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"HOW SOME APPRAISERS MIGHT VARY THE APPRAISAL PROCESS DEPENDING UPON THE CLIENT'S INSTRUCTIONS"

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HOW SOME APPRAISERS MIGHT VARY THE APPRAISAL PROCESS DEPENDING UPON THE CLIENT'S INSTRUCTIONS

The title of this paper suggests that an appraiser's opinion of value can depend upon the client's instructions. This premise would be in direct contrast with the Ethics Provision of the Uniform Standards of Professional Appraisal Practice (USPAP) which states "An appraiser must perform ethically and competently in accordance with these standards and not engage in conduct that is unlawful, unethical, or improper. An appraiser who can reasonably be perceived to act as a disinterested third party in rendering an unbiased appraisal, review or consulting service must perform assignments with impartiality, objectivity, and independence and without accommodation of personal interest."[1] If an appraiser is to adhere to this portion of USPAP, then how could market value conclusions differ based on the client's instruction? Actually, there are a number of reasons. These instructions can be, and often are, valid criteria for the appraiser in writing an appraisal report.

Eminent Domain

Probably the most frequent occurrence of differences of opinions between two appraisers, based on client instructions, is in the condemnation arena. Most states have eminent domain laws that are peculiar to that state, as does the federal government. In Texas, and certainly we do have our peculiar eminent domain laws, the instructions from the attorneys representing the landowners and those representing the condemning authority are often at the opposite ends of the spectrum. To give you an

example, the following certification is required by any appraiser completing an appraisal report for the Texas Department of Transportation: "I certify:……that such appraisal has been made in conformity with the appropriate state laws, regulations, and policies and procedures applicable to the appraisal of right of way for such purposes, and that to the best of my knowledge, no portion of the value assigned to such properties consists of items which are non-compensable under the established law of said state".[2] This instruction calls for a legal conclusion in most instances and I can assure you that the landowner's attorney will also instruct his appraiser to conform with the appropriate state laws and regulations. This necessarily includes a specific instruction not to include non-compensable items in their estimate of value. At this point, it would seem that both appraisers have been instructed to conform with the applicable law. So, why the difference? Of course, it is obvious. The difference is in the interpretation of appropriate state law and what is compensable in the particular jurisdiction. The condemnor's bar will interpret case law very literally and most likely instruct their appraisers to ignore any factor even close to being on the non-compensable borderline. On the other hand, an attorney representing the landowner or condemnee will probably research those cases dealing with these factors and more than likely will conclude somewhat differently. This usually becomes the basis for a lawsuit.

The Texas case that has had the most impact in eminent domain in recent years is the ***State of Texas, et al v. Schmidt, et al.***[3] From an appraiser's view point, this case states that landowners in a condemnation case are not entitled to damages to the remainder in a partial taking caused by (1) the impairment of its visibility from the main highway, and

(2) the inconvenience and disruption caused by construction extending over a period of several years, (3) the diversion of traffic from the highway at grade level; and (4) the security of travel required to gain access to the tract. This case has presented somewhat of a dilemma for all real estate appraisers in that conclusions of value, when following this case, are not necessarily based on market factors. When evaluating property for purposes other than condemnation, USPAP would require you to take into account those very factors that this case says to disregard. Standard Rule 1-4(f) of USPAP states that an appraiser must "consider and analyze the affect on value, if any, of anticipated public or private improvements, located on or off the site, to the extent that market actions reflect such anticipated improvements as of the effective appraisal date."[4] Comment to this standard rule is that in condemnation valuation in certain jurisdictions, the JURISDICTIONAL EXCEPTION may apply to this guideline. That simply tells appraisers that if a local law is in conflict with this standard, then an appraiser must follow the local law. The point here is that the interpretation of these cases give rise to different instructions to the appraisers.

Subsequent to the Schmidt case, in ***State of Texas v. Allen***,[5] the Supreme Court of Texas continued its position that these elements of damages are not compensable; however, the last paragraph of the opinion stated that if the highest and best use of the property was changed because of the taking, then those factors disallowed in ***Schmidt*** may possibly be considered in determining just compensation. Believe me, when opposing lawyers read this paragraph, you can be sure that the appraisers will receive differing legal instructions.

