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The folly of data base appraising: Serious issue faced by the appraisal industry

January 09, 2008 - Appraisal & Consulting

I recently was retained to review two appraisals of the same property. Both were retrospective appraisals with the same valuation date. The appraisals were widely apart. The high appraisal was 50% greater than the low!

How could this be? Differences of 5% to 10% between appraisers are not uncommon, but gaps of the magnitude described are not supposed to exist.

This article will explain data based appraising, describe the gaps of this actual case study, and summarize with my opinions on what I believe to be a serious issue faced by the appraisal industry; and in fact, the real estate industry overall.

What is data based appraising?

With the power of the internet, data sources are available with the push of a computer key. In this case, both appraisers used exactly the same five comparable sales within each report. The data source was Costar, a well known real estate data base.

With the income approach the choice of capitalization rates, while different, were from the PWC Korpacz Real Estate Survey with both appraisers using the exact survey.

The property under study was a garden apartment complex of 2½ stories in height with multiple buildings located on a large track of land in one of Greater Boston's Class A suburban communities.

What has happened in the appraisal business is that the bidding process followed by lending institutions has driven down appraisal fees where appraisers must perform quickly. Basic real estate judgment has been lost in the box in front of them called a computer.

Why the 50% gap?

Uniform standards of professional appraisal practice (USPAP) make clear that appraisers are expected to emulate the actions of their peers.

In this case, there was an all cash offer, with 60 days due diligence, within a year of the valuation date. The date of the reports was some three years ago. The offer was readily available for the asking. Neither appraiser made a call to the potential buyer to get behind the offer. Any buyer who places an "all cash" offer on the table with due diligence as the only contingency, I believe cannot be ignored.

The buyer's offer was between the ranges in value in the two appraisals, but far closer to one than the other. Further, this was just the first offer. In the sale process I see multiple bids. It would not be at all unusual for there to be 10 to 15 bids on a garden apartment complex in a Class A community.

Another reason for the gap is that none of the five data based comparables were comparable. None were suburban garden apartment complexes. The appraisers were adjusting comparables that were not comparable. Remember a comparable is a similar property.

The final error was in choice of capitalization rates. What appraisers do is that they interview key market participants. In this case, one of the top multi family brokers in New England was interviewed by me and both capitalization rates, as a result, were rejected as part of my review.

Summary

In the 1989-1991 period, in my view, the worst real estate depression of the century occurred. Not only did we have to live through the banking collapse, but we lost our educational base so important for our industry. Jim Graaskamp died. The insurance company real estate department training ground, which produced some of our top real estate people in this country, was wiped. The Appraisal Institute lost luster to licensure. Our colleges and universities, but for Wharton, did not pick up the slack.

For the past 15 to 17 years, I believe that a large void has existed. While various individuals may invest their own money in education restructure, the preponderance of those in the appraisal field are trapped. They did not come from insurance companies or other equivalent great training grounds. They cannot make the calls and open the doors necessary to obtain proper answers.

They are good people who work hard but when called upon, no matter how hard they try, just miss the mark. They are wandering without an anchor to windward to hold them on course.

The loser is the real estate industry itself. Appraisers deal with millions of dollars in value. When an appraisal is prepared, no one knows where it will end up. The extra steps required must be taken to insure that reports are within a "reasonable degree of professional certainty" and avoid errors that may result when data base appraising is applied.

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