



THINGS TO LOOK FOR IN AN APPRAISAL

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WHAT IS AN APPRAISAL?

- The appraisal process includes all typical methods and techniques
- The purpose of an appraisal is to reflect the MARKET and how it values real property
- What is the MARKET? Better, Who is the market?
- And What the MARKET is not
- What is the Appraiser's job?

WHAT IS THE ASSESSMENT PROCESS

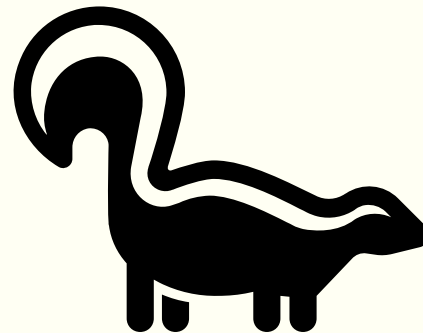
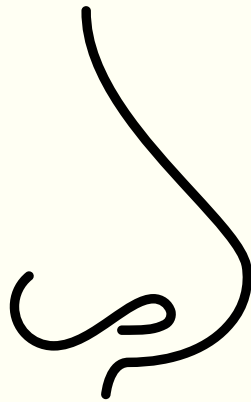
- Generally, all assessment in all jurisdictions is controlled by law
- How does this square up with expert witness appraisals? (fee appraisals)
- What is the Mass Appraisal process vs. the single property appraisal?
- Here we are not a 100% value state, we are also a “current usage” state
- What is our objective in the Litigation Unit?

THINGS TO LOOK FOR IN AN APPRAISAL

- Congratulations, you have 150 to 300-page appraisal sitting in front of you.
- What do you do and where do you begin? The reality is, we can't teach you appraisal theory in the 1 ½ hours.

THINGS TO LOOK FOR IN AN APPRAISAL

- However, there is Good News!
- We don't have to, because you already have all the tools you need!
- You're all in the legal profession, - lawyers and judges.
 - By nature, you apply logic all the time
 - You already know how to apply the “smell test”



THINGS TO LOOK FOR IN AN APPRAISAL

- You can apply the “smell test” to spot potential “red flags” within the appraisal.
- **RED FLAGS:**
 - These are things which don’t necessarily add up logically;
 - Prompting possible further investigation and questions;
 - These “red flags” may lead you to the possible conclusion that there just may be some “creative writing” going on in the appraisal report in front of you.
- So, what are some “RED FLAGS” to look for?

VARIOUS “SMELL TESTS” TO APPLY TO SPOT RED FLAGS

- “Market Value”
- Underlying Land Value
- Cost of Construction
- Deed of Trust / Loan



RED FLAG 1 - “MARKET VALUE”

- **MARKET VALUE** - A type of value that is the major focus of most real property appraisal assignments. Both economic and legal definitions of market value have been developed and refined.
- Source: Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 7th ed., s.v. “market value.” (Chicago: Appraisal Institute, 2022), PDF e-book.

Definition of “Market Value” used by Agencies that Regulate Federally Insured financial institutions in the U.S.

- The most probable price that 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 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.

(12 C.F.R. Part 34.42(h); 55 *Federal Register* 34696, August 24, 1990, as amended at 57 *Federal Register* 12202, April 9, 1992; 59 *Federal Register* 29499, June 7, 1994)

- Source: Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 7th ed., s.v. “market value.” (Chicago: Appraisal Institute, 2022), PDF e-book.

Market Value Cont.

- It takes two to tango. You need both a well informed and motivated “Buyer” and a “Seller”– in order to have “Market Value”.
- Remember that! It is really easy to lose focus of this, especially when:
 - There is a voluminous appraisal in front of you,
 - Along with an “expert witness” who opining a so called “market value”.
- “Smell Test” Application - Questions:
 - 1) Is there really a “buyer” at the value opined?
 - 2) More importantly, especially in ad valorem tax cases, is there really a **“SELLER”** at the value opined in the appraisal?
 - Example: Think of a house which is in a homogeneous neighborhood, where all the houses are relatively the same size, same age, same condition.

Market Value Cont.