Two other fairly recent cases in which instructions to appraisers became a valuation factor are ***State of Texas v. Samuels***[6] and ***State of Texas v. Rebota, Inc.***[7] In ***Samuels***, the Texas Supreme Court held that a denial of access to the property does not constitute compensable damage unless there is material and substantial denial. This case involved the taking of right-of-way along the front portion of an automobile dealership in North Richland Hills, Texas. Prior to the taking, the property was situated with frontage on the IH-820 service road with a driveway from the service road leading into the parts and service area. This routing was designed to bypass the new car display and showroom areas. The taking included the front part of the property and the denial of access to the existing service drive. Additional access was available to the property on a secondary street, and a new service drive would be permitted from the service road, however, the location was restricted to the opposite end of the property. This new drive would now conflict with the showroom/display space for new cars. The appraisers for landowner were instructed that the taking of an access drive was compensable and the impact on the value of the entire automobile dealership must be considered. The State instructed their appraisers to disregard the impact of closing the service driveway since alternate access would be available from the secondary road. Ultimately, the Supreme Court reversed the trial court, holding that denial of access to a property does not constitute compensable damages unless there is a material and substantial denial of that access. Once again, the legal interpretation of material and substantial denial as instructed by lawyers made a considerable difference to the appraised value.

State of Texas v. Rebota, Inc. was a condemnation case for the expansion of US Highway 183 in north Travis County. The taking by Texas Department of Transportation included a McDonald's restaurant, which was situated on the ground-leased property owned by Rebota, Inc. McDonald's ground lease had a number of years to go, and at the time of the condemnation, the rental paid by the sub-lessee was about $43.00 per square foot of building area. Both appraisers recognized that the lease rate was in excess of current market value, and the State's appraiser was instructed to disregard the lease and estimate the value of the property excluding the terms of the lease. The landowner's appraiser received instructions that the existing lease on the McDonald's property must be considered to the extent that it affected the market value of the property. The trial court agreed with the landowner's position and ultimately granted a motion for an instructed verdict since the state's appraiser ignored the lease. On appeal, the Texas Court of Appeals, Third District, held that "The lease increased the overall value of the property; including the lease value did not cause the sum of the parts to exceed the whole. Consideration of the above-market lease rate does not impinge upon the undivided fee rule. The experts agreed that the long term, guaranteed above-market rate from a solvent lessee added value to the property because it insured an income stream greater than the market would otherwise have provided. The enhanced income stream added value to the pre-condemnation value of the property as a unit." Obviously, the legal instructions to the appraisers were very significant factors in the appraisal process in this case.

Governmental Regulations

Another common situation in which appraisers instructed differently by their clients involves governmental regulations such as zoning or land use codes. A market analysis of a particular property may indicate that the highest and best use is for a high rise office building. The property owner will then hire an architect/land planner to prepare the necessary plans and specifications for submittal to a governmental agency for the necessary approvals. During this process, the architect discovers that a portion of the property lacks the technical zoning required to build the project. The ensuing battle is predictable. The governmental entity balks at approving the plans based on the architect's drawings and requires the project to be scaled down so as to meet the current zoning that is in place. The landowner contends that only a nominal zoning change is required and that the city is acting arbitrarily and capriciously by not allowing the zoning change. The governmental entity will not change their position and we have a disagreement ending up at the courthouse. A loss in value is claimed by the property owner and he hires an appraiser to assess that potential loss. Of course, the governmental entity responds with an appraiser to assess the valuation question from their standpoint. The landowner's appraiser is instructed to consider that the nominal zoning change could be accomplished and to determine the value of the property based on the original development plan. The governmental entity's appraiser is instructed to appraise the property based on the existing zoning plan with no change possible. Once again, the instruction to the appraiser can be the basis for a huge difference in value opinions.

Partial Interests

Often real estate appraisers are asked to appraise real property involving partial interest. This is fairly common in estate matters, partitioning partnership interests or in the purchase of one partner's interest by the remaining partners. Standard Rule 1-2(d) (USPAP) requires appraisers to "consider whether an appraised fractional interest, physical segment, or partial holding constitutes pro-rata to the value of the whole". USPAP further states, "This guideline does not require an appraiser to value the whole when the subject of the appraisal is a fractional interest, a physical segment or a partial holding. However, if the value of the whole is not considered, the appraisal must clearly reflect that the value of the property being appraised cannot be used to estimate the value of the whole by mathematical extension." In other words, the sum of the parts may not equal the value of the whole property or the sum of the parts made in excess of the market value of the whole property. The controversy of partial interest usually involves estate tax returns when audited by the Internal Revenue Service. Upon filing an estate tax return, the accountant or attorney representing the estate will usually retain a real estate appraiser to ascertain the value of any real property. Almost always, the appraiser is instructed to appraise the fractional interest that was owned by the estate and consider the appropriate discount that should be applied to that interest. This is based on the premise that if fractional interest had been available for sale in the open market, a willing and knowledgeable purchaser would discount that interest because of the lack of control of the physical use of the property and the management of the asset. Published studies have shown that discounts for these type fractional

interests range from a few percentage points up to 75% or 80%, depending upon the location and type of property. The Internal Revenue on the other hand, usually takes the position that these type fractional interests should not be discounted or if so, only by a minor amount. Their reasoning is typically based on the probable ability to sell the interest to other partner's or family member's. Quite often the instruction to the appraiser concerning valuation of partial interest is based on policy as opposed to market factors.

