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Understanding and using comparable transactions in relation to appraisal

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I recently taught a seminar, Understanding and Using Comparable Transactions. Developed by the Alliance for Valuation Education (Alliance), this seminar is based on the Appraisal Practices Board (APB) Valuation Advisory #4: Identifying Comparable Properties (Revised). The seminar covers, in a new and refreshing way, a core activity of any appraiser: identifying, selecting, understanding, and treating comparable data, in its many manifestations.

You may not have heard of the Alliance. From their website, the Alliance for Valuation Education (Alliance) is a "non-profit organization established with the support of thirteen appraisal-related organizations. Working in concert, we are solely dedicated to the advancement of quality valuation education. Our primary goal is to develop valuation education that broadens and complements those courses currently being offered . . . The Alliance is not a course provider." Notable members include the Mass Board of R.E. Appraisers (MBREA), American Society of Appraisers (ASA), Royal Institute of Chartered Surveyors (RICS), and the Appraisal Foundation (TAF).

The Alliance was TAF's brainchild, but it does not benefit financially from Alliance activities. As Dave Bunton, TAF president, notes, "today the appraisal profession in our country remains quite fragmented. .... What if we joined forces to develop better products and at the same time reduced duplicative costs?" What TAF did was facilitate a collaborative effort focusing on the development of timely, quality education that will be available to all education providers.

The Alliance's "Comparable Properties" course notes that appraisers use comparable property information every day. Often data is used without appraisers consciously thinking of reasons behind their selection and use. The entire appraisal process is dependent on the comparison of data.

What constitutes comparable data? Comparable data is found in the Sales Comparison Approach, most obviously, but also in the Cost and Income Capitalization Approaches. In the Cost Approach, comparable data is needed to establish costs, depreciation, and land value. Many appraisers tend to give the Cost Approach little attention mostly because they are unwilling or unable to ferret out essential comparable data needed to develop the approach credibly. Renovation or construction costs are accepted at face value without testing their reasonableness in the market. Not enough attention is paid to comparative expenses, vacancies, or overall rates from market data in the Income Approach. Highest and Best Use analysis often is inadequate because comparison of existing and proposed uses is not made systematically. Real estate taxes are pronounced to be reasonable without any specific analyses of competitive buildings.

Not all appraisers acknowledge--or thoroughly analyze--comparable data in its many forms. This is true both in development and reporting. For too many appraisers - residential and commercial - the comparison process becomes rote early on, something once learned in a particular way and suitable for a particular scope of work, but without the ability (or desire) to develop solutions for different appraisal problems, even within the same practice area. This lack of breadth, or rigor, is part of the "one size fits all" appraisal fallacy. This inflexibility severely limits the appraiser's ability to solve valuation problems outside of a narrow practice area. Further, improper on inapplicable appraisal requirements force appraisers to alter the comparative process to meet underwriting, investor, and/or deal-making requirements that have little to do with proper appraisal practice or run clearly counter to it.

Interestingly enough, Fannie Mae has recognized this failing in the way the appraisal process has been framed under their guidelines - more in the manner in which the guidelines are interpreted - in its recent changes and the introduction of Collateral Underwriter (CU), a lender-based system designed to promote more realistic selection, analysis, and treatment of comparables and the entire appraisal process.

Other appraisers have a keen understanding of how comparable data can be used to support the many elements of an appraisal and also know how to report this information. Too many appraisers have an incredibly strong intuitive grasp of market support for their conclusions but are often unable (or unwilling in some cases) to provide support with specific data points and rational analysis.

The comparative process lies at the heart of appraisal. For those who doubt that appraisal is nothing more than an opinion, a self-fulfilling prophecy, where facts are selected selectively to make an argument, a thoughtful and skilled appraiser can build his or her argument brick by brick through appropriate selection and analysis of comparable data. There is much data out there; much of it is irrelevant and useless. The art of appraisal is being able to discard what is not relevant and explain why it is not relevant, as well as being able to choose applicable comparative data and apply logical and persuasive argument to show its relevance.

The convergence of the art and science of appraisal takes place and reaches its apogee when intuition, rationality, and market-based support are utilized and appropriately disclosed in the written medium of the appraisal report.

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