

## Chapter 7

### **REAL ESTATE AND PARTIAL INTEREST VALUATION A General Review of Real Estate Appraisal in Divorce**

by Robert J. Strachota, Shenehon Company

#### **§7.1 INTRODUCTION**

Although frequently viewed as completely different disciplines, business valuation and real estate appraisal rely on the principle that value is the present worth of anticipated benefits. Both business appraisers and real estate appraisers base their opinions on the income stream generated by the subject asset (except when the real estate is land only). However, each discipline has its own label for the income stream. The real estate appraiser labels it “net operating income” (NOI) and the business appraiser calls it “net income before or after tax”. Both use the same approaches to value (cost, market and income) as well as the same standard of value (market value). There are, however, two notable differences: 1) Real estate appraisals are traditionally based on a “before debt basis” whereas debt is always taken out in the business valuation; and 2) Capitalization and discount rates for real estate valuations tend to be lower than those for business valuations. In real estate valuation, tangible assets, such as land and buildings, provide the basis for value. In business valuations, the appraiser measures - directly or indirectly - the tangible assets as well as the intangible assets (goodwill, patents, etc.) to arrive at the concluded value. Intangible assets (such as goodwill) are more difficult to quantify than tangible assets and, over time, the value assigned to them may erode to zero, making the asset more risky. Therefore, a higher discount or capitalization rate is required. Tangible assets such as land rarely, if ever, decrease. Clearly, the less risky real estate assets warrant a lower capitalization or discount rate compared to business valuation. Whether it is a business valuation or a real estate appraisal, it is the risk of the income stream that is measured.

A quality appraisal is supported by evidence found in the marketplace. The methods and standards of value employed are the same regardless of the intended use of the appraisal: marriage dissolution, financing, gifting, tax appeals and so on. The more unique the appraisal project, the more qualified and experienced the appraiser must be. Examples of special purpose properties include: landfills, mineral rights, lakeshore, radio towers and major shopping malls. If the real estate to be valued also includes a business owned by the same individual, the real estate appraiser and the business appraiser should work together to measure value. It is the attorney’s responsibility to hire qualified professionals. The attorney who insists on hiring a residential

appraiser to value undeveloped land ripe for new development (or vice versa) may end up with an inaccurate opinion of value.

### **PRACTICE TIP:**

In the case of marriage dissolution, it is most prudent to engage the real estate appraiser at the front end of the process rather than bringing him/her onboard just prior to the settlement conference or trial. In our experience, if the appraiser has the opportunity to identify the scope of the project and manage expectations (client and attorney) early on, he/she can develop a reasonable range of value. Being proactive and prepared increase the possibility of a fair settlement for all parties.

## **§7.2 WHAT THE ATTORNEY NEEDS TO KNOW**

In order to effectively represent the client, the attorney must select the best appraiser for the task. To work efficiently with the appraiser, the attorney needs a basic understanding of the appraiser's role; the standards governing the appraiser; the highest and best use; and the traditional approaches to value. A brief review of the common terms will ensure that all parties have a working knowledge of the appraisal process.

## **§7.3 DEFINING THE VALUATION PURPOSE**

The purpose of the assignment is to determine the market value of the subject as of a specific date. The following definition of market value was agreed upon by agencies that regulate federal financial institutions in the United States as well as the Appraisal Standards Board:

The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- buyer and seller are typically motivated;
- both parties are well informed or well advised and acting in what they consider their own best interests;
- a reasonable time is allowed for exposure in the open market;
- payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and

- the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

One must keep in mind that the legal system does not operate in a vacuum. Although the analysis is performed as of a certain date, one cannot blindly ignore subsequent events which may significantly alter the concluded value. For example, consider a building which has been vacant for many years. On the selected date of value, it is considered unusable, in need of repair and of little value. However, in the event that the owner negotiates a lease which fills the building six months after the date of value, the market outlook and the value of the building change dramatically. It is just as important to consider the “fairness” of the concluded value as it is to adhere to the specified date. The ethical appraiser will consider all aspects of the market in his/her value conclusion.

## **§7.4 DETERMINING THE DATE OF VALUE**

The importance of selecting the date of value is often overlooked. The attorney should clearly instruct the appraiser as to the date upon which the property value will be based and the selected date must be agreed upon by all parties. While appraisers are trained to verify the date of value at the time of engagement, it is the attorney’s responsibility to discuss any issues surrounding the selection of a valuation date. If the appraisers are given the wrong date of value, it not only adds to the expense, it delays the possibility of resolving the divorce in that the entire valuation process must be repeated using the correct date.

## **§7.5 UNDERSTANDING AND USING USPAP (Uniform Standards of Professional Appraisal Practice)**

These standards were originally developed (by the Appraisal Standards Board in 1987), to address problems in the real estate industry. The Uniform Standards of Appraisal Practice, published by the Appraisal Institute, represent the generally accepted and recognized guidelines of appraisal practice in the United States. USPAP is updated on a regular basis and practitioners are required to attend review classes in order to maintain their licenses and designations. The goal is to promote and maintain a high level of public confidence in the field of appraisal practice by establishing strict guidelines for developing and communicating the appraisal findings. The appraiser is directed to present analyses, opinions and conclusions in a manner that is meaningful and in no way misleading. For each appraisal, the appraiser is required to identify the problem to be solved; determine and perform the scope of work necessary to develop credible assignment results; and disclose the scope of work in the report.

Identification of the problem must include:

- Client and intended uses
- Intended use of the appraiser's opinion
- Definition of value
- Date of value
- Subject of the assignment

Conditions of the assignment include: general assumptions; extraordinary assumptions; hypothetical assumptions; supplemental standards; jurisdictional exceptions and any other conditions which may affect the scope of work

The scope of work is a mandatory aspect of the appraisal report which fully discloses what was and was not done during the appraisal process. The scope of work must also pass the peer review test: other competent appraisers would solve the valuation problem in a similar fashion. If the appraiser elects to skip one or more of the approaches to value, this must be acknowledged and explained in this section. As mentioned above, any extraordinary assumptions are revealed in the scope of work section as well. The objective of an appraisal is to develop a credible opinion of value; clearly and completely laying out the circumstances is essential to that credibility. The appraisal report must describe the process of gathering data, how it was analyzed, and how the appraiser arrived at the conclusion.

Three types of reports are now allowed under USPAP rules:

1. Self-Contained Appraisal Report
2. Summary Appraisal Report
3. Restricted Use Appraisal Report.

The essential differences among the three options are in the use and application of the terms "describe", "summarize", and "state". "Describe" is used to connote a comprehensive level of detail in the presentation of information. "Summarize" is used to connote a more concise presentation of information. "State" is used to connote the minimal presentation of information. Attorneys who are familiar with these types of reports and understand how they differ are better able to advise their clients.

Standards 2 and 8 of USPAP describe, in detail, the three types of appraisal reports (See Exhibit A.) Standard 2 requires that an appraiser make a prominent statement of which report option is being used. In Advisory Opinion G-11 regarding the content of the appraisal report options of Standard 2, the ASB advises that the statement should appear at or near the beginning of the report. In narrative appraisal reports, the statement of which report option is used may appear with the statement of the purpose and intended use of the appraisal. It could also appear on any cover page or transmittal letter if this is part of the report.

