluation of the data, methods and conclusions in an appraisal. These professionals also offer additional appraisal consulting or independent counseling services with insightful analyses, creative and practical solutions to real estate problems, and assistance with strategic planning, management and disposition of assets.

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