

Legal Instructions

Litigation, USPAP & Appraisal
Institute Standards

By Ted Whitmer, MAI CCIM
Attorney

The Family



The Confusion...

USPAP – e.g. should adjust from the date of sale, not “meeting of the minds.”

Law – may tell you to adjust from the meeting of the minds

Practical – may be some other date if extended exposure times

Generally accepted practices – may be different in different areas of the country

Attacking & Defending an Appraisal Model

▣ Appraiser

- Competency
- Ethics
- Compared to the other appraiser
- Presentation
- Consistency

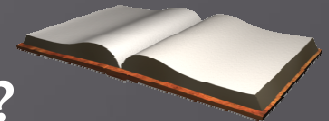


▣ Appraisal

- Standard 1 Checklist
- Recognized methods & techniques
- Premises or Assumptions
- Support
- Judgment

▣ Appraisal Report

- Standard 2 Checklist
- Assumptions reported
- Math errors
- Discoverable?
- Admissible?



▣ Appraisal Review

- Is it a review?
- Standard 3-1 checklist as to the review
- Standard 3-2 checklist as to the review report



Assignment Conditions In General – From USPAP Scope Rule

An appraiser must not allow assignment conditions to limit the scope of work to such a degree that the assignment results are not credible in the context of the intended use.

Comment: If relevant information is not available because of assignment conditions that limit research opportunities (such as conditions that place limitations on inspection or information gathering), an appraiser must withdraw from the assignment unless the appraiser can:

- modify the assignment conditions to expand the scope of work to include gathering the information; or
- use an extraordinary assumption about such information, if credible assignment results can still be developed.

An appraiser must not allow the intended use of an assignment or a client's objectives to cause the assignment results to be biased.

Assignment Conditions In General – From USPAP Conduct Rule

An appraiser must perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests.

An appraiser:

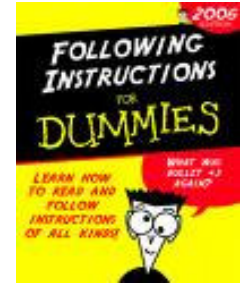
- **must not perform an assignment with bias;**
- **must not advocate the cause or interest of any party or issue;**
- **must not accept an assignment that includes the reporting of predetermined opinions and conclusions;**

Assignment Conditions In General – From USPAP Management Rule

An appraiser must not accept an assignment, or have a compensation arrangement for an assignment, that is contingent on any of the following:

- 1. the reporting of a predetermined result (e.g., opinion of value);**
- 2. a direction in assignment results that favors the cause of the client;**
- 3. the amount of a value opinion;**
- 4. the attainment of a stipulated result (e.g., that the loan closes, or taxes are reduced); or**
- 5. the occurrence of a subsequent event directly related to the appraiser's opinions and specific to the assignment's purpose.**

Should you Take Legal Instructions?



- You must take legal instructions!!!
- There are minimum instructions that must be given from the lawyer(s) to the appraiser(s).
 - “I don’t want to lead you, just appraise this property.”
- Many lawyers, if not most, do not want to give the appraiser instructions in writing
- The instructions do not have to be, in a sense, reasonable for the appraiser to take the instructions
 - Does not have to be likely to happen in the foreseeable future
 - Does not even have to be the “as is” of the property --- we often appraise without ever coming to the “as is” value of the property.
 - There are common sense limitations though!

- An Arizona attorney was in chambers with opposing attorney to handle pre-trial details.

- When he was leaving he told the judge...

“The only reason the appraisers are \$1,000,000 apart is because of the instructions we gave them!”

- The judge called them back into chambers and ordered the attorneys to cross up their witnesses and give the other appraiser the same instructions.
- The case ended when there in fact was no difference except for instructions!!!



Case That Went Away...

Appraised Value \$

Date

Definition
of Value

Property
Interest

Property

Other:
Hypothetical
Extraordinary
Assumption
Legal
Requirements

Anatomy of a Value...

Adjustment to Comparable Sales

As of Date of Sale

- Conditions of market value
 - Cash equivalency
 - Other
- Property rights in sale, not in subject
- Other assignment conditions
- Property

Time

1. Market conditions
2. Inflation/deflation

As of Date of Appraisal

Property rights in subject not in sale
Other differences known as of appraisal date.

We should adjust for assignment conditions...

