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REMARKS OF

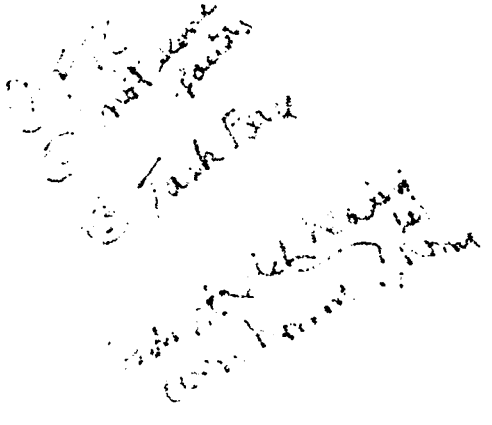
CONGRESSMAN DOUG BARNARD JR., CHAIRMAN
COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
U.S. HOUSE OF REPRESENTATIVES

AT A SEMINAR SPONSORED BY
THE UNIVERSITY OF WISCONSIN REAL ESTATE ALUMNI
BALTIMORE-WASHINGTON CHAPTER

"IMPACT OF APPRAISAL REFORM ON LENDERS
DEVELOPERS, AND THE APPRAISAL BUSINESS"

BALTIMORE, MARYLAND

APRIL 23, 1987



I'M DELIGHTED TO BE HERE TODAY TO PARTICIPATE WITH YOU IN THIS IMPORTANT SEMINAR ON "THE IMPACT OF APPRAISAL REFORM ON LENDERS, DEVELOPERS AND THE APPRAISAL BUSINESS." I MUST CONFESS, HOWEVER, TO SOME NERVOUSNESS AT HAVING TO DELIVER A LECTURE ON A SUBJECT ABOUT WHICH THE AUDIENCE ALREADY KNOWS SO MUCH. IN FACT, I FEEL A LITTLE LIKE ZSA ZSA GABOR'S FIFTH HUSBAND MUST HAVE FELT ON THEIR WEDDING NIGHT -- I KNOW WHAT I'M SUPPOSED TO DO BUT I'M NOT SURE I CAN MAKE IT INTERESTING!

SERIOUSLY THOUGH, MY PURPOSE THIS MORNING IS NOT TO BE "INTERESTING," BUT RATHER TO ENLIST YOUR SUPPORT IN WHAT COULD BECOME A BRUISING BATTLE IN CONGRESS OVER LEGISLATIVE REFORM OF THE APPRAISAL INDUSTRY. IN JUST A FEW WEEKS, I WILL INTRODUCE A BILL IN THE HOUSE THAT WILL CREATE A SELF-REGULATORY ORGANIZATION (SRO) FOR YOUR PROFESSION. ITS PURPOSE IS TO STEM THE HEMORRHAGING NOW TAKING PLACE IN MANY OF OUR

FINANCIAL MARKETS BECAUSE ABUSIVE APPRAISALS ARE BEING USED -- AT GREAT ECONOMIC COST -- TO JUSTIFY THOUSANDS OF UNSAFE AND UNSOUND REAL ESTATE TRANSACTIONS.

FRANKLY, THERE ARE SOME ECONOMIC FORCES IN THIS COUNTRY WHO DON'T WANT THE STATUS QUO DISTURBED; WHO DON'T WANT THE BROKERING OF REAL ESTATE DEALS TO BE "ENCUMBERED" BY OBJECTIVE APPRAISALS. IF THESE FORCES DECIDE TO OPPOSE MEANINGFUL LEGISLATIVE REFORM OF THE APPRAISAL BUSINESS, THEN ONLY KNOWLEDGEABLE PRIVATE SECTOR INDIVIDUALS, LIKE YOURSELVES, WILL BE ABLE TO CONVINCE CONGRESS THAT CHANGE IS NOT ONLY DESIRABLE, <u>BUT ESSENTIAL</u>.

I HAD ANOTHER REASON FOR ACCEPTING JIM GRAASKAMP'S KIND INVITATION TO COME HERE TODAY. THE CENTRAL FEATURE OF MY APPRAISAL LEGISLATION -- WHICH I WILL DESCRIBE LATER IN MY REMARKS -- IS THE ESTABLISHMENT OF A GOVERNMENT CHARTERED APPRAISAL INDUSTRY FOUNDATION, WHICH WOULD

PROMULGATE NATIONAL APPRAISAL STANDARDS AND SET APPRAISER CERTIFICATION REQUIREMENTS. SINCE SO MUCH OF THE COUNTRY'S APPRAISAL EXPERTISE RESIDES AT YOUR ALMA MATER -- THE UNIVERSITY OF WISCONSIN'S SCHOOL OF BUSINESS -- IT WOULD MAKE MY LEGISLATIVE EFFORTS SO MUCH EASIER IF WE COULD JUST TRANSFORM THE REAL ESTATE AND URBAN LAND ECONOMICS SCHOOL INTO THE APPRAISAL FOUNDATION CREATED BY MY BILL! IT ALSO OCCURRED TO ME THAT THIS IDEA MIGHT APPEAL TO THE FELLOW FROM WISCONSIN WHO CHAIRS THE SENATE BANKING COMMITTEE AND HELP GUARANTEE QUICK SENATE PASSAGE!

AS MOST OF YOU KNOW, THE HOUSE COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE, WHICH I CHAIR, ISSUED A REPORT LAST SEPTEMBER 25TH -- AFTER A YEAR-LONG INVESTIGATION -- THAT DETAILED THE NATURE, EXTENT AND CONSEQUENCES OF THE NATION'S APPRAISAL PROBLEMS. MUCH OF THE REPORT FOCUSED ON HOW ABUSIVE APPRAISAL PRACTICES IMPACTED FEDERAL PROGRAMS. I INTEND TO TAKE SOME

TIME THIS MORNING DISCUSSING THE SPECIFIC FINDINGS OF OUR INVESTIGATION; SUMMARIZING THE PROGRESS THAT HAS ALREADY BEEN MADE TOWARD ASSURING THE KIND OF INDEPENDENT APPRAISALS WE ALL SEEK; AND DESCRIBING THE LEGISLATION I WILL SOON BE INTRODUCING. I ALSO WANT TO MAKE SOME BRIEF OBSERVATIONS ABOUT HOW THE PHENOMENON OF APPRAISAL ABUSES FITS INTO THE LARGER FRAMEWORK OF FINANCIAL SERVICES ISSUES FACING THE 100TH CONGRESS. BUT BEFORE I DO ALL THAT, I WANT TO TAKE A MOMENT TO PAY TRIBUTE TO YOU AND MOST OF YOUR COLLEAGUES IN THE APPRAISAL PROFESSION, FOR THE COURAGEOUS WAY IN WHICH YOU HAVE RESPONDED TO YOUR INDUSTRY'S PROBLEMS.

I HAVE BEEN AROUND STATE AND FEDERAL POLITICS LONG ENOUGH TO HAVE WITNESSED HOW VARIOUS INDUSTRY GROUPS CONFRONT EVIDENCE OF IMPROPER OR SHARP PRACTICES BY THEIR OWN MEMBERS. I CAN THINK OF NO OTHER INDUSTRY THAT HAS FACED ITS PROBLEMS MORE FORTHRIGHTLY THAN YOURS. IF ONE EXAMINES

MAJOR INITIATIVES BY CONGRESS TO END INDUSTRY MALPRACTICES, ONE FREQUENTLY FINDS MISSED OPPORTUNITIES, BY INDUSTRIES, TO PUT THEIR OWN HOUSES IN ORDER AND THEREBY AVOID MASSIVE GOVERNMENTAL INTERVENTION. LET ME CITE A FEW EXAMPLES: IN THE 1960'S, BANKERS WERE BESIEGED WITH, BUT TURNED A DEAF EAR TO, BORROWER COMPLAINTS THAT THEY WEREN'T BEING TOLD THE REAL COST OF INTEREST ON THEIR LOANS. BUT CONGRESS LISTENED AND THE RESULT WAS TRUTH-IN-LENDING LEGISLATION. IN THE EARLY 1970'S, FOOD MANUFACTURERS KNEW THAT GROCERY SHOPPERS WERE CONFUSED BY MULTIPLE PACKAGE SIZES AND WEIGHTS AND WERE UNABLE TO MAKE PRICE AND QUANTITY COMPARISONS. THEY DID NOTHING AND GOT TRUTH-IN-PACKAGING FOR THEIR NON-EFFORTS. U.S. AUTO MAKERS WERE INTENT ON PRODUCING GAS GUZZLING, UNSAFE CARS THAT WERE PROGRAMMED TO SELF-DESTRUCT AS SOON AS THE WARRANTY EXPIRED. WHAT THEY REALLY PRODUCED WAS RALPH NADER, THE

JAPANESE IMPORT AND A SLEW OF AUTO SAFETY AND FUEL ECONOMY LAWS.

