

The mythogenesis of appraisal methods

May 09, 2013 - Appraisal & Consulting

The appraisal profession has its own complex system of beliefs, values, and attitudes. Mythologia, in Greek, is "story telling." Mythos is the repetition and retelling of traditional lore and beliefs relevant to some accepted meaning particular to a culture, in this case to the practice of appraisal.

Nearly 20 years ago, I wrote a journal article titled The Myth and Magic of Developing Capitalization Rates. That writing attempted a mythoclastic explanation of why that particular appraisal methodology had become unthinking mythical magic. Real estate appraisers have transformed appraisal method and concepts into mythical status. For example, in investment analysis, a cap rate is the inverse of a P/E ratio. In business valuation, it is a risk rate reflected in the cost of capital. A discount rate is a cap rate plus anticipated growth. In real estate, it is an applied mathematical formula that turns the concept into a mixture of theology and mythology.

The mythogenesis of appraisal methods, approaches, beliefs, evolved starting with the National Housing Act of 1935 and Fredrick Babcock. He was a professor, founding member of the Society of Real Estate Appraisers (SREA), and chief underwriter for the FHA. In 1938, he wrote the first appraisal manual. Among other thoughts, Babcock listed eight approaches to value. In 1950, the American Institute of Real Estate Appraisers (AREA now AI) concretized just three approaches in the textbook The Appraisal of Real Estate. Today, the majority of appraisers, including many in personal property and business valuation treat the three approach concept as the holy trinity of appraisal methodology. Some appraisers may remember when mythologers taught that an appraiser should average the three approaches. Eventually the folly of averaging fell out of favor and the mythologers new story was that appraisers should weigh the approaches. Just how does the cost approach apply to the valuation of a Picasso or Rembrandt? And how does one apply the income approach to a lathe or diamond ring? Many business appraisers use the cost and comparable sale approaches with bizarre interpretations.

There are many more illogical myths rooming around the appraisal profession including, discount rates, cap rates, the cost approach somehow magically equaling the comparable-sales approach, and the most apparent illogical mythopoeic belief is applying adjustments to comparable sales.

The mythos of appraisal adjustments is illustrated in a true story of a Massachusetts appraiser who was criminally indicted by a federal grand jury. Three participants, a lender and two of his appraisers went to federal prison. Our client was the owner of the firm, decent, good guy, not involved in the crimes of his two subordinate appraisers, but was indicted with the group. During his grand jury testimony he was asked where he obtained the comparable sales adjustments. He said, "From the book." The inquisitor asked, "What book?" Appraiser, "Oh, we have a book on the shelf." This went on until the inquisitor asked the appraiser to describe the book, who wrote it and how the book was used. The appraiser answered, "It is a loose leaf note book where a page shows all the adjustments in both percentages and dollar figures." He went on to say, "I created the listing for use by

appraisers and trainees in my office." When asked how he had arrived at the percentages and dollar figures, the appraiser knew what the answer should be. He lied, saying, "Through a study of matched pairs." The inquisitor asked, "when did you do the matched pair study?" The appraiser answered, "oh, about ten years ago." Yes, he looked foolish, was made to look more foolish. If appraisers were to answered truthfully that they pull the numbers out of thin air, make them up, or simply guess, then the illogical myth, method, and crafty deceit just might go away.

I have not addressed the sloppiness, compromised vagueness, and ambiguity of USPAP rule making that requires pages of teeny type footnote amendments, statements of standards, advisory opinions, and Q&A publications to explain or further confuse a rule's meaning and creates the need to train and ordain teaching priests inculcated with faith based but illogical myths. All of this is further compounded by state regulatory personnel interpretation and misinterpretation of state statutes including USPAP. Sorry to say, all this, more likely than not, will continue well into the future.

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