The appraisal is only as good as the information that goes into it and the competence of the person analyzing the data. By hiring appraisers who maintain the highest levels of accreditation, continuously fine tune their techniques and maintain ethical standards, the attorney has a reasonable assurance of bringing the valuation assignment to a successful conclusion.

**AUTHOR'S COMMENT:** Can an appraiser invoke the Departure Provision and perform a limited appraisal? It is no longer legal to perform a limited appraisal; this option is no longer available to the appraiser.

**Practice Tip:**

If requested to do so, by an attorney, can an appraiser purge his files and records of an appraisal that was not utilized in loan underwriting or in any other manner by the client? The Appraisal Standards Board (ASB), states in the ethics provision that “an appraiser must prepare written records of appraisal, review and consulting assignments - including oral testimony and reports - and retain such records for a period of at least five years after preparation or at least two years after the final disposition of any judicial proceeding in which testimony was given, whichever period expires last.” USPAP does not permit appraisers to destroy written records prior to five years after preparation for any reason, including a client’s request to do so, or the fact that an appraisal is not utilized by the client.

It is important for the attorney to be familiar with the appraiser’s code of ethics and the statutory requirements of federal and state law. Many appraisers belong to professional associations that award designations. Each of these associations has an appraiser’s code of ethics. An attorney should be familiar with these when reviewing an opponent’s appraisal report and conducting cross-examination. All licensed appraisers are subject to the Uniform Standards of Professional Appraisal Practice (USPAP). Every appraisal conducted by a licensed appraiser is subject to the rules and regulations of USPAP in the year that the appraisal is conducted.

Appraisers do not have “conflicts” like attorneys because value is the same for any client. The same value applies to both sides, so appraisers can work for both sides of a dispute because the value remains the same. In reality however, most appraisers will not work for both sides in a specific project. Appraisers do have “conflicts” in the sense that they must respect confidential information. An appraiser must not disclose confidential information or assignment results prepared for a client to anyone other than: (1) the client and persons specifically authorized by the client; (2) state enforcement agencies

and third parties as may be authorized by due process of law; and (3) a duly authorized professional peer review committee.

Minnesota has a unique state law that requires the appraiser to clearly acknowledge, in all appraisals, whether the appraiser has conducted a previous appraisal of the subject property. The value of the previous appraisal is not required, but it will be discovered in litigation. Most other states do not have this requirement.

The Competency Rule outlined in USPAP requires an appraiser to have both the knowledge and the experience required to perform a specific appraisal service competently. Prior to accepting an assignment or entering into an agreement to perform any assignment, an appraiser must properly identify the problem to be addressed and have the knowledge and experience to complete the assignment competently. Alternatively, the appraiser must (1) disclose any lack of knowledge and/or experience to the client before accepting the assignment; (2) take all steps necessary or appropriate to complete the assignment competently; and (3) describe the lack of knowledge or experience and the steps taken to complete the assignment competently in the report. The appraiser can gain the required experience in various ways including, but not limited to, personal study by the appraiser, association with an appraiser reasonably believed to have the necessary knowledge or experience, or retention of others who possess the required knowledge or experience.

## **§7.6 HIGHEST AND BEST USE OF THE PROPERTY**

Before the appraiser can perform the approaches to value, he/she must determine the “highest and best use” of the property (HBU). The highest and best use is the reasonable and probable use that supports the highest present value, as defined, as of the date of the appraisal. Alternatively; “The highest and best use is the reasonably probable and legal use of vacant land or an improved property that is physically possible, legally permissible, appropriately supported, financially feasible, and that results in the highest value.” (p. 305, *Appraisal of Real Estate*.12<sup>th</sup> ed. Chicago; Appraisal Institute, 2001.)

Normally, when the property has modern building improvements, the determination of HBU is simple and straight forward. The existing use is, and remains, the highest and best use. However, if the land value in its highest and best use as vacant exceeds the existing use, the HBU will change. The appraiser must perform a separate analysis for each HBU within the appraisal report under the following sections: Highest and Best Use of the Property “As Improved” and Highest and Best Use of the Property “As Though Vacant.” In each highest and best use analysis, the appraiser must address the following: What uses are physically possible on the site? What uses are legally

permissible? What uses are economically viable (financially feasible) and maximally productive?

For most assignments, the HBU is the current use. Complex real estate assignments dealing with special purpose properties, excess land issues, non-conforming uses and future land use complicate the HBU analysis and impact the value. Assume we have a small, two-story building approximately 5,000 square feet in a downtown metro area sitting on one square block (360,000 sq. ft) of land. Based on the leases in place for the building, we might conclude that the value of the property is \$1.5 million. Let's assume that the building is demolished and we appraise just the vacant land. Based on the market comparables and the demand for land in the area, we may conclude a market value for the land of \$54,000,000 (360,000 square feet x \$150/sf). This illustration demonstrates the extremes. Nonetheless, it shows the importance of carefully determining the highest and best use of the subject property with and without improvements. A thorough HBU analysis is basic to every appraisal assignment with the appraiser taking into consideration any and all situations no matter how unique they seem. The highest and best use of the property should be discussed with the attorney and client because it sets the stage for the valuation analyses.

## **§7.7 THE APPROACHES TO VALUE**

Next, the appraiser must focus on the methods of appraisal which are appropriate to the assignment. Most appraisers rely chiefly on the Cost, Market and Income Approaches to value, and if applicable, the Development Cost Approach. Each technique gives the client an indication of value. In the end, one method may be more reliable than the others for any given assignment, but the appraiser should attempt to employ all applicable methods, comparing the concluded values. During the final reconciliation, the appraiser considers and selects the most likely value based on the market evidence and current valuation trends.

### **7.7.1 Cost Approach to Value**

#### Description of Cost Approach

The Cost Approach is a methodology through which an appraiser derives value by considering the cost to create a new building with optimal physical condition and functional utility. The appraiser estimates the cost to construct a reproduction of; or replacement for, the existing structure and site improvements (including direct costs, indirect costs, and an appropriate entrepreneurial profit), and then deducts all accrued depreciation in the property being appraised from the reproduction or replacement cost of the structure as of the appraisal date. When the depreciated value of the building is measured, the value of the land is then added to this figure and an indication of the value for the fee simple interest in the property results.

### When Cost Approach Is Most Applicable

This approach is most applicable in valuing new or relatively new construction when the existing improvements represent the highest and best use of the land, land value is well supported and little functional or external obsolescence is evident. It is also used to estimate the value of proposed construction, additions and renovations, special purpose properties, and properties that are not frequently exchanged in the market. An estimate of probable building and development costs is an essential component of feasibility studies which test the investment assumptions on which land use plans are based. Financial feasibility is indicated when a property's market value exceeds its total building and development cost, including a reasonable market-supported entrepreneurial profit.