THE POINT HERE IS THAT EVEN IN THE CYNICAL WORLD OF POLITICS, ATTEMPTING TO "TOUGH OUT" PROBLEMS CAN BE COSTLY -- COSTLY TO INDUSTRY AND EVEN, UNINTENTIONALLY, "COSTLY" TO THOSE WHO CONGRESS IS SEEKING TO PROTECT. CONVERSELY, VIRTUE CAN BE ITS OWN REWARD. AND WHILE I THINK IT WILL BE FOR THE APPRAISAL INDUSTRY, THE WIDESPREAD NATURE AND SEVERE CONSEQUENCES OF APPRAISAL ABUSES MAKE INEVITABLE A FEDERAL ROLE IN APPRAISAL REFORM -- PARTICULARLY BECAUSE THE FEDERAL INTEREST IS SO STRONG IN THIS AREA.

IN ORDER TO UNDERSTAND THE RATIONALE BEHIND MY LEGISLATIVE PROPOSAL, IT IS NECESSARY FOR YOU TO RECOGNIZE THAT THERE IS A GROWING CONVICTION IN WASHINGTON, D.C., THAT APPRAISAL ABUSES ARE A MAJOR CONTRIBUTOR TO LARGER PROBLEMS FACING OUR FINANCIAL MARKETPLACE. ACCORDINGLY, THE QUESTION OF WHAT TO DO ABOUT THE NATIONAL EPIDEMIC OF

APPRAISAL ABUSES, HAS BECOME TIED TO LARGER DECISIONS THAT ARE NOW BEING MADE DURING THE 100TH CONGRESS: DECISIONS ON HOW TO STEM THE TIDE OF FAILED OR FAILING FINANCIAL INSTITUTIONS AND HOW TO RESTORE SOLVENCY TO OUR SYSTEM OF FEDERAL DEPOSIT INSURANCE. DECISIONS CONCERNING EXPANSION OF FINANCIAL SERVICES AND THE INCREASINGLY IMPORTANT ROLE OF OUR BANK SUPERVISORY AGENCIES IN A DEREGULATED MARKETPLACE. AND MOST PARTICULARLY, DECISIONS CONCERNING THE APPARENT EAGERNESS OF MANY LENDERS TO RISK DEPOSITORS' OR INVESTORS' FUNDS IN SELF-SERVING OR SPECULATIVE VENTURES, EITHER FOR INSTITUTIONAL PROFIT OR FOR QUESTIONABLE PERSONAL GAIN.

AN INDICATION OF HOW THESE ISSUES ARE TIED TOGETHER, IS THAT MY SUBCOMMITTEE'S APPRAISAL INVESTIGATION WAS TRIGGERED BY A SERIES OF HEARINGS UNRELATED TO THIS ISSUE -- HEARINGS THAT WERE DESIGNED TO EXAMINE THE STATUS OF THE DEPOSIT

INSURANCE FUNDS, THE CAUSES OF RECENT FINANCIAL INSTITUTION FAILURES, AND WHY THE FEDERAL REGULATORY AGENCIES COULDN'T PREVENT THOSE FAILURES. AMONG THE INSOLVENCIES STUDIED WERE THE PENN SQUARE BANK OF OKLAHOMA, UNITED AMERICAN BANK (THE JAKE BUTCHER BANKS) OF KNOXVILLE, TENNESSEE, AND EMPIRE SAVINGS AND LOAN ASSOCIATION OF MESQUITE, TEXAS. THE DEMISE OF THESE INSTITUTIONS WAS DUE IN LARGE MEASURE TO FRAUD AND SELF-DEALING BY INSIDERS. BUT TO A SIGNIFICANT DEGREE IN THE EMPIRE AND UAB FAILURES, AND TO A SLIGHTLY LESSER EXTENT WITH PENN SQUARE, FAULTY AND FRAUDULENT REAL ESTATE APPRAISALS WERE UTILIZED TO FACILITATE THE FRAUD AND TO FOOL THE BANK EXAMINER.

REGRETTABLY, IT IS IMPOSSIBLE TO TALK ABOUT APPRAISALS WITHOUT ALSO TALKING ABOUT CRIMINAL MISCONDUCT INSIDE OUR NATION'S FINANCIAL INSTITUTIONS. THREE YEARS AGO, AFTER THE MOST COMPREHENSIVE STUDY EVER CONDUCTED BY CONGRESS

OF WHY FINANCIAL INSTITUTIONS FAIL, MY SUBCOMMITTEE CONCLUDED THAT 50 PERCENT OF THE COMMERCIAL BANK INSOLVENCIES AND 25 TO 35 PERCENT OF THRIFT FAILURES ARE DUE IN LARGE MEASURE TO FRAUD AND SELF-DEALING BY OFFICERS, DIRECTORS AND INSIDERS. IN MANY OF THE 150 FAILED OR PROBLEM INSTITUTIONS STUDIED, ABUSIVE APPRAISAL PRACTICES WERE AN INTEGRAL PART OF THE PROBLEM. THIS DISTURBING PATTERN OF APPRAISAL ABUSES AND THEIR RELATIONSHIP TO FINANCIAL INSTITUTION FAILURES PROMPTED LAST YEAR'S INVESTIGATION AND REPORT BY MY SUBCOMMITTEE.

GIVEN THIS BACKGROUND, WE WERE NOT SURPRISED TO LEARN THAT APPRAISAL ABUSES ALMOST ALWAYS RESULT FROM EXTREME BORROWER AND LENDER PRESSURES ON APPRAISERS TO PRODUCE INFLATED MARKET VALUES THAT WILL JUSTIFY A LOAN OR INVESTMENT.

BUT IF APPRAISAL ABUSES ARE SO CLOSELY TIED TO PRESSURES FROM BORROWERS AND LENDERS AND IF THEY ARE ABETTED BY INEFFECTIVE BANK

SUPERVISORS -- AND THEY ARE -- THEN WHY IS EVERYONE COMING DOWN ON APPRAISERS? BECAUSE, IN MY JUDGMENT, THE APPRAISAL IS THE CRITICAL DOCUMENT WITHOUT WHICH THE DEAL CAN'T BE MADE! IN VIRTUALLY EVERY REAL ESTATE VENTURE AND IN VIRTUALLY EVERY DERIVATIVE PRIMARY AND SECONDARY MARKET TRANSACTION, THE VALUE OF THE UNDERLYING PROPERTY -- AS ESTABLISHED BY THE APPRAISER -- IS THE KEY ELEMENT. LENDERS, BORROWERS, BROKERS, INVESTORS, INSURERS AND REGULATORS ALL LOOK TO THE APPRAISAL TO VALIDATE THE LEGITIMACY OR WISDOM OF THE TRANSACTION. MOREOVER, IN THE EVENT OF A DEFAULT ON A REAL ESTATE LOAN OR A FAILURE TO PAY INTEREST ON MORTGAGE-BACKED SECURITIES, THE MARKET VALUE OF THE COLLATERAL IS OFTEN THE ONLY THING THAT STANDS BETWEEN THE LENDER OR INVESTOR AND A LOSS.

