Survey Says!

So cried out the late Richard Dawson on the TV game show, *Family Feud*.

Appraisers love surveys of every kind.

Rental rates, cap rates, rates of return, demographic projections, sale prices per square foot, average room rates, soil productivity, absorption rates… you name it, we’ll quote them all.

Appraisers who provide reports on large-scale projects such as flagged hotels, office complexes, power centers, and the like, make good use of national surveys.

The properties that they’re appraising are often regional if not national in scale. The subjects of their reports may be part of a REIT or other portfolio holding that is considered to be an institutional-grade investment.

Problems arise when appraisers start quoting national surveys for a small, local commercial property.

When I was in private practice I typically appraised small commercial properties.

The image below is of a Bozo Hot Dogs stand that I appraised back in 2005.

Properties like this can’t really be pegged to national surveys that zero in on the same performance metrics you’d use to research a McDonald’s or KFC.

Still, we see plenty of commercial reports in complaint where the appraiser has relied upon a national survey to bolster their conclusions on a small property.

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Survey Says!

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There’s a tendency for appraisers to ape what they’ve seen in other reports. A narrative report that tells an adequate story as to the value of a small commercial building in a small market doesn’t need thirty pages of census data and ten pages on institutional cap rates.

Appraisers shouldn’t just perform a data dump without drawing a conclusion from the data that’s presented. More is more, is the common misconception.

I’ve seen reports where a 2,500 Sq.Ft. restaurant in a community of fewer than 7,000 residents has demographic data drawn from a dozen surrounding counties. This was no Rick Bayless enterprise.

Embedding a Korpacz bar chart regarding cap rates for shopping centers isn’t going to tell the reader anything useful about the 1,200 Sq.Ft. House of Gently Used Socks that you’re appraising that rents for $1,000 per month.

Properties like that aren’t surveyed. Berkshire Hathaway isn’t lining up to add your House of Gently Used Socks to its vast holdings.

Appraisers need to read the fine print in these surveys to see how relevant the information will be.

What follows is a typical survey disclaimer:

Survey Process: Survey participants represent a cross section of major institutional equity real estate investors who invest primarily in institutional-grade property. As such, the information presented is not generally applicable to non-institutional-grade investments. In addition, the information represents investors’ investment expectations and does not reflect actual property performances.

The information in this survey is gathered through online questionnaires and telephone interviews. As such, the findings and opinions expressed reflect those of our investor participants and do not necessarily reflect those of PricewaterhouseCoopers LLP. Although we do not represent that the survey is statistically accurate, its results provide important insight into the thinking of a significant portion of the equity real estate marketplace.

Have a sense of proportion when applying investor surveys and regional cap rate studies to small-scale assignments.

Don’t mislead the reader with data dumps and investor surveys that fall flat. Focus on what really matters.
Letting the AIR Out

First, HVCC is dead. Dead and buried. It died back in 2010.

Second, even when it was still plaguing the profession, it never stated that appraisers couldn’t or shouldn’t talk to real estate agents or brokers.

Ever.

I still have a copy of the HVCC because you never know when revisionist history will appear.

Eventually, AIR took its place. AIR stands for Appraiser Independence Requirements.

I have a copy of AIR. It resembles HVCC in many ways but, again, it doesn’t say a single word about appraisers being prohibited from chatting up or being chatted up by a real estate agent or broker.

So, why do I still hear crazy stories of appraisers refusing sales data from agents and brokers and refusing to discuss the transaction with them?

What does AIR really say?

It basically addresses collusion, bribery, inducement...the generally obvious and blatant forms of coercion.

Not garden-variety chit-chat between two real estate professionals about a transaction with which they’re both involved.

Apparenty, for some appraisers, any discussion with a broker is a sinister back-channel to fraud.

There’s a bright line between remaining independent and becoming a Howard Hughes-like recluse about your appraisal product.

Not every conversation with a broker about relevant sales that might have been overlooked can be construed as inappropriate influence.

It’s no less outrageous than when some brokers accuse appraisers of killing their deals.

Many of the complaints coming in lately involve some appraiser’s unwillingness to engage brokers on any level.

Clients have event given written permission for an appraiser to discuss the report with the borrower only to have the appraiser disappear.

As a valuation professional, you should be able to tell the difference between honest assistance and a threat.

You should be able to defend your conclusions.

Right?

Appraisers need to take a deep breath and relax.

Stop being so fearful about conversation.

After all it’s AIR; not a vacuum.
Lost Cost

The residential Cost Approach gets a bad rap.

Fannie & Freddie don’t think that they need it. Most appraisers consider it to be as useful as an ashtray on a motorcycle. As a result, fewer and fewer appraisers know how to apply it properly.

A disturbing trend in complaints are Cost Approaches that seem to have no basis in reality.

As an example, our subject property is 1,500 Sq.Ft. brick ranch with a 20’ x 20’ garage. The Sales Comparison Approach has already revealed a value of $110,000. Now we’re faced with completing the Cost Approach.

The appraiser has determined that 25% of depreciation is attributed to physical wear and tear.

There was no measurable functional loss and, although the market overall has tanked, the subject doesn’t appear to suffer any external loss.

The Cost Approach appears to support the Sales Comparison conclusion of $110,000.

Right?

Not really.

Is it possible to build a house like this for $45.00 per Sq.Ft.?

Not since the mid 1980s. So what went wrong?

Some appraisers who find themselves unable to reflect external loss end up backfilling a sour market into the base cost per square foot.

Remember, it was already noted how the overall market has tanked.

This appraiser failed to note the loss as a separate external item.

External loss is always found outside of the property lines of the subject, generally incurable, and beyond the control of the property owner.

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Typically, many residential appraisers see external loss only in the form of poor locations or unfavorable views.

External loss also takes into account the larger economic picture aside from any local impacts.

How should the appraiser have handled this?

First, the actual cost per square foot to replace this improvement was estimated to be $110 for our example.

Physical wear & tear still reflects 25% depreciation.

However, the external loss attributed to the tanked overall market reflects a 40% hit in this particular example.

Will there be an external loss appearing on the market grid?

Not if the sales used all suffer from the same economic downturn.

In the end, our new Cost Approach supports the Sales Comparison conclusion and underscores the larger economic picture.

The Cost Approach may not be appropriate for many assignments but if done correctly, still has a story to tell.
Public Disciplines

Here’s what comes back to the Division and the Board as off-handed comments from out in the profession:

“They (the state) won’t do anything.”

“They’ll end up sending them (the respondent) to some CE course and that’s pretty much it.”

If you say so.

George K. Lagassa—553.002198

2012-08625—FINED $25,000 for completing a retrospective real estate appraisal on a steam generating station located at 4200 Pine Bluff Road in Grundy County prior to having been issued a license to do so.

Richard Robin—Unlicensed

2011-09824—CEASE & DESIST for unlicensed practice plus a $30,000 civil penalty for offering appraisal services through his business known as RMR Property Tax Solutions/Pro Tax.

Samuel V Scrivani—556.003515

2010-01057—REVOKED for incompetence and communicating a misleading appraisal report for a residential property located at 13323 Morning Mist Place, Plainfield, IL 60585.


Missed that the subject was located in Kendall not in Will. Failed to reconcile the January 2007 sale price of the subject ($417,717) with the appraised value of $570,000 nine months later. Failed to provide an accurate improvement sketch. Failed to consider 13402 Morning Mist Place, another “Asbury” model that sold in August 2006 for $385,000.

Effective as of November 13, 2012.

Keith A Rogers—556.003508


Happy Holidays from everyone at IDFPR