Premises or Assumptions

- ▣ Date of the Appraisal
- ▣ Definition of Value
- ▣ Property Interest to be Appraised
- ▣ The Property to be Appraised
- ▣ Other Assignment Conditions
 - Extraordinary assumptions
 - Hypothetical conditions
 - Inclusion or exclusion of approaches
 - Legal requirements

- ▣ Jurisdictional Exception Does Not Usually Apply

FIRREA

Minimum Appraisal Standards

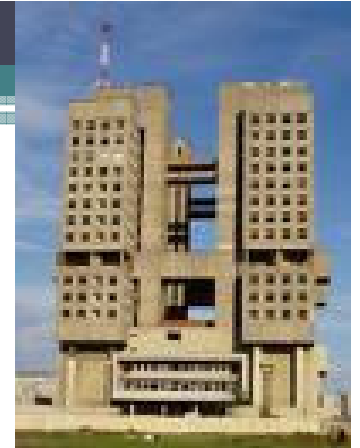
- Conform to USPAP
- Be written & contain sufficient information & analysis to support the institution's decision to engage in the transaction
- Analyze & report appropriate deductions & discounts for proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units
- Be based upon the FIRREA definition of market value
- Be performed by state licensed or certified appraisers

Date of Value



- ❖ East Texas Case That Went Away!
 - ❖ Appraiser had the wrong date of value
 - ❖ Whose fault was that???
- ❖ The date of value is a legal instruction to the appraiser.
 - ❖ It depends upon the case
 - ❖ Date of damages
 - ❖ Date of take
 - ❖ Date for property tax purposes
 - ❖ The date of value assumes that the property sold as of that date! The exposure time precedes the date.

Definition of Value



❖ Use value

- ❖ If a property can be tagged “special use” or “special purpose”, then the appraisal can be for a “use value”
- ❖ Can use value be greater than market value?
- ❖ This is basically saying the following...
 - ❖ There are limited comparables
 - ❖ Therefore, use value
 - ❖ Therefore, cost approach
 - ❖ Therefore, shift the burden of proof of functional obsolescence to someone else.

Interest to be Appraised

- Fee simple
 - All the interests in the property are intact except for the four limitations of government.
 - PETE – Police power, eminent domain, taxation, escheat
 - The definition has many more court cases left for a more workable definition
 - Does “fee simple” equate to market rent and market occupancy for a multi-tenant property?

Interest to be Appraised

- Fee simple, continued
 - The definition of fee simple does not say anything about market rent & market occupancy!
 - The assumption comes from the definition of “market value” but only implicitly
 - Because buyer and seller are well informed and acting in their own best interest, the courts will assume competent management & competent management usually means market rent and market occupancy for a multi-tenant property...
 - BUT NOT ALWAYS

Interest to be Appraised

- Fee simple, continued
 - **The appraisal of a house for purchase as a residence assumes no occupancy to be fee simple**
 - **A vacant tract can be appraised in fee simple and there may be no occupancy or rent assumption**
 - **Even a multi-tenant property, under a fee simple scenario, could have a different assumption than market occupancy. A building may have excellent management but lose their lead tenant. If you assume the occupancy assumption is from competent management, the property could be significantly under market occupancy yet satisfy the competent management assumption.**

Interest to be Appraised

- Fee simple, continued
 - Many have tried arguing that if fee simple is without an encumbrance then you should argue no occupancy --- this has not gotten far in the courts!

Interest to be Appraised

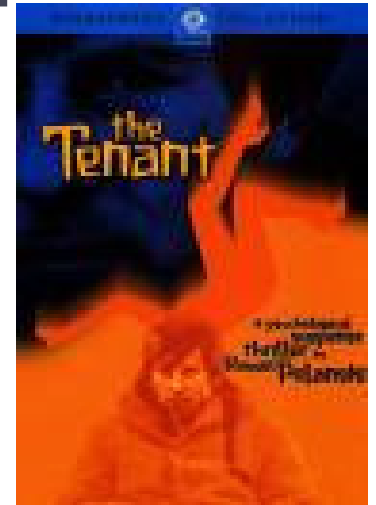
- Fee simple, continued
 - You cannot process leases in place to do a fee simple – this would be appraising the leased fee interest.
 - However, you can use the last leases signed as evidence of market rent (but not everywhere)!

Interest to be Appraised

- Leased fee
 - The leased fee estate is valued by taking the present value of the contract rents + the present value of a reversion.
 - The reversion does not have to be the same as if fee simple.

Interest to be Appraised

- Leasehold Interest
 - Tenant' interest in leased property
 - If paying market rent, has a leasehold estate but value is \$0
 - Cannot subtract fee simple value minus leased fee value!!!
 - Hawaii case tried that.



Property to Be Appraised

- Land
- Building
- Easement, etc.
- Legal description
- If owner chooses the “larger parcel” or “parent tract”



~~OTHER INSTRUCTIONS~~

Hypothetical & Extraordinary Assumptions

- (f) **identify any extraordinary assumptions necessary in the assignment;**

Comment: An extraordinary assumption may be used in an assignment only if:

- it is required to properly develop credible opinions and conclusions;
- the appraiser has a reasonable basis for the extraordinary assumption;
- use of the extraordinary assumption results in a credible analysis; and
- the appraiser complies with the disclosure requirements set forth in USPAP for extraordinary assumptions.