BECAUSE APPRAISAL ABUSES ARE A CRITICAL FACTOR IN SO MANY REAL ESTATE TRANSACTIONS THAT HAVE GONE SOUR, IT MIGHT BE USEFUL FOR ME TO PAINT

A PICTURE OF THE TROUBLED BACKDROP AGAINST WHICH THE APPRAISAL ISSUE IS BEING CONSIDERED. IT'S A PRETTY DEPRESSING LANDSCAPE:

-- LET'S LOOK, FIRST, AT THE GROWING NUMBER OF FINANCIAL INSTITUTION INSOLVENCIES: IN 1984, 79 FDIC-INSURED BANKS FAILED. IN 1985, 120 FAILED. IN 1986, 145 BANKS HAD TO BE CLOSED BY THE FDIC.

THE THRIFT INDUSTRY PICTURE IS IN MANY WAYS WORSE: IN 1984, 28 THRIFTS WERE CLOSED OR MERGED OUT OF EXISTENCE BY THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION. IN 1985, THAT NUMBER GREW TO 60. IN 1986, 113 S&L'S WERE EITHER DECLARED INSOLVENT, PLACED UNDER A MANAGEMENT CONSIGNMENT PROGRAM, OR FORCIBLY MERGED.

-- THIS INCREASE IN FINANCIAL INSTITUTION FAILURES IS THREATENING THE SOLVENCY OF OUR FEDERAL DEPOSIT INSURANCE FUNDS. SOME WOULD ARGUE THAT TECHNICALLY, FSLIC IS ALREADY INSOLVENT. BETWEEN 1984 AND 1986, THE THRIFT DEPOSIT

INSURANCE FUND LOST CLOSE TO $10 BILLION. THE USEABLE ASSETS OF THE FSLIC HAVE NOW SHRUNK TO LESS THAN $2 BILLION. IF ALL THE OPEN THRIFT INSTITUTIONS THAT ARE INSOLVENT UNDER GENERALLY ACCEPTED ACCOUNTING PRINCIPALS, WERE FORCED TO CLOSE, THE FSLIC FUND WOULD HAVE TO PAY OUT AT LEAST $20 BILLION MORE THAN IT CURRENTLY HAS. AND, THE LOSSES ARE GROWING.

TOTAL LOSSES TO THE FDIC FUND IN 1984, '85 AND '86 WERE ABOUT $6 BILLION. ALTHOUGH IT APPEARS TO BE IN GOOD CONDITION WITH $18 BILLION IN ASSETS, THE INSOLVENCY OF A SINGLE MONEY CENTER BANK COULD, BY ITSELF, PUT THE FUND INTO BANKRUPTCY.

-- ANOTHER PART OF THE BACKDROP AGAINST WHICH THE APPRAISAL ISSUE IS BEING CONSIDERED IS THE ETHICS QUOTIENT OF THE BANKING PROFESSION. SOME WOULD SUGGEST THAT THE TERM "ETHICS IN BANKING" IS AN OXYMORON LIKE "CAFETERIA FOOD." AS I MENTIONED A MOMENT AGO, MY SUBCOMMITTEE ISSUED A REPORT THREE YEARS AGO ON CRIMINAL

MISCONDUCT INSIDE OUR NATION'S FINANCIAL INSTITUTIONS WHICH FOUND

> "A DEEPLY DISTURBING PICTURE OF AN INDUSTRY THAT SUFFERS TOO MANY FAILURES DUE TO INSIDER FRAUD, A BANK SUPERVISORY SYSTEM THAT FREQUENTLY FAILS TO DETECT, INVESTIGATE OR PENALIZE SUCH FRAUD, AND A CRIMINAL LAW ENFORCEMENT SYSTEM THAT FREQUENTLY FAILS TO PROSECUTE IT."

THE SITUATION TODAY IS ONLY SLIGHTLY IMPROVED. WHILE THE FEDERAL BANKING AGENCIES AND THE JUSTICE DEPARTMENT HAVE MADE MODEST IMPROVEMENTS IN THEIR RESPONSES TO INSIDER FRAUD, THE INCIDENCE OF THAT FRAUD CONTINUES AT UNACCEPTABLY HIGH LEVELS. RECENTLY, ATTORNEY GENERAL MEESE REPORTED TO THE SUBCOMMITTEE THAT PENDING CRIMINAL BANK FRAUD CASES, EACH INVOLVING LOSSES OF AT LEAST $100,000, HAD INCREASED FROM 2,500 IN SEPTEMBER 1985 TO APPROXIMATELY 3,000 IN JUNE OF 1986. THESE CASES REPRESENT A MINIMUM OF $300 MILLION LOSS TO THE FDIC AND FSLIC.

BUT IS THE ROLE OF APPRAISAL ABUSES IN ALL OF THIS BEING EXAGGERATED? I DON'T THINK SO. LET'S LOOK AT THE RECORD:

WHEN THE SUBCOMMITTEE INITIATED ITS FORMAL HEARINGS INTO APPRAISAL PROBLEMS IN DECEMBER 1985, I STATED THAT THE HEARINGS SOUGHT ANSWERS TO THE FOLLOWING QUESTIONS:

> "HOW EXTENSIVE ARE APPRAISAL ABUSES AND HOW MUCH OF A ROLE DO THEY PLAY IN CREATING FINANCIAL LOSSES AND OTHER ADVERSE CONSEQUENCES IN THE REAL ESTATE AND FINANCIAL MARKETS? ARE FALSE AND FRAUDULENT APPRAISAL MERELY INCIDENTAL TO THESE ADVERSE CONSEQUENCES OR ARE THEY CENTRAL? IF ABUSIVE APPRAISAL PRACTICES HAVE A SIGNIFICANT NEGATIVE IMPACT ON REAL ESTATE FINANCING AND INVESTMENT, WHAT SPECIFIC ACTION SHOULD BE TAKEN TO ADDRESS THE PROBLEM?"

HERE IS WHAT WE FOUND:

1. SAVINGS AND LOANS:

HUNDREDS OF SAVINGS AND LOANS INSURED BY THE FSLIC HAVE BEEN SEVERELY WEAKENED OR DECLARED INSOLVENT BECAUSE FAULTY AND FRAUDULENT REAL ESTATE APPRAISALS PROVIDED DOCUMENTATION FOR LOANS LARGER THAN JUSTIFIED BY THE COLLATERAL'S REAL VALUE. CORRESPONDING LOSSES TO THE FINANCIAL INSTITUTIONS AND THE FSLIC HAVE BEEN IN THE MANY BILLIONS OF DOLLARS. IN JUST TWO THRIFTS STUDIED IN-DEPTH BY THE SUBCOMMITTEE -- THE SUNRISE SAVINGS AND LOAN ASSOCIATION OF FLORIDA AND THE COMMUNITY SAVINGS AND LOAN OF MARYLAND -- APPRAISAL-RELATED LOSSES WERE ESTIMATED AT MORE THAN $300 MILLION.

A. BETWEEN JANUARY 1983 AND MID-OCTOBER 1985, THE REAL ESTATE LOAN PORTFOLIOS OF MORE THAN 800, OR 25 PERCENT, OF THE APPROXIMATELY 3,200 FEDERALLY INSURED THRIFTS WERE

FOUND TO HAVE SIGNIFICANT APPRAISAL DEFICIENCIES. IN MORE THAN 300 OF THESE INSTITUTIONS, APPRAISAL-RELATED PROBLEMS CONTRIBUTED SIGNIFICANTLY TO THEIR BEING PLACED IN PROBLEM STATUS OR DECLARED INSOLVENT. THE PROBLEM APPRAISALS FOUND IN THESE 800-PLUS ASSOCIATIONS IMPROPERLY OVERVALUED THE COLLATERAL SECURING REAL ESTATE LOANS BY AN AGGREGATE OF $3 BILLION.

B. DURING THE SAME 1983-1985 PERIOD, MORE THAN HALF OF THE FHLBB'S 115 CEASE-AND-DESIST, REMOVAL AND PROHIBITION ORDERS INVOLVED SERIOUS APPRAISAL PROBLEMS.