Third Party Experts

In complicated litigation cases involving the appraisal of real estate, invariably the use of other experts are a necessity and the reliance upon these experts are common for real estate appraisers. Examples of these type experts include architects, engineers, land planners, financial analyst, market analysts, cost engineers, industry experts, etc. When the appraisal problem calls for the use of these type experts, by necessity, the appraiser is given certain instructions/advice and will rely upon their findings. Obviously, those kinds of experts also have different opinions and the two appraisals may differ significantly based upon the differing opinions of the other experts. The Supplemental Standards of Professional Appraisal Practice of the Appraisal Institute[8] addresses this issue in Guide Note 6, entitled "Reliance on Reports Prepared by Others". This supplemental standard requires appraisers who are members of the Appraisal Institute to consider the following criteria before using reports prepared by others:

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 relied upon this information in making decisions in preparing his or her report; and
4) The process and procedure used to evaluate the reports prepared by others.

The Standard further states "Other reports prepared by, or at the direction of the client, or real estate professionals, or others, require a careful review for reasonableness. The appraiser must understand the assumptions on which these reports are based as well as their applicability and validity to the assignment." Appraisers are obligated to make reasonable judgements about instruction / advice from their client or client's other experts.

Other Valuations

Instructions to appraisers often include valuations other than market value, as follows:

Use Value – "Use value is the value a specified property has for a specific use".[9] The valuation focuses on the contribution of the real estate to the enterprise and does not necessarily consider highest and best use. These type appraisals are performed to value assets for mergers, acquisitions and when the existing business enterprise includes the real estate. Case

law and specific statutes also create the requirement for use value appraisals. Most taxing districts have provisions allowing agricultural land to be appraised / assessed on its use value rather than based on its highest and best use. Also, IRS allows for use value on certain agriculture properties when filing estate tax returns.

Investment Value – "investment value is the value of an investment to a particular investor, based on his or her investment requirements".[10] Many times an appraiser is asked to perform an evaluation of the "investment value" of a property during the due-diligence period for a potential purchaser. Investment value is not market value and the potential for a misunderstanding concerning the valuation is obvious.

Going-Concern Value – "Going concern value is the value a proven property operation…Going concern value refers to the total value of a property, including both real property and intangible personal property attributed to business value."[11] Examples of property types that might require this type valuation include motels, hotels, restaurant and some industrial properties. A real estate appraiser may want to engage the services of an outside consultant whose expertise is specific to the project.

Insurable Value – "Insurable value is the portion of the value of an asset or asset group that is acknowledged or recognized under the provisions of

an applicable loss insurance policy."[12] Most appraisals of insurable value are based on the replacement and/or reproduction cost of improvements.

Public Interest Value – This has become the latest and sometimes hotly debated issue among real estate appraisers. One side argues for inclusion of a highest and best use or non-economic use for certain properties and that the appraisal be based on comparable sales data of properties with similar use, including sales to public agencies. The other side argues that the value of property must include the market concept of highest and best use and that the use of comparable sales data to public or quasi-public entities do not qualify as fair market data. Obviously, instructions to the appraiser on the value sought could greatly vary the value conclusion.

Conclusion

Can an appraiser vary the appraisal success depending upon the client's instructions? Yes. The instructions can vary based on legal interpretation, governmental regulations, the type of interest being appraised, instruction/advise from third party experts and the type of value sought depending on the appraisal problem. The instructions can be perfectly logical and even if they are in dispute, can be reasonable, if so determined by the appraiser.

[1] Uniform Standards of Professional Appraisal Practice, Appraisal Standards Board, 1998 Edition.
[2] Texas Department of Transportation, Form D-15-2 – Rev. 12/84
[3] *State of Texas, et al v. Schmidt, et al*, 867 S.W.2d 769 (Tex. 1993).
[4] Uniform Standards of Professional Appraisal Practice, Appraisal Standards Board, 1998 Edition.
[5] *State of Texas v. Allen*, 870 S.W.2d 1 (Tex. 1994), cert. Denied, 115 S. Ct. 64 (1995).
[6] *State of Texas v. Samuels*, 917 S.W.2d 283 (Tex. App. – Ft. Worth 1995, writ denied).
[7] *State of Texas v. Rebota, Inc.*, No. 03-93-00640-CV (Tex. App. – Austin 1994, writ denied).
Pursuant to TEX.R.APP.P.47.7, it is impermissible to cite unpublished opinions to a court as authority in Texas.
[8] Supplemental Standards of Professional Appraisal Practice with Explanatory Comments, January 1996
[9] The Appraisal of Real Estate, 11th Edition, Appraisal Institute
[10] ibid
[11] ibid
[12] ibid