### When Cost Approach Is Most Relevant

The Cost Approach is an essential ingredient in any development cost analysis or feasibility study. It is most appropriately applied when an appraiser wants to evaluate the economics of a proposed real estate project. In valuing investment properties, the persuasiveness of the Cost Approach is seriously diminished by the premise that improvements can be constructed without undue delay. Development and construction of investment properties may take several months to several years and, in the eyes of most investors, this constitutes an unacceptable delay.

## **7.7.2 Market Approach to Value**

### Description of Market Approach

The Market Approach is the process in which a market value estimate is derived by analyzing the market for similar properties and comparing those properties to the subject property. Market value is estimated by comparing the subject property to similar properties that have recently sold, are listed for sale, or under contract. The major premise of the Market Approach is that the market value of a property is directly related to the prices of comparable, competitive properties that could be proxies for the subject.

### When Market Approach is Most Applicable

It is applicable to all types of real property interests when there are sufficient recent, reliable transactions to indicate value patterns or trends in the market. For property types that are bought and sold regularly, the Market Approach provides a supportable indication of market value. When data is available, this is the most direct and systematic approach to value estimation. When the number of market transactions is insufficient, the applicability of this approach may be limited. For example, the Market Approach is rarely applied to special purpose properties because few similar properties may be sold in a given market,

even one that is geographically broad. This approach can also be used in estimating a level of market rents, replacement cost information, depreciation and other value parameters that may be used in the other approaches to value.

#### When Market Approach Is Most Relevant

The Market Approach is persuasive when sufficient data is available. It is probably most useful in appraisals of properties that are not purchased for their income-producing characteristics. It provides the best indication of value for small, owner-occupied commercial or industrial properties. In a market with rapidly changing economic and market conditions, the Market Approach will lose much of its reliability. For example, changes in income tax laws and zoning regulations, the availability and cost of financing, moratoriums on buildings and infrastructure development may result in a lack of useful comparable information and the appraiser will find it difficult to rely on the Market Approach.

### **7.7.3 Income Approach to Value (Direct Capitalization or Discounted Cash Flow Analysis)**

#### Description of Income Approach

The Income Approach is an approach through which an appraiser derives a value estimate for income-producing property by converting anticipated benefits, i.e., cash flows and reversions, into current property value. This conversion can be accomplished in two ways: One year's income expectancy or an annual average of several years' income expectancies may be capitalized at a market-derived capitalization rate or at an overall rate that reflects a specified income pattern, return on investment, and change in the value of the investment; secondly, the annual cash flows may be discounted for the holding period and the reversion of the sale price, say 11 years later, at a specified yield rate.

#### When Income Approach Is Most Applicable

From an investor's perspective, the earning power of a real estate investment is the critical element affecting its value. The fundamental investment premise is the higher the earnings, the higher the value. Investment in an income-producing property represents the exchange of present dollars for the right to receive future dollars. In the Income Approach, an appraiser analyzes a property's capacity to generate benefits and converts these benefits into an indication of present value. The Income Approach is typically used in appraisals of all investment property that is income-producing (i.e., office buildings, shopping centers, multi-tenant warehouses, hotels, apartments and multi-tenant industrial). This approach is also very helpful in market value appraisals of specialized properties, especially where market comparables are

sometimes more difficult to find (i.e., mining properties, parking lots, landfill operations, movie theaters).

#### When Income Approach Is Most Relevant

The Income Approach is a primary approach to valuation of investment real estate. It represents the thinking and actions of the equity investor. It is clear that investors purchase income producing properties for the future dollar benefits that these properties will produce. Thus, in all instances when appraising investment property, the Income Approach is the most useful and meaningful in reflecting the true motivations of buyers and sellers. It is also most useful when it is difficult, if not impossible to adjust adequately, for various market comparables to obtain a true valuation.

#### Discounted Cash Flow

The Discounted Cash Flow is a type of income approach that can be used both to estimate the present value and to extract a discount rate from a comparable sale. Cash flow refers to the periodic income attributable to the interest in real property. Each cash flow, including the reversion if any, is discounted to present value and then all present values are added together to obtain the value of the real property interest being appraised. When is it used? The earning power of real estate investment is a critical element affecting its value. In recent years, appraisers have focused on the use of discounted cash flow because it adapts well to the dynamics of the market and can be applied to specific cash flow characteristics of a particular property. Often, the discounted cash flow more closely mirrors the behavior of market participants than any other approach to value. It is used in all types of residential, industrial, commercial, and recreational properties.

#### **7.7.4 Investment Value (or Fair Rate of Return)**

##### Description of Investment Value

This approach to value is an adaptation of the income approach that evaluates investment-backed expectations and can be based on specific, and sometimes subjective and personal parameters of information for a particular property. Oftentimes, a client's investment criteria are different from the market on average. This methodology allows the appraiser to measure a specific value of goods or services to a particular investor. The appraiser will analyze a series of investment opportunities or possible decisions and evaluate them in terms of their benefits to a given client for a particular property. Often, the decisions involving a single parcel of real estate will require the evaluation of other possible decisions and an analysis of how each possibility may affect the decision being considered.

### When Investment Value Is Most Appropriate

Typical kinds of assignments where investment value is appropriate include highest and best use studies, market studies, marketability studies, rent studies, absorption analyses, feasibility studies, and other studies that have a specific analytical objective. It can be applied in all types of real estate and is used by investors, developers, lenders, and other real estate professionals.

### When Investment Value is Most Relevant

Investment value is most relevant to a specific investor with specific investment criteria.

AUTHOR'S COMMENT: Investment value is not the same as "Fair Market Value", as that term is defined for divorce purposes in Nardini v. Nardini, 414 N.W.2d 184, 193 (Minn. 1987).

### **7.7.5 Development Cost Approach to Value**

#### Description of Development Cost Approach to Value

This technique is a method used to value land when either subdivision or development represents the highest and best use of an appraised land parcel. This technique may involve industrial, residential, commercial, or recreational land. An appraiser applies the subdivision development technique by determining the optimum improvement that can be created on vacant land (or improved land with the possibility of expanding the improvements) by considering all physical, legal, and economic constraints. This valuation methodology is a residual valuation technique which encompasses the cost, income and market approaches to value. It is often used in a feasibility analysis.

#### When Development Cost Approach to Value Is Most Applicable

Subdivision Development Analysis can be used for all types of land appraisals when future development for residential, commercial, industrial, and recreational use is anticipated. The appraiser first determines what actual or hypothetical improvements represent the highest and best use of the land, and then subtracts all direct and indirect costs associated with developing and marketing the proposed highest and best use. These costs may include engineering and other expenses to clear, grade and finish the land (to build streets, roads, and sidewalks) and to install utilities. Carrying costs such as taxes, insurance premiums, overhead expenses and inspection fees must be considered along with marketing costs for sales commissions and advertising. Further deductions must be made to provide an appropriate return on the total investment during the development period and an entrepreneurial profit for the developer.

## When Development Cost Approach Is Most Relevant

It is most appropriately used when the current use of the property does not represent the highest and best use of the land.