- (g) **identify any hypothetical conditions necessary in the assignment; and**

Comment: A hypothetical condition may be used in an assignment only if:

- use of the hypothetical condition is clearly required for legal purposes, for purposes of reasonable analysis, or for purposes of comparison;
- use of the hypothetical condition results in a credible analysis; and
- the appraiser complies with the disclosure requirements set forth in USPAP for hypothetical conditions.

~~Other instructions -~~

Condemnation

- Before & After
 - Neither is what the property is worth!
- Compensability
 - Proof has nothing to do with it!
- Benefits
 - Can offset damages & even part taken in Federal

Other instructions – Property Tax

- Value property in place in use
- Value as of the statutory date
- Value the fee simple interest
- However, equity arguments are made regardless of market value of property
 - Most equity reports I've seen are Appraisal Reports of

Other Instructions – Etc.

- Zoning
- Utilities
- Condition and quality of destroyed property
- Etc., etc. etc.
- **THIRD PARTY OTHER EXPERT REPORTS!!!**

Categories

General Informational Reports

General informational reports are usually descriptive in nature and provide information pertaining to an overall area. They include data on demographics, economic trends, and other such matters. They are not specific to the property being appraised.

Reports Prepared by Licensed or Certified Non-Real Estate Appraisal Professionals

Reports prepared by licensed or certified non-real estate appraisal professionals are specific to the subject property and may be either descriptive or factual in nature. They include engineering services, environmental studies, soil reports, impact studies, survey reports, zoning opinions, audited financial statements, and other reports relating to matters beyond the scope of appraisers' expertise, or services not typically offered by appraisers.

Reports Prepared by Other Non-Real Estate Appraisal Professionals

Reports in this category are prepared by experts who are not licensed or certified but have specific experience or expertise that an appraiser may rely upon. Examples include reports pertinent to the appraisal problem from academicians, operators of special use properties, and personal property valuers.

Other Reports

Other reports pertaining to the subject property may be prepared by the client, by another real estate professional, or by others. These reports include financial statements, rent rolls, prior appraisal reports on the subject property, highest and best use studies, rental surveys, computer programs (or other electronic media), cost studies, and others.

Third Party Reports

Guide Note 4 From The Appraisal Institute

Basis for Proper Evaluation

Before relying upon reports prepared by others the appraiser must consider:

1. the criteria under which the reports were prepared;
2. the source and extent of the instructions given to the preparer of the reports;
3. how the appraiser might rely on this information in making decisions and preparing his or her report; and
4. the process and procedures used to evaluate the reports prepared by others.

Third Party Reports

Guide Note 4 From The Appraisal Institute

General Informational Reports

General informational reports usually require limited verification. Most discrepancies are easily clarified.

Reports Prepared by Licensed or Certified Non-Real Estate Appraisal Professionals

Reports prepared by licensed or certified non-real estate appraisal professionals typically offer conclusions as to the adequacy of a specific property component or issue pertaining to the property. These conclusions are generally based on accepted procedures or standards and represent informed opinions on matters beyond the appraiser's expertise. Absent reasonable doubt, these reports usually can be accepted conditioned upon the qualification that they were prepared by recognized professionals. Should observed or apparent material discrepancies exist between the appraiser's investigation and the submitted report prepared by a licensed or certified non-real estate appraisal professional, such material discrepancies must be disclosed.

Reports Prepared by Other Non-Real Estate Appraisal Professionals

An appraiser's reliance on reports prepared by these experts is distinct from that of the preceding paragraph in the greater care the appraiser should exercise in determining the pertinent expertise of the author.

Other Reports

Other reports prepared by, or at the direction of, the client, other real estate professionals, or others, require a careful review for reasonableness. To the degree possible and practical, computer programs or other electronic media should be reviewed for errors or inconsistencies. The level of investigation should be appropriate to the problem. The appraiser must understand the assumptions on which these reports are based as well as their applicability and validity to the assignment.

Third Party Reports

- **They are a part of the assumption set.**
- **They create a chain problem – the strength of the appraiser is only as strong as the weakest link!**



Summary of Legal Instructions

- **Appraisers must take legal instructions!**
- **They must be reasonable from a practical standpoint (not from a legal standpoint)!**
- **They don't include what is against our ethics!**
 - **E.g. "Don't write a report"**

Question & Answer Period

1. Adjust meeting of the minds vs. Closing date
2. FIRREA vs. USPAP
3. USPAP doesn't define Market Value
3. Other
4. Market for market value
5. Paradox – Definition vs. market (duress)
6. Highest price vs. most probable price