2. COMMERCIAL BANKS:

SIGNIFICANT APPRAISAL PROBLEMS HAVE ALSO PLAGUED LARGE NUMBERS OF COMMERCIAL BANKS CONTRIBUTING TO HUNDREDS OF MILLIONS OF DOLLARS IN LOSSES, HUNDREDS OF WEAKENED AND/OR

FAILED INSTITUTIONS, AND HUNDREDS OF ENFORCEMENT ACTIONS.

A. OF THE HUNDREDS OF ENFORCEMENT ACTIONS TAKEN BY THE FEDERAL RESERVE AGAINST STATE MEMBER BANKS AND BANK HOLDING COMPANIES BETWEEN JANUARY 1983 AND MID-NOVEMBER 1985, MANY INVOLVED THE INSTITUTIONS' FAILURE TO OBTAIN ADEQUATE APPRAISALS.

B. (I) THE FDIC FOUND EVIDENCE OF FAULTY OR FRAUDULENT APPRAISALS IN 30 INSTITUTIONS BETWEEN JANUARY 1983 AND NOVEMBER 1985. CRIMINAL REFERRALS AND/OR CIVIL ENFORCEMENT ACTIONS AGAINST THE INSTITUTIONS INVOLVED WERE MADE IN ALL 30 CASES.

(II) DURING ITS RESCUE OF THE FAILING CONTINENTAL ILLINOIS NATIONAL BANK, THE FDIC ACQUIRED APPROXIMATELY $400 MILLION OF THAT BANK'S PROBLEM REAL ESTATE LOANS. THE REAPPRAISED VALUE OF THE 21

LARGEST PROPERTIES TOTALED $184.4 MILLION -- A 64 PERCENT DECLINE FROM THEIR ORIGINALLY APPRAISED VALUE OF $518.4 MILLION. OF THE 10 REAL ESTATE APPRAISALS IN THIS PORTFOLIO EXPRESSLY EXAMINED BY THE FDIC AT THE SUBCOMMITTEE'S REQUEST, THE FDIC FOUND EXTENSIVE, SERIOUS APPRAISAL DEFICIENCIES IN ALL 10. THE FDIC PROJECTS A $200 MILLION LOSS FROM THESE 21 PROBLEM LOANS.

C. IN RECENT YEARS, THE OCC HAS TAKEN MANY APPRAISAL RELATED CIVIL ENFORCEMENT ACTIONS AGAINST INSTITUTIONS IT REGULATES. BANK OF AMERICA, WELLS FARGO BANK, AND CONTINENTAL ILLINOIS HAVE EXPERIENCED COMBINED APPRAISAL-RELATED LOSSES FROM REAL ESTATE LOANS OR MORTGAGE-BACKED SECURITIES THAT ARE EXPECTED TO EXCEED $300 MILLION.

3. THE VETERANS ADMINISTRATION, FHA AND PRIVATE MORTGAGE INSURERS HAVE SUFFERED MAJOR LOSSES

ATTRIBUTABLE TO PROBLEM APPRAISALS AND POOR APPRAISER PERFORMANCE. ESTIMATES SUGGEST THAT AS MUCH AS 40 PERCENT OF VA'S $420 MILLION LOAN GUARANTEE PROGRAM LOSS FOR FISCAL YEAR 1985, WAS CAUSED BY PROBLEM APPRAISALS. THE DRAMATIC INCREASES IN THE NUMBER OF VA DISCIPLINARY ACTIONS AGAINST APPRAISERS FOR INCOMPETENCY OR UNETHICAL BEHAVIOR FURTHER ILLUSTRATES THE SITUATION: IN FISCAL YEAR 1983, IT WAS 348. IN '84 IT WAS 505. IN FY '85 IT WAS 631. AND IN FISCAL 1986 IT GREW TO 1,200! FHA HAS BEEN SIMILARLY VICTIMIZED. PRIVATE MORTGAGE INSURERS TESTIFIED THAT BETWEEN 10 AND 15 PERCENT OF ITS $1.3 BILLION IN LOSSES IN 1984 AND 1985 WERE ATTRIBUTABLE TO FAULTY AND FRAUDULENT APPRAISALS PERFORMED IN CONNECTION WITH THE MORTGAGES THEY INSURED.

4. FANNIE MAE AND TO A SOMEWHAT LESSER EXTENT FREDDIE MAC, HAVE ALSO EXPERIENCED SIGNIFICANT APPRAISAL

RELATED PROBLEMS AND LOSSES. BETWEEN JULY 1984 AND SEPTEMBER 1985, FANNIE MAE UNDERTOOK MORE THAN 400 SEVERE PENALTY ACTIONS AGAINST LENDERS BECAUSE OF APPRAISAL PROBLEMS IN CONNECTION WITH REAL ESTATE LOANS IT HAD PURCHASED FROM THEM. DURING THE SAME PERIOD, FANNIE MAE SOLD 4,307 PROPERTIES ACQUIRED AS A RESULT OF DEFAULT AT AN AGGREGATE SALES PRICE WHICH WAS $63 MILLION LESS THAN THEIR ORIGINAL APPRAISED VALUE, AN AVERAGE LOSS IN VALUE OF 22 PERCENT.

5. THE FAST GROWING MULTI-BILLION DOLLAR PRIVATE MARKET FOR MORTGAGE-BACKED SECURITIES IS EXTREMELY VULNERABLE TO APPRAISAL ABUSES. AND I KNOW THAT SOME OF YOU ARE DEEPLY CONCERNED ABOUT PENSION PLAN INVESTMENTS IN REAL ESTATE THAT ARE OSTENSIBLY PROTECTED BY THE LABOR DEPARTMENT UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1978 (ERISA). THE RECENT COLLAPSE OF THE EQUITY PROGRAMS INVESTMENT

> CORPORATION (EPIC) (HEADQUARTERED IN WASHINGTON, DC) WAS ATTRIBUTABLE IN SUBSTANTIAL PART TO APPRAISAL ABUSES WHICH OVERVALUED PROPERTIES BY AT LEAST 25 PERCENT ABOVE ACTUAL MARKET VALUE. FRAUDULENT APPRAISALS APPEAR TO BE ENDEMIC ON THE WEST COAST. LAST YEAR, THE BANK OF AMERICA TOOK A $95 MILLION LOSS BECAUSE OF FRAUDULENT APPRAISALS ON SOME HOUSTON AND SOUTHERN CALIFORNIA PROPERTIES IN CONNECTION WITH MORTGAGE-BACKED SECURITIES THAT IT SOLD TO INVESTORS.

MOST RECENTLY, THE SUBCOMMITTEE HAS DEVELOPED INFORMATION THAT OF THE 28 THRIFT INSTITUTION FAILURES IN CALIFORNIA OVER THE PAST TWO YEARS, ALMOST ALL INVOLVED ABUSIVE APPRAISALS AND/OR FRAUD BY INSIDERS. IN LATE MAY OR EARLY JUNE, THE COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE WILL HOLD HEARINGS IN CALIFORNIA TO EXAMINE THESE ISSUES.