### **7.7.6 The Appraisal Process**

The following steps, in descending order, are used by the appraiser when conducting an appraisal:

- Define the appraisal problem.
- Set up a fee arrangement with the client to conduct the appraisal within the scope of the appraisal problem.
- Gather and evaluate client information about the subject property.
- Inspect the subject property and surrounding neighborhood.
- Gather comparable market information, which may include land sales, cost information, rentals, expenses, offerings, and sale information about properties that compete with the subject.
- Conduct a highest and best use analysis of the land. (Refer to the previous discussion of the importance of highest and best use.)
- Apply the appropriate valuation techniques.
- Reconcile the valuation techniques and finalize the value estimate.
- Convey the valuation analysis in a written report to the client.

## **§7.8 REPORT RECONCILIATION**

During the appraisal process, the appraiser arrives at several value indications. Most likely, there will be a range of values within each approach. It is the appraiser's duty to review the supporting data for consistency and verify the accuracy of mathematical calculations as well as to make certain that the goals (purpose and use) of the appraisal were met. At this point, experience and good judgment come into play. Using the reconciliation criteria of appropriateness, accuracy, and quantity of evidence, the appraiser analyzes each value estimate and ultimately draws a value conclusion. The appraiser may rely more heavily on one or more of the approaches or may discard an approach all together. However, the appraiser must logically explain how the weighting was determined. The value conclusion may be indicated as a single value or as a range. Confidence in the validity of an appraisal conclusion increases as the amount of supporting data increases and vice versa.

## **§7.9 OTHER CONSIDERATIONS IN MARRIAGE DISSOLUTIONS**

In Aaron v. Aaron, 281 N.W.2d. 150 (Minn.1979), the Supreme Court upheld the lower court's decision refusing to consider reductions in value for possible broker's commission, terms of sale over time, using a contract for deed and possible tax consequences. Significantly, Mr. Aaron testified that the properties "were intended to be a long-term investment."

The Supreme Court also noted, in its opinion, "We do not hold that in a proper case, where the sale of the real estate is required or is likely to occur within a short time after the dissolution, that the court should not consider tax consequences - - indeed it should."

**AUTHOR'S COMMENT:** Generally, courts are not willing to speculate about tax consequences or other potential costs in the future. As an example the owner may be able to do a Section 1031 tax free exchange in which no tax is due upon sale, noting however you are postponing only the due date, not the taxes.

### **PRACTICE TIP:**

Based on the trial court's opinion (as well as the Supreme Court's opinion in Aaron v. Aaron), if the property needs to be sold as part of the dissolution, all costs, including taxes, should be deducted from the net value. If the intention is to hold the properties, no deductions for commission or taxes should be made as these are deemed to be too speculative.

**AUTHOR'S COMMENT:** Normally, the issue of discounts for selling costs and/or taxes will be handled by the business valuation expert or accountant rather than the real estate appraiser. The real estate appraiser only values the property and, in this case, the specific interest owned must be also appraised. Additional information related to taxes is contained in Chapter 10.

## **§7.10 VALUING A PARTIAL (FRACTIONAL) INTEREST IN REAL ESTATE**

With respect to valuing a fractional interest in real estate, there are some additional considerations necessary when approaching the valuation process.

In the case of stock ownership of a publicly-owned actively-traded corporation, the market value of the subject ownership interest is a known quantity at a given point in time (i.e., the public market exchange price). The market values of publicly-owned corporations represent the collective judgment of actual and potential buyers and sellers of a given stock.

Because an undivided interest in real estate is privately owned and/or inactively traded, the market value cannot so readily rely upon the collective judgment of buyers and sellers, as the basis of valuation. In such cases, the accepted

techniques of valuation analysis (found in I.R.S. Revenue Ruling 59-60) include eight primary factors recognized by the Internal Revenue Service and Judicial rulings, like Nardini v Nardini, the seminal Minnesota Supreme Court Case involving valuation issues.

Each of the following factors (not necessarily an all inclusive list) requires careful analysis.

1. Nature and history of the enterprise
2. General economic and industry outlook
3. Book value and historic financial condition (balance sheet analysis)
4. Earning capacity (financial statement analysis)
5. Dividend paying capacity
6. Goodwill and other intangible values
7. Any sales of stock and size of the stock holding valued
8. Market prices of comparable or similar actively traded companies

Because the above factors outline the strategy for a basic business valuation, not all apply directly to the valuation of an undivided interest in real estate. However, consideration should be given where applicable. With regard to the valuation of a fractional undivided interest in real estate, the net market value of a 100% ownership interest in the property is determined first. From the 100% ownership interest market value, the appropriate discounts are taken to reflect the fractional interest position. As an example, a 50.0% undivided interest in a residential home is the subject of an appraisal. The residential home has an estimated 100% ownership market net value of \$2,700,000 less all debt and liabilities.

From the 100% ownership interest net market value, we next examine all discounts which may pertain to a 50.0% undivided interest, and find that a fractional interest and various lack of marketability discounts are applicable in this instance. A fractional interest refers to a property owner's ownership of less than 100% of the fee interest, which fractional interest is inadequate to exercise de facto operating control of the subject property without obtaining the agreement of the other owners of undivided interests in the property. In the present example, the interest is an undivided 50.0% interest. As a result, such an undivided interest owner retains only a right to seek to partition the property and shared use and control of the real estate. Therefore, a fractional interest discount (in business valuation, this is commonly called a minority or lack of control discount) is taken from the pro rata share of the entire pro rata interest to reflect the absence of the exclusive power of control on the partial interest

and the fact that the subject undivided interest would be less marketable than a 100% full ownership interest.

The second discount, if applicable, is due to the lack of marketability. A lack of marketability discount is taken to reflect a difference in liquidity between the undivided interest being valued and the object of comparison. For example, if privately-held stock is being valued based on a comparison to publicly-traded stock (which is not the case in this instance), a discount for lack of marketability would be necessary to reflect the difference in liquidity. In the valuation of a undivided interest in real estate, a lack of marketability discount would be applied in general to reflect the increased difficulty (time and cost) in selling such an undivided interest rather than the fee ownership interest. In this example, the subject undivided interest is such a partial undivided interest, and as a result, a discount for lack of marketability would be warranted as well.

Tenancy in common presents a unique ownership relationship as all tenants are technically owners and have full rights to use the property, provided their use of the property does not materially infringe on any of the other tenants' use of the property. At the same time, despite having full use of the property, no one interest has single-handed control of the property. Control in a tenancy in common situation is shared among all interest holders since they all must approve significant actions affecting the property such as a sale. That being said, any interest, no matter how small, has the ability to block any move desired by the remaining interest holders.

Since the subject interest is less than 100%, control of the property is shared with the other interest holders, each of whom has the power to block major actions affecting the property. The term "shared" in this sense can be understood as control which has been apportioned among the interest holders according to ownership. In other words, since the approval of all interest holders is required for major actions, a 50.0% interest would be termed "minority interest" as it does not have control. On the other hand, as an undivided interest rather than a more formal partnership or corporate interest, the owner retains a right to seek to partition the property. Effecting partition would require legal expenses and time which renders the property interest somewhat less marketable, and such holder would have less than shared control of the property during the interim. Notwithstanding his or her limited rights to control the property's use, however, the holder of the subject undivided interest nevertheless is obligated pay 50.0% of all costs necessary to maintain and improve the real property, including real estate taxes, assessments, maintenance, and repairs and would also receive 50.0% of all revenues or income. Therefore, the fractional interest discount that applies to the subject is less than the lack of control discount applied to real estate holding companies or businesses.