- Houses in the neighborhood are all selling for \$400,000?
- “BUYERS”
 - If you list your house for \$1,000,000, how many “buyers” are there going to be?
 - **None!**
 - There are no well informed and motivated “Buyers” at \$1,000,000, if everything is selling for \$400,000.
- “SELLERS”
 - More importantly, *in ad valorem tax cases*, consider whether there really are any “sellers” at the appraiser’s opined value
 - If the appraisal in front of you opines a value of \$200,000, how many “sellers” are there really?
 - **None!**
 - There are no well informed and motivated “Sellers” at \$200,000, if everything is selling for \$400,000.
- **IF NO “SELLER” THAN NO “MARKET VALUE”** (no matter what the appraiser opines, and under whatever so called theory the appraiser is attempting to use).

Market Value Cont.

- COMMERICAL PROPERTY– Same logic and smell test applies. No Difference.
- No matter what the appraiser opines as a “market value” in their report, always ask yourself :
 - In the real world, are there really any well-informed and motivated “SELLERS” at the value opined value?
 - Consider asking the company representative if they would be willing to sell their property at the amount opined.
- **IF NO “SELLER” THAN NO “MARKET VALUE”!**
- Again, both a well-informed and motivated “buyer” and “seller” are needed to have “market value”.
 - You just may be looking at some “creative writing” if there are no “sellers” to be found at value opined.
 - You just may be looking at a theory not recognized and used in the real world by actual market participants
 - Further questioning is needed, as there are red flags.

Underlying Land Value

- In this vein, consider the underlying land value.
- Compare the value opined for just the underlying land, to the value opined for the entire property (both land and Improvements).
- **Example:** The appraiser for the County appraises the underlying land value at \$3,000,000. Tax-payer's appraiser appraises both improvements and land at \$2,000,000. **HUGE RED FLAG.** More questions are needed.
 - If the value of the underlying land (without the building improvements) is worth \$3,000,000, how many well-informed and motivated “sellers” are going to be found at \$2,000,000 for both the underlying land and building improvements combined? **None!**
 - IF NO “SELLER” THAN NO “MARKET VALUE”!

Cost of Construction

- Example: Consider that the building improvements for a new building cost \$5,000,000 to construct (without the underlying land)
- Consider further that the underlying land costs \$3,000,000.
- Consider further that the store is currently operating; is in a good location; and has good overall sales.
- Taxpayer's appraiser opines a value \$2,000,000. There is a **HUGE RED FLAG**, and something is starting to smell fishy. More questions needed.
- Ask yourself, are there really any well-informed and motivated "sellers" at \$2,000,000? Especially if it is going to cost the taxpayer at least \$8,000,000 to duplicate what already exists.
- **IF NO "SELLER" THAN NO "MARKET VALUE"!**

Deed of Trust – LTV & LOAN Tests

- Recorded “Deed of Trust” (Rough test only).
 - Look for loan amount; Apply typical loan to value ratio
 - Compare LTV range results to the value opined in the appraisal.
 - If the appraiser has opined a “market value” underneath the typical loan to value ratio range – **Red Flag**, and more questions need to be asked. More investigation is needed.

- Banks who lend money are sophisticated and are not in the business to lose money.
 - Appraisal process for all “Federally Related Transactions.”
 - Financing Appraisal vs. appraisal done for “Ad Valorem”.
 - If the taxpayer’s appraiser has opined a “market value” which is less than the loan amount found in the Deed of Trust. **Huge Red Flag**. More questions should be asked.

Other

- Ad-Valorem appraisal vs. condemnation appraisal. (We find that ad valorem and condemnation are on the two ends of the spectrum).
- Comps should be kept as similar as possible to as your subject:
 - 1st generation to 1st generation
 - Occupied to Occupied (No lease up)
- Don't capitalize un-stabilized income.

WHAT IS THE BOTTOM LINE?

- We have to use common sense and know what the MARKET activity shows
- We do have some statutorily valued property types that are not typical, BUT
- What is the test for us and the court?
- A competent value estimate of MARKET value. Are we above or below?
- What can we do to help the court make a decision?