HAPPILY, HOWEVER, MANY STEPS HAVE ALREADY BEEN TAKEN AND OTHERS ARE PLANNED TO REDRESS THIS

CONTINUING NATIONAL PROBLEM. THE MOST IMPORTANT ARE THOSE OF THE MAJOR PROFESSIONAL APPRAISAL GROUPS THEMSELVES, PARTICULARLY THE CREATION OF SELECT COMMITTEES ON APPRAISAL STANDARDS AND IMPLEMENTATION. MY STAFF HAS BEEN WORKING CLOSELY WITH THE LEADERSHIP OF THESE COMMITTEES IN AN EFFORT TO DEVELOP A CONSENSUS FOR LEGISLATIVE REFORM. ALTHOUGH THE LEGISLATION IS NOT QUITE COMPLETED, I WANT TO DESCRIBE ITS BROAD-BRUSH OUTLINE:

LET ME MAKE TWO POINTS AT THE OUTSET: THE FIRST IS THAT THE BILL I AM DRAFTING RELATES ONLY TO REAL ESTATE APPRAISING. RECENTLY, MY SUBCOMMITTEE HAS BEEN CONTACTED BY SEVERAL PERSONAL PROPERTY APPRAISAL GROUPS WHO BELIEVE THAT THEY SHOULD ALSO BE INCLUDED IN THE NEW LEGISLATION. WHILE THE LEGISLATIVE HEARING PROCESS MAY ULTIMATELY DO THAT, OUR INVESTIGATION INDICATED THAT TROUBLED REAL ESTATE TRANSACTIONS

COMPRISE THE BULK OF THE PROBLEM. ACCORDINGLY, MY BILL WILL ONLY ADDRESS REAL ESTATE APPRAISING.

THE SECOND POINT IS THAT MY BILL PLACES PRIMARY RESPONSIBILITY FOR ESTABLISHING APPRAISAL STANDARDS AND CERTIFICATION REQUIREMENTS IN THE HANDS OF PRIVATE SECTOR APPRAISERS, WHO WOULD CONTROL THE APPRAISAL FOUNDATION. AND, IT LEAVES TO THE STATES, ENFORCEMENT OF THOSE STANDARDS AND REQUIREMENTS. HOWEVER, IN RECOGNITION OF THE STRONG FEDERAL INTEREST IN PREVENTING APPRAISAL ABUSES, THE LEGISLATION CREATES A FEDERAL OVERSIGHT ENTITY THAT COULD EXERCISE AUTHORITY IF THE PRIVATE SECTOR FOUNDATION AND THE STATES FAILED TO ACT EFFECTIVELY.

THE LEGISLATION WILL CREATE A SELF-REGULATORY STRUCTURE COMPRISED OF THREE PARTS: THE FIRST PART IS A FEDERALLY CHARTERED APPRAISAL INDUSTRY FOUNDATION, THE MAJORITY OF WHOSE MEMBERS WILL BE FROM THE APPRAISAL PROFESSION. THE SECOND PART AUTHORIZES CREATION OF STATE BOARDS OF

PROFESSIONAL APPRAISER RESPONSIBILITY WHICH WOULD LICENSE AND DISCIPLINE APPRAISERS. AND, THIRDLY, THE BILL ESTABLISHES A FEDERAL INTERAGENCY APPRAISAL COUNCIL TO OVERSEE THE WORK OF THE FOUNDATION AND THE STATE BOARDS.

THE APPRAISAL INDUSTRY FOUNDATION WOULD PERFORM TWO MAJOR FUNCTIONS: IT WOULD ESTABLISH NATIONAL REAL ESTATE APPRAISAL STANDARDS -- THAT IS, HOW AN APPRAISAL SHOULD BE PERFORMED AND THE FACTORS THAT MUST BE CONSIDERED IN ESTABLISHING A PROPERTY'S MARKET VALUE. AND, IT WOULD PROMULGATE APPRAISER CERTIFICATION OR LICENSING REQUIREMENTS -- THAT IS, THE EDUCATIONAL, WORK EXPERIENCE, AND CONTINUING EDUCATION QUALIFICATIONS NECESSARY TO BE AN APPRAISER.

MY LEGISLATION GIVES THE 50 STATES AN EXTREMELY IMPORTANT ROLE TO PLAY. EACH STATE WOULD BE AUTHORIZED TO ESTABLISH BOARDS OF PROFESSIONAL APPRAISER RESPONSIBILITY WHOSE FUNCTION WOULD BE TO LICENSE APPRAISERS WHO MEET

THE FOUNDATION'S CERTIFICATION REQUIREMENTS; AND TO DISCIPLINE THOSE WHO FAIL TO ADHERE TO THE STANDARDS OF PRACTICE SET BY THE FOUNDATION. THE BOARDS WOULD BE AUTHORIZED TO PROMULGATE APPRAISAL STANDARDS AND CERTIFICATION REQUIREMENTS HIGHER, BUT NOT LOWER, THAN THOSE ESTABLISHED BY THE FOUNDATION; AND THEY COULD USE CIVIL ENFORCEMENT MECHANISMS TO REMOVE, SUSPEND, FINE OR OTHERWISE DISCIPLINE UNETHICAL OR NEGLIGENT BEHAVIOR. ESSENTIALLY, THE STATES WOULD LICENSE AND DISCIPLINE APPRAISERS IN MUCH THE SAME WAY THAT THEY CURRENTLY LICENSE AND DISCIPLINE DOCTORS, LAWYERS AND OTHER PROFESSIONAL GROUPS.

THE FEDERAL INTERAGENCY APPRAISAL COUNCIL WOULD OVERSEE THE WORK OF BOTH THE FOUNDATION AND THE STATE BOARDS. REPRESENTATIVES OF FEDERAL AGENCIES MOST DIRECTLY CONCERNED WITH THE INTEGRITY OF THE APPRAISAL PROCESS -- THE FEDERAL BANKING AGENCIES, THE SECURITIES AND EXCHANGE

COMMISSION, THE VA AND FHA, AND FANNIE MAE AND FREDDIE MAC -- WOULD MAKE UP THE COUNCIL'S MEMBERSHIP. OTHER FEDERAL AGENCIES MIGHT BE INVITED TO PARTICIPATE ON AN ADVISORY BASIS. IN SOME WAYS, THE COUNCIL WOULD OPERATE A LITTLE LIKE THE EXISTING FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL.

THE APPRAISAL COUNCIL WOULD BE AUTHORIZED, UNDER PROPER DUE PROCESS SAFEGUARDS, TO AMEND THE FOUNDATION'S APPRAISAL STANDARDS AND TO STRENGTHEN ENFORCEMENT OF CERTIFICATION/LICENSING REQUIREMENTS, <u>BUT ONLY IF THE FOUNDATION AND THE STATES FAILED TO EXERCISE THESE RESPONSIBILITIES ADEQUATELY</u>. APPRAISAL STANDARDS WOULD BE AMENDED BY REGULATION UNDER THE ADMINISTRATIVE PROCEDURE ACT, AFTER PUBLIC NOTICE AND A HEARING. CERTIFICATION REQUIREMENTS COULD BE ENFORCED BY THE COUNCIL THROUGH THE USE OF CIVIL ENFORCEMENT ACTIONS SUCH AS CEASE-AND-DESIST ORDERS. AGAIN, THE COUNCIL WOULD ACT ONLY

IF THE FOUNDATION'S APPRAISAL STANDARDS WERE SERIOUSLY INADEQUATE; OR ONLY IF THE STATE BOARDS LICENSED INCOMPETENT APPRAISERS OR REFUSED TO DISCIPLINE APPRAISERS WHO ENGAGED IN UNETHICAL BEHAVIOR.

A KEY FEATURE OF MY LEGISLATION IS THAT EACH STATE WOULD BE GIVEN A SPECIFIED PERIOD OF TIME -- PROBABLY 24 MONTHS -- DURING WHICH IT WOULD HAVE TO DECIDE WHETHER OR NOT TO PARTICIPATE IN THIS SYSTEM. IF ANY STATE DECLINED TO DO SO, THEN THE FEDERAL INTERAGENCY COUNCIL WOULD BE REQUIRED TO PROHIBIT ANY APPRAISER IN THAT STATE FROM PERFORMING AN APPRAISAL WHERE THERE IS A "COVERED FEDERAL INTEREST" -- A TERM I WILL EXPLAIN IN A MOMENT. IT IS MY INTENTION, HOWEVER, TO PERMIT THE COUNCIL SOME OPPORTUNITY TO EXTEND THE 24-MONTH DEADLINE, IF THERE IS GOOD CAUSE TO DO SO.