Regarding the lack of marketability discount, it is our opinion that this discount would also apply. Since the asset in question is an undivided fractional interest

in real estate property, it enjoys more rights if it is dissatisfied with management than would a minority interest in an operating business, which tends to reduce the applicable marketability discount. Further, the 100% ownership value of the real estate is reported at market values, with risk components related to real estate already being considered within the 100% valuation. Thus, lack of marketability considers only the excess lack of marketability resulting from restrictions resulting from an undivided fractional interest, since many aspects of the real estate market are already considered in the valuations as well as within the fractional interest discount. Again the lack of marketability discount that applies to a subject undivided interest is less than the discount applied to real estate holding companies or businesses.

## **§7.11 ATTORNEY PREPARATION AND SELECTION OF APPRAISER**

### **7.11.1 Sources of Information**

It is essential that the attorney know the law applicable to the use of the valuation approaches (see §7.7) in the relevant jurisdiction. For litigation cases, in particular, the attorney needs a more in-depth knowledge of the appraisal process and the limitations imposed by the courts in that jurisdiction relating to the type of appraisal testimony that may be offered. Determine what the courts have said as to relevant legal principles impacting valuation for the specific type of litigation involved. Read the *Appraisal of Real Estate* (12<sup>th</sup> ed. Chicago; Appraisal Institute, 2001) and *Real Estate Valuation in Litigation* (2nd ed. Eaton, J.D., Chicago, Appraisal Institute, 1995.) Other specialized texts published by the Appraisal Institute may also be relevant.

**AUTHOR'S COMMENT:** The appraiser must look to the attorney to advise him/her of special legal issues or requirements that must be considered.

#### **Practice Tip:**

Discuss with the appraiser any difficult issues in the subject case. Review articles on emerging appraisal issues. This is especially relevant if the subject property is a special use property.

Many sources are available for the attorney to use in developing a list of potential appraisers to be retained. These include, but are not limited to:

- Other attorneys who practice in that area of law and area of the state where property is located.
- Professional groups in the appraisal field offer designations to those who meet their requirements. Consider reviewing the Appraisal Institute (MAI) membership list for Minnesota (or other state in which you are working) and those of other appraiser associations such as the American Society of Appraisers (ASA). It is helpful to understand the basis of some of the more common professional designations.

MAI - Member of the Appraisal Institute: This designation is sponsored by the Appraisal Institute. It is the highest designation conferred by this organization and is given to appraisers who are qualified to evaluate all types of real estate.

SRPA - Senior Real Property Appraiser: These appraisers are qualified to evaluate all different types of real estate, but this designation has been phased out over the last ten years. The number of SRPA designations is declining as people retire from the industry. Eventually, the SRPA designation will no longer exist.

SRA - Senior Residential Appraiser: This designation (previously sponsored by the Society of Real Estate Appraisers) is now sponsored by the Appraisal Institute and indicates that an individual is qualified to evaluate single-family homes. It is the highest residential designation offered by the Appraisal Institute and will continue to be conferred for many years to come.

CRE - Counselor of Real Estate: This is a designation sponsored by the American Society of Real Estate Counselors. It is awarded to real estate experts who display unique knowledge of the market and is conveyed by invitation only. It is recognized by real estate experts as one of the highest expert designations to be achieved after many years of experience. Some consider this to be the most difficult designation to obtain.

ASA - American Society of Appraisers: The American Society of Appraisers sponsors the ASA designation which is given to real estate and business valuation experts who are qualified in many different types of valuation. The ASA sponsors six principal different types of designations, but all appraisers have the same ASA letters after their names. The attorney should always ask how the ASA designation was obtained. Occasionally, an individual has an ASA designation with a

specialty in an area other than real estate, yet the witness is being qualified as a real estate expert. This may lead to some fertile cross-examination. An ASA designation is common among machinery and equipment appraisers.

CBA – Certified Business Appraiser: This designation is conferred by the Institute of Business Appraisers. The MCBA (Master Certified Business Appraiser) is the IBA's highest designation awarded only to those qualified business appraisers who have been evaluating businesses for many years.

AUTHOR'S NOTE: Most professional associations have a candidate status for each of the designations mentioned above. It is unethical for candidate to make reference to the designation

- Yellow pages (CAUTION: sometimes the biggest ads are by the least experienced appraisers).
- Real estate brokers in that area of the state where property is located. (CAUTION: brokers are not appraisers and may be prohibited by law from offering opinions of value).
- Financial institutions in that area of the state where property is located.
- Your client is also a valuable resource - careful inquiry should be made about any earlier valuations. If you have a working relationship with a local appraiser, ask that appraiser to help you find the right appraiser in the area.
- Other experts may be needed. It is very common for an appraiser to request the assistance of additional, outside experts to complete the valuation. The appraiser is not an expert in every area. Examples of other experts often utilized by appraisers are as follows:

Planning firms - to lay out plats for undivided land. To prepare concept plans illustrating highest and best use. Probability of rezoning or reguinding.

Engineers - to estimate the costs of utilities and roads in subdivision developments.

Surveyors - to accurately measure the land area being appraised.

Realtors/Brokers - to assist in current market information on leasing, sale activity, or general market supply and demand factors.

Traffic experts - to evaluate the impact of traffic on safety standards and circuitry of access.

Statisticians - to educate the court on the appraiser's use of statistical models that are used in mass appraisal evaluation.

Fixture appraisers - to assist in the valuation of immovable fixtures. They can also help determine what is personal property and what is real estate.

Business appraisers - to estimate the value of a business operation or going concern.

Experts on geotechnical, environmental and wetland issues.

### **7.11.2 Process of Interviewing the Appraiser**

What does the attorney look for (generally) in an appraiser when interviewing a prospective appraiser? First of all, there should be no conflict of interest from attorney's perspective: discuss property, parties, and attorneys involved. Appraisers generally do not have a conflict of interest because the opinion of value should always be the same regardless of what parties are involved; attorneys may have a different view. Next, the attorney must assess the basics of a good fit with the candidate by reviewing his/her:

- **General experience with the specific type of property in the area.** Examples include: industrial, commercial, multifamily, single family residential, vacant and developed properties. Specific experience as to specialized property if relevant (e.g. sand and gravel pits, parking lots and ramps, gas stations, car dealerships, etc.) Ask for specific examples and names of clients or attorneys involved. Require a list of references. Call to confirm experience and outcomes.
- **Ability to write a well reasoned and thorough appraisal report.** Obtain and read examples from the appraiser as to specific type of property involved.
- **Credentials as a professional.** Verify that the appraiser is licensed to perform the type of appraisal requested and is current for the state in which the appraisal is to be used. If an appraiser has a Minnesota license, the appraiser must apply for reciprocity to another state and receive a temporary license. The temporary license must be referenced in the appraisal and the temporary license number should appear under the signature block. Have any ethics charges ever been filed against the

appraiser; what were they and what were the results thereof? Are there any pending charges? Check with the Department of Commerce for the State of Minnesota (or other state involved). Know the rules by which the appraiser must abide.