ONE OF THE COUNCIL'S MOST IMPORTANT FUNCTIONS WOULD BE TO DETERMINE WHICH SPECIFIC FEDERAL INTERESTS WOULD BE "COVERED" BY THE

FOUNDATION'S APPRAISAL STANDARDS AND CERTIFICATION REQUIREMENTS. FOR EXAMPLE, THE COUNCIL MIGHT DECIDE THAT ALL APPRAISALS INVOLVING MULTI-FAMILY AND COMMERCIAL LOANS OR INVESTMENTS BY FEDERALLY INSURED FINANCIAL INSTITUTIONS, WOULD BE COVERED; WHILE APPRAISALS PERFORMED FOR MORTGAGE LOANS ON SINGLE FAMILY RESIDENTIAL PROPERTIES, WOULD NOT BE COVERED. THE COUNCIL MIGHT DECIDE THAT APPRAISALS PERFORMED IN CONNECTION WITH THE SALE TO THE PUBLIC OF MORTGAGE-BACKED SECURITIES UNDER FEDERAL SECURITIES LAWS, WOULD BE COVERED; WHEREAS PRIVATE PLACEMENTS OF SUCH SECURITIES WOULD NOT BE. THE COUNCIL MIGHT DETERMINE THAT MORTGAGE LOANS INSURED OR GUARANTEED BY VA, FHA OR THE FARMERS HOME ADMINISTRATION, WOULD BE A COVERED ACTIVITY; BUT THAT APPRAISALS USED IN CONNECTION WITH FEDERAL EMINENT DOMAIN PROCEEDINGS WOULD NOT BE. THE COUNCIL MIGHT DECIDE THAT MORTGAGES PURCHASED BY FANNIE MAE AND FREDDIE MAC WOULD BE COVERED; BUT

THAT APPRAISALS PERFORMED IN CONNECTION WITH ESTATE OR OTHER TAX ISSUES, WOULD NOT BE.

THE POINT HERE IS THAT THE INTERAGENCY COUNCIL WOULD BE REQUIRED TO PROMULGATE BY REGULATION, EXACTLY WHICH FEDERAL INTERESTS WERE OF SUFFICIENT IMPORTANCE TO JUSTIFY THEIR INCLUSION IN THE APPRAISAL STANDARD AND CERTIFICATION PROGRAM.

GIVEN THE STRONG EMPHASIS IN MY LEGISLATION ON THE PRIMACY OF THE APPRAISAL INDUSTRY AND ON THE ROLE OF THE STATES; AND GIVEN THE CONTINUING NATURE OF THE APPRAISAL PROBLEM, MY HOPE IS THAT THE BILL WILL BE SUPPORTED ENTHUSIASTICALLY BY ALL THE MAJOR APPRAISER GROUPS AND RECEIVE FAVORABLE CONSIDERATION IN CONGRESS. HOWEVER, UNTIL LEGISLATION IS ENACTED, THE APPRAISAL INDUSTRY MUST CONTINUE ITS ADMIRABLE SELF-ENFORCEMENT EFFORTS; AND CONCERNED FEDERAL AGENCIES MUST USE EXISTING POWERS AGAINST APPRAISERS, LENDERS, BORROWERS AND OTHERS WHO

ABUSE THE INTEGRITY OF THE APPRAISAL PROCESS. IN THIS REGARD, I AM ENCOURAGED BY TWO DEVELOPMENTS: THE FIRST IS THAT THE APPRAISAL GROUPS COMPRISING THE SELECT COMMITTEES ARE PREPARED TO ESTABLISH THEIR OWN PRIVATELY INCORPORATED APPRAISAL FOUNDATION, WHICH WOULD ENCOURAGE -- BUT COULD NOT REQUIRE -- USE OF UNIFORM APPRAISAL STANDARDS AND MORE RESPONSIBLE APPRAISAL PRACTICES. THE SECOND DEVELOPMENT IS THAT THERE IS NOW IN PLACE, A FUNCTIONING FEDERAL INTERAGENCY TASK FORCE THAT IS WORKING TO RESOLVE APPRAISAL PROBLEMS AT THE ADMINISTRATIVE LEVEL.

IN THE FINAL ANALYSIS, HOWEVER, <u>ONLY A LEGISLATIVE SOLUTION</u> CAN RESTORE SAFETY TO OUR FINANCIAL INSTITUTIONS, SOLVENCY TO THE DEPOSIT INSURANCE SYSTEMS, AND SOUNDNESS TO ALL THE OTHER REAL ESTATE TRANSACTIONS THAT RELY ON HONEST APPRAISALS. AND ONLY LEGISLATION CAN ELEVATE APPRAISERS TO THEIR PROPER ROLE AS PROFESSIONALS

WHO ARE TRULY INDEPENDENT OF BORROWER AND LENDER PRESSURES.

I HOPE I WILL HAVE YOUR HELP IN ACHIEVING THESE OBJECTIVES.

Union Calendar No. 536

99th Congress, 2d Session - - - - - - - - - - - - House Report 99-891

IMPACT OF APPRAISAL PROBLEMS ON REAL ESTATE LENDING, MORTGAGE INSURANCE, AND INVESTMENT IN THE SECONDARY MARKET

FORTY-EIGHTH REPORT

BY THE

COMMITTEE ON GOVERNMENT OPERATIONS

SEPTEMBER 25, 1986.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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LETTER OF TRANSMITTAL

HOUSE OF REPRESENTATIVES,
Washington, DC, September 25, 1986.

Hon. THOMAS P. O'NEILL, Jr.,
Speaker of the House of Representatives,
Washington, DC.

DEAR MR. SPEAKER: By direction of the Committee on Government Operations, I submit herewith the committee's forty-eighth report to the 99th Congress. The committee's report is based on a study made by its Commerce, Consumer, and Monetary Affairs Subcommittee.

JACK BROOKS, *Chairman.*

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Union Calendar No. 536

99TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
99-891

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SEPTEMBER 25, 1986.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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Mr. BROOKS, from the Committee on Government Operations, submitted the following

FORTY-EIGHTH REPORT

BASED ON A STUDY BY THE COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE

On September 23, 1986, the Committee on Government Operations approved and adopted a report entitled "Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in the Secondary Market." The chairman was directed to transmit a copy to the Speaker of the House.

I. INTRODUCTION

In accordance with its oversight jurisdiction for the activities and operations of the Federal banking regulatory agencies,[1] the Commerce, Consumer, and Monetary Affairs Subcommittee has investigated the circumstances surrounding major financial institution failures, including those of the Penn Square Bank of Oklahoma City, OK, United American Bank of Knoxville, TN, and Empire Savings and Loan Association of Mesquite, TX. The demise of these institutions typically involved elements of fraud, self-dealing, extreme concentrations of credit, and pervasive managerial negligence or incompetence. To a significant degree in the Empire and UAB failures, and to a lesser extent with Penn Square, faulty and fraudulent real estate appraisals also were found to have played a

[1] The Federal Home Loan Bank Board (FHLBB), Federal Deposit Insurance Corporation (FDIC), Comptroller of the Currency (OCC), Federal Reserve Board (Fed), and the National Credit Union Administration (NCUA).

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crucial role in their gradual weakening and ultimate collapse.[2] The disturbing pattern of appraisal abuses identified in these investigations and their negative impact on the affected institutions prompted a separate inquiry into these problems, the results of which are the subject of this report.

The report examines the impact of faulty and fraudulent appraisals on the real estate loans of federally insured financial institutions; on residential loans guaranteed by the Veterans Administration (VA) and Federal Housing Administration (FHA); on the purchase of mortgages by the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac); and, on the mortgage insurance industry and mortgage-backed securities markets. It is based on an extensive hearing record, analysis of thousands of pages of documents, and interviews with knowledgeable public and private sector sources.

The report seeks to answer a number of questions posed by subcommittee chairman, Congressman Doug Barnard, Jr., in his opening remarks at the December 1985 hearings on the appraisal issue, as follows:

> How extensive are appraisal abuses and how much of a role do they play in creating financial losses and other adverse consequences in the real estate and financial markets? Are false and fraudulent appraisals merely incidental to these adverse consequences or are they central?
>
> Have the Federal agency and private sector responses to abusive appraisal practices been adequate?
>
> What percentage of defective appraisals are due merely to incompetency and what percentage to the deliberate actions of the appraiser?
>
> If abusive appraisal practices have a significant negative impact on real estate financing and investment, what specific actions should be taken to address the problem?

II. Background

Real estate appraisals have become an intrinsic part of the mortgage loan underwriting process, beginning with the 1930's when the Great Depression exposed the virtual non-existence of property valuation standards and methods within the residential and commercial real estate markets. In the wake of the stock market collapse of 1929, tens of thousands of home owners faced foreclosure and operating costs far exceeded income for office and apartment

[2] In the respective reports, "Federal Supervision and Failure of the United American Bank in Knoxville, Tenn., and Affiliated Banks," H. Report No. 98-573, November 18, 1983 and "Federal Home Loan Bank Board Supervision and Failure of Empire Savings and Loan Association of Mesquite, Tex.," H. Report 98-953, August 6, 1984, the subcommittee recommended that the FHLBB and FDIC " . . . give serious consideration to systematically seeking civil liability recoveries from real estate appraisers when appraisals prove to be the result of improper influence or failure to adhere to adequate professional appraisal standards. Moreover, . . . [they] should widely publicize . . . [their] intent to seek civil liability recoveries from appraisers." In the reports, additional recommendations were made urging: FDIC examiners and supervisory personnel to carefully monitor insider lending, including the verification of collateral and detection of excessive appraisals; and, that in FHLBB institutions where appraisals have been found to be a problem, a specific officer be designated to certify in writing that appraisal reports satisfy appropriate regulatory requirements. While the FHLBB, for the most part, has responded effectively to the recommendations addressed to it (see, Hearings, pp. 793-794), the FDIC, in general, decided against taking action along the lines suggested.

buildings, causing the Federal Government, the financial community, and real estate industry to develop new lending institutions and procedures to correct the abuses and inadequacies identified. A critically important part of these governmental and private sector efforts was a requirement that mortgage loan applications henceforth include an estimate of property value based on some type of standard methodology. With this and other new requirements serving as the point of departure, real estate appraisal practices and procedures have undergone continuous development and refinement over the ensuing half-century, culminating in the comparatively sophisticated system of concepts and methods utilized in contemporary mortgage lending activities.

For the purpose of this report, a real estate appraisal is defined as those methods, procedures, and documents which, collectively, lead to and support an estimate of the market value of the collateral securing a mortgage loan or investment. In the event of a default, the collateral's market value is what stands between the lender or investor and a loss. If performed competently and honestly, an appraisal is conducted independently of the other parties—borrower, lender, broker, et al.—who have a vested interest in a loan transaction's completion. In this respect, only the appraiser is considered to be neutral and only the appraiser is responsible for certifying the value estimate.

The appraisal function is neither entirely an art nor wholly scientific. It consists of a dynamic blend of subjective judgment and objective methodology, depending on the assignment involved. However, notwithstanding the inherent subjectivity involved, objective appraisal approaches and techniques have reached a state of development and sophistication that affords considerable accuracy in determining value estimates.

The real estate appraisal serves a variety of purposes, which affect investment choices, insurance decisions, and regulatory activities, in addition to the primary area of loan origination.[3] In the case of lending institution officials, it provides market information and other critically important data to support sound underwriting decisions on risk exposure, loan-to-value ratios, and maximum loan amounts. The appraisal also serves as an essential part of the process by which public (e.g., VA and FHA) and private sector mortgage insurers attempt to assure themselves of an acceptable risk of loss. Similarly, and particularly in recent years that have seen tremendous growth in the secondary mortgage market and in the sale of mortgage-backed securities, the appraisal serves as one of the principal means by which individual investors and institutions (e.g., Fannie Mae, Freddie Mac, and thrifts) evaluate the quality of the loans they purchase. Finally, the appraisal serves as an important tool used by Federal and State regulators who supervise the Nation's financial institutions, to monitor loan portfolio quality

[3] The role of the appraisal extends further into people's everyday lives than is commonly realized. For instance, appraisals are used by assessors to assist them in calculating property tax bills. Government agencies outside of those discussed in this report, such as the Internal Revenue Service and the U.S. Department of Transportation, use appraisals in various ways; e.g., to settle estate disputes and those involving eminent domain. Appraisals also frequently serve as a means by which parties to a civil proceeding, such as a divorce, can arrive at an agreed upon property settlement.

both in terms of the institutions' overall soundness and the potential risk exposure to State and Federal (FDIC and FSLIC) insurance funds.

In short, accurate and reliable appraisals have come to serve new and increasingly important functions. They are essential, not only in the loan origination context, but in the broader realm of the public's perception of and confidence in the Nation's real estate finance and mortgage insurance and investment industries.

III. Findings and Conclusions

A. SUMMARY

Faulty and fraudulent real estate appraisals have become an increasingly serious national problem. Their harmful effects are widespread, pervasive, and costly. They have seriously damaged and contributed directly to the insolvency of hundreds of the Nation's financial institutions and have helped cause billions of dollars in losses to lenders, private mortgage insurers, investors, and Federal insurance funds. Responsibility for this problem rests with those who perform appraisals or base lending and related mortgage insurance/investment decisions on appraisals they know or should have known were improper or inaccurate. Equally culpable are the Federal agencies that regulate or oversee lending and mortgage insurance/investment activities and programs. The nature and extent of the appraisal problem suggest that for meaningful changes to occur, a broad array of corrective measures will have to be developed and instituted by Federal regulatory authorities, the appraisal industry, and real estate finance and investment interests.

B. NATURE AND EXTENT OF THE PROBLEM

1. *Savings and loans:*

Hundreds of savings and loans chartered by the FHLBB or insured by the FSLIC have been severely weakened or declared insolvent because faulty and fraudulent real estate appraisals provided documentation for loans larger than justified by the collateral's real value. Corresponding losses to the financial institutions and the FSLIC have been in the hundreds of millions of dollars.

a. Between January 1983 and mid-October 1985, the real estate loan portfolios of more than 800, or 25 percent, of the approximately 3,200 federally insured thrifts were found to have significant appraisal deficiencies. In more than 300 of these institutions, appraisal-related problems contributed significantly to their being placed in problem status or declared insolvent. The problem appraisals found in these 800-plus associations overvalued the collateral securing real estate loans by an aggregate of $3 billion. In 70 percent of these associations' loans, the reappraised value of the collateral property was significantly less than the market value cited in the original appraisal.

b. During the same 1983-1985 period, more than half of the FHLBB's 115 cease-and-desist, removal and prohibition orders involved serious appraisal problems. A "very substantial number" of

270 separate supervisory agreements also addressed appraisal problems in these associations.

c. Two thrifts studied in-depth by the subcommittee—the Sunrise Savings and Loan Association of Florida and the Community Savings and Loan of Maryland—were found to have failed in large part due to major appraisal problems and abuses, with resultant appraisal-related losses estimated at more than $300 million.

2. *Banks and credit unions:*

Significant appraisal problems have also plagued large numbers of commercial banks and credit unions regulated and/or insured by the FDIC, OCC, Federal Reserve, and NCUA. Appraisal abuses and deficiencies have, in varying degrees, contributed to hundreds of millions of dollars in losses, hundreds of weakened and/or failed institutions, and hundreds of enforcement actions.

a. Of the hundreds of enforcement actions taken by the Federal Reserve between January 1983 and mid-November 1985 against State member banks and bank holding companies, many involved the institutions' failure to obtain adequate appraisals or to obtain and maintain in their files supporting loan documentation, including appraisals. In at least two instances, Fed-supervised institutions became insolvent or were liquidated because of circumstances in which fraudulent appraisals played a significant role.

b. (i) In connection with its examination responsibilities regarding open banks and its insurance role as receiver for closed banks, the FDIC found evidence of faulty or fraudulent appraisals in 30 institutions between January 1983 and November 1985. Criminal referrals and/or civil enforcement actions against the institutions involved were made in all 30 cases.