The minimum education experience, examination requirements and standards are set by the Appraisal Qualifications Board (AQB) and are enforced by the individual states. The AQB, a division of the Appraisal Foundation created by Congress, has established two separate classifications for appraisers.

The Certified Residential Classification requires 200 hours of instruction and 2,000 experience hours over a period of at least 12 months as well as an Associate Degree or 21 credit hours.

The Certified General Classification requires 300 hours of instruction and 2,000 experience hours over a period of at least 12 months as well as a Bachelor Degree or higher.

- **Ability of the appraiser to complete assignment on schedule.** Expect, at a minimum, that a timeline for the following items is clearly addressed: preliminary value letter; draft appraisal for the attorney's review to identify any factual or legal errors; and final appraisal. Discuss the availability of the appraiser for consultation, hearings and trial, etc.
- **Access to support staff and resources.** Does the appraiser use support staff to do some of the "leg work"? Does the appraiser rely unduly on work done by staff? Is affiliation necessary for this appraiser with another appraiser (not in same office) in order to complete the assignment? What non-appraiser experts must be hired to provide information or opinions on which the appraiser must rely in order to complete the assignment?
- **Cost of services.** This is a very important part of any engagement. Discuss the hourly rate for each person involved as well the average overall hourly rate for assignments of this type. Set a fee or fee range for each major step (phase) of the appraisal process. Agree on a payment date: when task completed, or after loan closed or case over, etc. Obtain and read a proposed retainer agreement and the proposed conditions of the appraisal (disclaimers) so there are no surprises later.

Understanding how appraisers estimate fees for financing or litigation appraisals is another area which deserves attention. Certain types of appraisals are more involved than others and will, therefore, be more costly. A financing appraisal is generally a single-phase project that results in an estimate of value. A litigation appraisal usually involves two phases. The first phase concerns itself with the evaluation of the problem and the resulting value, which are generally reported on a verbal basis.

Phase II involves the preparation of a written narrative report that will be used in litigation.

Fee structures for appraisers are similar to those of other professionals such as CPAs, attorneys, and management consultants. Each individual appraiser has an hourly billing rate which is used in estimating the amount of time needed to complete an assignment. It is reasonable for an attorney to ask what an appraiser's hourly billing rate is and approximately how many hours it will take to complete an assignment. The fee quote should tie into the budget set forth by the appraiser in terms of total hours and hourly billing rate. Attorneys should request written fee proposals from appraisers when requesting assignments in excess of \$1,000 in fees. The letter should include a clear explanation of the scope of the assignment and the fee to be charged. Furthermore, this letter may be used to make a request for the information needed to conduct the appraisal.

When conducting litigation assignments, the appraiser and attorney should discuss the number of pre-trial meetings that will be needed so that these costs can be included in the fee estimate. Oftentimes, client meetings are billed over and above the cost of conducting the appraisal. The typical hourly fee for a Senior Appraiser/Manager in the Twin Cities ranges from \$275 to \$375 or more. Senior Appraisers who do not have supervisory responsibilities generally bill between \$150 and \$250 per hour. Typical Staff Appraisers, with approximately five years of experience, generally bill between \$110 and \$150 per hour. It is unethical, under most Appraisal Standards, for an appraiser to work on a contingent fee basis.

**Practice Tip:**

It is wise to have a written retainer agreement between the appraiser and the client so that the attorney is not liable for the bill.

**Practice Tip:**

The attorney should work to ensure that the bill is paid by the client. If the client refuses to pay a valid bill, the attorney will have a difficult time employing that appraiser in the future!

**7.11.3 Lending Institution Requirements**

The attorney may have additional questions for the appraiser should the attorney wish to use the real estate appraisal to obtain a loan to fund part of the divorce settlement. When this is the case, rely on experience with specific lending institutions for guidance. Is the appraiser on the approved appraisal list as required by the lending institution? Obtain this list from the lending institution. Discuss acceptability of the potential appraiser with the lending institution. If the appraiser is on the list, does the lending institution use him/her? Who will be the review appraiser, if any, for the lending institution? If

this is a Federally-regulated lending institution, the lending institution selects the appraiser, hires the appraiser and is the recipient of the appraisal. The appraiser may not share the appraisal with the applicant for the loan without approval from the lending institution.

**Practice Tip:**

Federal financial regulatory agencies have set de minimis levels, which are currently at \$100,000 for all loans that involve federal financial agencies. Any loan of \$100,000 or greater must be supported by an appraisal performed by a licensed appraiser who is on the FHA appraisal roster.

**7.11.4 The Attorney – Appraiser Relationship**

In addition to understanding the mechanics of hiring a good appraiser, the experienced attorney considers how his/her own behaviors positively or negatively affect the appraisal process. An attorney who facilitates the timely gathering of necessary information and, ultimately, allows the appraiser to estimate value is using the expert wisely. He/she may also provide relevant case law pertaining to the specific valuation situation at issue and will interface with the client and the appraiser to facilitate the appropriate fee arrangements (i.e., obtaining the proper written authorization from the client and, if necessary, payment of the appraisal fees). The smart attorney always inspects the subject property with the appraiser in litigation situations. Likewise, he/she conducts an extensive, constructive review of the appraisal and provides observations regarding its strengths and weaknesses, comments on the methodology used, etc. The proactive attorney helps the appraiser prepare for direct and cross examination and assists the appraiser in retaining additional experts as needed to assist in the valuation process.

An attorney who dictates a value or desired valuation result and does not provide enough time to properly conduct the appraisal is thwarting the appraisal process. Sometimes, the attorney is uncooperative in gathering information or will not provide access to other necessary experts. It is not uncommon for the attorney to ask the appraiser to critique another appraiser's report while in the courtroom, in front of the judge or jury. Most appraisers are more than happy to help the attorney critique another appraiser's report, but those efforts should stay out of the courtroom.

**§7.12 LITIGATION INVOLVING REAL ESTATE VALUES**

**7.12.1 Special Considerations – Selection of Real Estate Appraiser**

The attorney may also have questions for the appraiser relating to litigation cases. Does he/she have prior litigation experience? What cases? What results? Which attorneys were involved? Talk to the attorneys to make sure the appraiser can do the job. Does the appraiser have the ability to effectively educate a jury, judge or arbitrators as to the appraisal process used; the ability to persuade those who try the facts and the ability to respond adequately to cross-examination? Does the appraiser understand the special legal or factual issues involved?

- What effective strategies does he/she use during the appraisal process and testimony?
- Is the appraiser willing to review the opponent's appraisal, assist in preparation of discovery and cross-examination, and, possibly, testify in the rebuttal case as to flaws in the opponent's appraisal?
- Will the appraiser be a strong advocate for his/her opinion of value or damages at hearing or trial or before arbitrators?
- Is the subject appraisal consistent with prior appraisals on similar properties or issues? Do articles, speeches, past depositions and previous court transcripts of the appraiser reflect this consistency?
- Does the appraiser fully acknowledge all publications and reference materials consulted? It is important to acknowledge sources and not mislead the reader about the originality of the appraisal. Plagiarism has become an important issue for the court system and it is a violation of the USPAP ethics/standards.

It is also important for the attorney to give some thought to the opposing attorney's likely assessment of the ability of the appraiser and whether this will have an impact on settlement. There is a definite advantage to residing in the area where case will be tried (a high-powered suburban appraiser may not be the best fit for a rural community). Consult the local attorneys. Are there local experienced appraisers available? Is it possible to use a local appraiser or realtor in addition to the non-local appraiser? In any event, hire the best qualified and most experienced appraiser, almost regardless of cost. Make sure that the client will pay for an in-depth analysis. Inexpensive appraisals are often weak appraisals. An experienced appraiser is especially crucial if the attorney is not experienced in valuation matters.

In litigation cases, success may depend upon the attorney's selection of and interactions with the appraiser. The appraiser must have sufficient experience in appraising properties similar to the subject property and be vigilant when gathering comparable information (i.e., personally verifying sale transaction data). Often, the appraiser and attorney have not spent enough time reviewing the appraisal together and do not have a mutual understanding of the appraisal

process. Some appraisers do not understand that a standard appraisal is not applicable in litigation. There are “standard” appraisals and then there are “litigation” appraisals. The appraiser selected should have credibility with the fact finder(s) or report reader(s). Credibility is often the result of being viewed as impartial. In condemnation cases, appraisers who work for both the condemning authorities and the property owners tend to have more credibility.

Avoid hiring an appraiser who is technically competent, but ineffective as a witness. Selection of an appraiser who will never admit to being wrong or making a mistake is not realistic. Select an appraiser who listens to the questions and directly responds without over-elaborating.

It is important that the appraiser has access to the relevant market data and is realistic regarding the delivery schedule for the appraisal, thus avoiding additional expense and delays. The appraiser and attorney must clearly communicate the valuation principles upon which the appraisal is to be conducted (i.e., value in use versus value in exchange). Appraisers are required to identify all who assisted in the preparation of the appraisal and he/she must indicate the type of report being prepared and why it is appropriate in this instance. (CAUTION: Do not confuse the tangible value of real estate with the intangible nature of a business enterprise).

### **7.12.2 Working with the Selected Real Estate Appraiser**

Once the appraiser is selected, the attorney should inspect the property and neighborhood with the client and the appraiser as well as review all material from the client. Any unique circumstance found should be discussed. Gather as much information as possible including that from prior appraisals. Discuss any relevant legal issues impacting valuation. Find out what additional information the appraiser needs (will other experts be necessary?) and determine who is to obtain it. Determine the date of valuation. Discuss the appraiser’s preliminary understanding of facts, applicable law, and request an oral opinion of range of values.

If the appraiser’s factual understanding and oral preliminary range of value appear to be reasonable, have the appraiser proceed to complete an unsigned draft written valuation analysis addressed to the attorney. If the client and attorney disagree with range of value, try to find out if the client, attorney or appraiser disagrees with the accuracy of relevant facts and/or relevant legal principles. If the client believes the appraiser is not capable of understanding the true value of the property, consider selecting another appraiser. In some cases, the attorney may decide not to represent the client further.

Once the draft of the appraisal is received, review it with your client to see if there are any: mistakes of fact; mistakes of law or mathematical errors. Verify that the report is clear and concise; that the supporting documentation is adequate; and the stated appraisal assumptions are reasonable. It is

imperative that the attorney be provided with the draft sufficiently in advance so that this review can be carefully done. The attorney should then review the identified areas of concern with the appraiser. Both the attorney and the client should inspect comparables used by the appraiser to determine how relevant they are as well as assess the appropriateness of adjustments made by the appraiser.

The appraiser is and must be an independent expert. However, the attorney and client have the right (and also an obligation) to review the appraiser's work for mistakes and weaknesses. Agree upon the date by which the final appraisal should be completed. Delays are to be avoided. Discuss with the appraiser what information the appraiser believes is relevant to be sought through interrogatories, request for admissions and/or depositions. Timing of discovery should be coordinated with the due date of the appraisal. Prepare the appraiser for direct examination and cross-examination as appropriate.

### **7.12.3 Trial Considerations and Tactics**

It is useful to have some general guidelines for how much time it takes to complete an appraisal assignment. The typical financing appraisal takes four to six weeks to complete, while a typical litigation assignment may take four weeks for a Phase I (verbal opinion) and an additional four weeks for a Phase II (written report) suitable for testimony. Complicated litigation appraisal assignments often take much longer. It helps to be aware of the following situations when preparing for trial.

If an attorney has reviewed an appraisal report and does not have questions or comments, it is a bad sign. It usually means that he or she did not understand the appraisal report in the first place, or that the report was, in fact, not read at all. If the direct testimony occurs smoothly, the attorney probably understands the appraisal as well as the appraiser does. On the other hand, if the direct testimony is choppy, it is likely that the attorney is reviewing the appraisal report for the first time while conducting the direct examination. (CAUTION: Sometimes direct examination is worse than cross-examination if the attorney did not understand his or her own witness' report).

The toughest cross-examination comes from a knowledgeable attorney who understands the appraisal as well as the appraiser. Usually, the opposing attorney will avoid asking open-ended questions and will resist posing a last summary question. Summary questions often provide an appraiser with a welcome opportunity to elaborate and, possibly, close the door on the attorney's strategy. Often, wise attorneys finish their arguments in briefs or closing arguments, as opposed to trying to accomplish them in cross-examination.

## **§7.13 THE USE OF NEUTRALS IN DIVORCE CASES**

A recent trend is the use of neutrals as an alternative to litigation. In certain circumstances, the parties will provide for the use of neutrals as a means of determining the property value to avoid the uncertainties that frequently accompany court proceedings involving real estate or business valuations and to save money. Qualifications are extremely important when selecting the proper neutral for the job. The neutral should have some experience with the geographic region and the type of property involved, as well as the ability to make decisions in a timely fashion. Additionally, it is desirable for him/her to be persuasive, organized and well-respected by peers.

Appraisers originally thought that being hired as a neutral was less confrontational as both sides would simply accept the neutral's value. In many of the larger cases where an appraiser is hired as a neutral valuation expert, the valuation becomes much more detailed because you are serving two clients who may even hire a review appraiser to challenge the neutral's value. Extra due diligence is needed with a neutral report as both sides' review experts and attorneys' must understand the appraiser's rationale in coming to the valuation conclusion.

Both attorneys working with a neutral should be able to sit down and cross examine the neutral as to the rationale for the approaches to value and the ultimate value conclusion.

## **§7.14 MAKING THE APPRAISAL MORE PERSUASIVE**

In 1995 Bruce Malkerson, Mark Savin and Marilyn Michales presented to a seminar the results of a survey they had sent to 370 condemnation commissioners throughout the State of Minnesota. 109 commissioners responded. Following, are summary conclusions developed from the responses. They are relevant not only as to condemnation commissioners, but also, with few exceptions, as to juries, judges, neutrals and arbitrators.

- Most commissioners usually visit comparable properties identified in the proceeding. (This may not be true in divorce litigation or mediation. Therefore the appraisal must be user friendly with maps and photos.)
- Most commissioners frequently use their own files and sources for information about properties identified as comparables. (This is not true in divorce cases as the finder of fact is not as knowledgeable as the commissioner and will rely on the appraisers.)
- More than half of the commissioners use their own files and sources to find properties that should be used as comparables even if not

identified in the hearing and they inspect those comparables. (Again, this is not true in divorce as the fact finder will rely on the information provided by the appraiser.)

- Most commissioners are more persuaded by an appraiser who has prepared his own report, visited the comparable properties and has previously testified about similar kinds of property than by one who has not.
- Most commissioners believe that effective cross-examination does not nit-pick.
- Most commissioners rely on their own inspections of comparable properties and frequently rely on information not presented at the hearing, e.g. their own experience and knowledge. (Again this is not true in divorce cases as the finder of fact will rely on the evidence from the appraiser but will insert their own perspective into the decision.)
- Most commissioners are skeptical of adjustments to comparables that exceed 20% and would rather see a few good comparables than many comparables with large adjustments. Most commissioners believe that a derived cap rate is most persuasive.
- Most commissioners will pay attention to a comparable which has sold even if the sale has not yet closed and are skeptical of comparables that have environmental problems regardless of any adjustment as well as those for which the zoning is not described in detail and in terms of its specific classification under the zoning code.
- Most commissioners believe that all three approaches to value should be used, but do not favor valuations which result from a forced reconciliation of the three approaches.
- Most commissioners believe the development cost approach is an effective check on the market approach, but, on its own, it is usually too complicated to be effective. Most commissioners object to the appraiser's using only the highest comparable sales for a conclusion of value ("high balling"), or using only the lowest comparable sales ("low balling").

## **§7.15 CONCLUSION**

When retaining an appraiser, it helps if the attorney has a clear idea of the purpose of the appraisal. What valuation principles apply? Is this a "value in use" or "value in exchange" appraisal? What standard of valuation

applies? Is it “fair market value” or “fair value”? Valuation is a fascinating subject because, like beauty, value is in the perception of the beholder. Despite the subjectivity surrounding the issue of valuation, we continually strive to measure value precisely and objectively.

There are valuation techniques available which are generally recognized and accepted by the appraisal profession and the courts. It helps if the attorney and the appraiser review what valuation format is needed and what functions the appraiser may legally perform (i.e., financing engagements versus litigation assignments). Who ultimately needs the appraisal (i.e., the bank, the court, the city council, arbitrators, etc.) will affect the technique the experienced appraiser uses to present his/her opinion. Each assignment is unique. Although earlier valuation cases may provide guidance, one case is rarely on point with another, and a thorough review of the facts will usually reveal significant differences.

In valuation, there are no absolutes. There are general guidelines to which individual judgments must be applied; there is no irrefutable “right” answer and the experts will and do differ. If the attorney and the appraiser communicate with each other fully, the chances of obtaining a positive outcome are immeasurably improved.

## EXHIBIT A

### STANDARDS RULES 2-2 AND 8-2 REPORT COMPARISON CHART:

The essential difference among the three options is in the use and application of the terms “describe,” “summarize,” and “state.” “Describe” is used to connote a comprehensive level of detail in the presentation of information. “Summarize” is used to connote a more concise presentation of information. “State” is used to connote the minimal presentation of information.

a) Self-Contained Appraisal Report	b) Summary Appraisal Report	c) Restricted Use Appraisal Report
i. state the identity of the client and any intended users, by name or type:	i. state the identity of the client and any intended users, by name or type;	i. state the identity of the client by name or type; and state a prominent use restriction that limits use of the report to the client and warns that the appraiser’s opinions and conclusions set forth in the report may not be understood properly without additional information in the appraiser’s workfile;
ii. state the intended use of the appraisal;	ii. state the intended use of the appraisal;	ii. state the intended use of the appraisal;
iii. describe information sufficient to identify the real estate or personal property involved in the appraisal, including the physical and economic property characteristics relevant to the assignment;	iii. summarize information sufficient to identify the real estate or personal property involved in the appraisal, including the physical and economic property characteristics relevant to the assignment;	iii. state information sufficient to identify the real estate or personal property involved in the appraisal;
iv. state the property interest appraised;	iv. state the property interest appraised;	iv. state the property interest appraised;
v. state the type and definition of value and cite the source of the	v. state the type and definition of value and cite the source of the	v. state the type of value, and cite the source of its definition of value pertinent to

<p>definition;</p> <p>vi. state the effective date of the appraisal and the date of the report;</p> <p>vii. describe the scope of work used to develop the appraisal;</p> <p>viii. describe the information analyzed, the appraisal methods and techniques employed, and the reasoning that supports the analyses, opinions, and conclusions; exclusion of the sales comparison approach, cost approach or income approach must be explained;</p> <p>ix. state the use of the property existing as of the date of value and the use of the real estate or personal property reflected in the appraisal; and, when an opinion of highest and best use was developed by the appraiser, describe the support and rationale for that opinion;</p> <p>x. clearly and conspicuously state all extraordinary assumptions and hypothetical conditions; and that their use might have affected the assignment results; and</p> <p>xi. include a signed</p>	<p>definition;</p> <p>vi. state the effective date of the appraisal and the date of the report;</p> <p>vii. summarize the scope of work used to develop the appraisal;</p> <p>viii. summarize the information analyzed, the appraisal methods and techniques employed, and the reasoning that supports the analyses, opinions, and conclusions; exclusion of the sales comparison approach, cost approach, or income approach must be explained;</p> <p>ix. state the use of the property existing as of the date of value and the use of the real estate or personal property reflected in the appraisal; and, when an opinion of highest and best use was developed by the appraiser, summarize the support and rationale for that opinion;</p> <p>x. clearly and conspicuously state all extraordinary assumptions and hypothetical conditions; and that their use might have affected the assignment results; and</p> <p>xi. include a signed</p>	<p>the purpose;</p> <p>vi. state the effective date of the appraisal and the date of the report;</p> <p>vii. state the scope of work used to develop the appraisal;</p> <p>viii. state the appraisal methods and techniques employed, state the value opinion(s) and conclusion(s) reached and reference the workfile; exclusion of the sales comparison approach, cost approach, or income approach must be explained;</p> <p>ix. state the use of the property existing as of the date of value and the use of the real estate or personal property reflected in the appraisal; and, when an opinion of highest and best use was developed by the appraiser, state that opinion;</p> <p>x. clearly and conspicuously state all extraordinary assumptions and hypothetical conditions; and that their use might have affected the assignment results; and</p> <p>xi. include a signed</p>
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certification in  
accordance with  
Standards Rules 2-3  
or 8-3.

certificate in  
accordance with  
Standards Rule 2-3 or  
8-3.

certificate in  
accordance with  
Standards Rule 2-3 or  
8-3.

Comments have not been included in this chart