(ii) Pursuant to its involvement in the effort to rescue the failing Continental Illinois National Bank and Trust Company, the FDIC acquired approximately $400 million of that bank's problem real estate loans. The reappraised value of the 21 largest properties totaled $184.4 million—a 64 percent decline from their originally appraised value of $518.4 million. Of the 10 real estate appraisals in this portfolio expressly examined by the FDIC at the subcommittee's request, the FDIC found extensive, serious deficiencies in all 10; which, in part, accounts for FDIC's projected $200 million loss from these problem loans.

c. In recent years, the OCC has taken many enforcement actions against institutions it regulates—formal agreements and cease-and-desist orders, as well as informal memorandums of understanding—designed to address significant deficiencies in underwriting practices, including appraisals. At least three major OCC-supervised institutions, the Bank of America, Wells Fargo Bank, and Continental Illinois National Bank and Trust Company, have experienced combined appraisal-related losses from real estate loans or mortgage-backed securities that are expected to exceed $300 million. (see 2-b(ii), above and 5-b, below)

d. According to the NCUA, appraisal problems—inflated property values due to self-dealing and the failure to obtain adequate appraisals from a qualified appraiser—in connection with real estate loans have become a cause for serious concern. The NCUA reports that such abuses have been linked directly to losses of $1.2 million in two insured credit unions, both of which ultimately failed.

3. *VA, FHA, and private mortgage insurers:*

Public and private sector mortgage insurers have suffered major losses attributable to problem appraisals and poor appraiser performance:

a. Estimates suggest that from 10 percent to as much as 40 percent of the VA's $420 million loan guaranty program loss for FY 1985 was caused by inaccurate or dishonest appraisals and internal appraisal-related administrative deficiencies. According to the VA's Inspector General, between 1981 and 1984 original home loan guaranty program appraisals frequently overvalued properties, resulting in higher claim losses and increased veteran indebtedness. The IG also found major deficiencies in the performance of VA-approved appraisers and home loan guaranty program officials responsible for important appraisal-related functions. In FY 1985, for example, about 10 percent of the VA's approved appraisers were suspended or removed. Also, a nationwide series of major swindles perpetrated against the FHA involved VA appraisers and appraisal documentation.

b. In FY 1985, the FHA's mortgage insurance program lost more than $200 million, attributable to a number of factors, including faulty and fraudulent appraisals. For the past several years, the FHA has been victimized by a continuing series of fraudulent schemes, which relied on falsified and highly inflated appraisal documents. Investigations regarding these schemes are in varying stages of progress in at least six cities nationwide, with possible losses of millions of dollars. HUD's Inspector General has found problems both in the performance of FHA appraisers and the response of responsible FHA officials to appraisal abuses. In FY 1985, the FHA instituted 1,200 disciplinary actions involving its pool of 5,000 approved appraisers. Eight hundred of these actions consisted of warnings, while the remainder were more severe measures that resulted in temporary suspensions and denials of appraiser participation or recertification.

c. At least 10-15 percent of the $1.3 billion in losses experienced by private mortgage insurers in 1984 and 1985 can be attributed to faulty and fraudulent appraisals performed in connection with the mortgages they insured. Private mortgage insurers have found appraiser incompetence, negligence, and misconduct to be widespread. For example, a major insurer's review of 300 defaulted loans it had insured disclosed that 40 percent of the appraisals were defective. In accordance with such findings, the private mortgage insurance companies have declared hundreds of appraisers to be unacceptable and have placed some 200 appraisal companies on "watch lists." (see 5-a, below)

4. *Fannie Mae and Freddie Mac:*

Government-chartered, private sector corporations that package and sell mortgages in secondary markets have experienced significant appraisal problems and/or associated losses:

a. Appraisal abuses and deficiencies constitute about 10 percent of all the significant findings developed under Fannie Mae's post-purchase review system. As a result, for example, between July 1984 and September 1985, Fannie Mae undertook more than 400 severe penalty actions against lenders because of appraisal problems in connection with real estate loans it had purchased from them. Approximately half of these actions required the lender to repurchase the mortgages in question. During the same period, Fannie Mae sold 4,307 properties acquired as a result of default, the aggregate sales price of which was $63.2 million less than their original appraised value—an average loss in value of 22 percent. (see also 5-b, below)

b. Between January 1984 and November 1985, Freddie Mac required 70 participating lenders to repurchase slightly more than 300 mortgages (about one-fifth of the total number of repurchases) for unacceptable, inadequate, or missing appraisals. The estimated dollar value of these appraisal-related repurchases was $15.2 million.

5. *Mortgage-backed securities:*

The fast-growing markets for mortgage-backed securities not guaranteed by an agency of the Federal Government, and for mortgage loan participations by out-of-area institutions, are extremely vulnerable to appraisal abuses. This was evidenced by two cases studied by the subcommittee where hundreds of millions of dollars were lost as a result of schemes in which fraudulent or grossly inflated appraisals played a key role:

a. The recent collapse of the Equity Programs Investment Corporation (EPIC) is attributable in part to endemic appraisal abuses, wherein investment properties were systematically overvalued by at least 25 percent of the actual market value. About $1.4 billion of EPIC mortgages were packaged and sold to scores of FSLIC-insured thrifts, FDIC-insured banks, and other investors, such as Fannie Mae and Salomon Bros. The financial institutions and other investors face possible aggregate losses in the hundreds of millions of dollars. In addition, as a direct result of its involvement in insuring EPIC mortgages, one leading private mortgage insurance company (TICOR) has been placed under State conservatorship. The collective loss exposure of this private mortgage insurance company and two other major ones similarly involved with EPIC is nearly $350 million. Moreover, as a result of its affiliation with EPIC, a thrift insured by the State of Maryland, the Community Savings and Loan, was declared insolvent, with attendant appraisal-related losses estimated at about $100 million.

b. Highly inflated and fraudulent appraisals played an essential part in an intricate scheme that resulted in losses of some $95 million to the Bank of America, which (along with the Wells Fargo Bank) served as trustee/escrow agent for mortgage-backed securities that were packaged by the National Mortgage Equity Corporation (NMEC) and sold to 21 federally insured savings and loans in the Northeast and Middle West. If the Bank of America had not assumed liability, six of the investor thrifts would have found themselves in a negative net worth position and others could have been classified as problem institutions by the FHLBB. At least another 27 banks and thrifts have suffered significant losses because of similar faulty or fraudulent appraisals performed in connection with NMEC activities.

C. SOURCES AND CAUSES OF THE PROBLEM

6. *The appraisal industry:*

a. Appraiser ineptitude, negligence, and misconduct are widespread. Of greatest concern is "client advocacy appraising," wherein large numbers of appraisers willingly agree, or otherwise succumb, to pressure brought to bear by lenders, borrowers, and others involved in the loan origination and underwriting process. Essentially, in exchange for an implicit or explicit promise of future business, so-called "advocacy appraisers" provide the numbers needed "to make the deal work," instead of the independent value estimate they are supposed to furnish.

b. The real estate appraisal industry is fragmented and its members are not generally subject to effective discipline. Only about one-third of the estimated 150,000 to 250,000 appraisers are affiliated with a highly regarded professional trade organization. However, even those organizations are not able to successfully discipline their members, as indicated by 1983-1985 data furnished by four of the largest ones with a combined membership of about 40,000. These data show that out of some 1,600 complaints against appraisers screened and submitted for further consideration, just 40 resulted in suspension or expulsion and another 125 resulted in lesser sanctions such as admonishment or censure.

7. *Lenders:*

a. Alarming numbers of lending institution officials regard appraisals as an obstacle to be overcome or a rubberstamp necessary in order to make a real estate loan under consideration. Loan officers are particularly suspect in this regard, since they are typically under explicit pressure to book as many loans as possible.

b. Many lending institution officers, directors, and managers are demonstrably more interested in up-front fees and other tangible benefits accruing from a completed loan transaction, than they are with being assured that their institution's risk exposure is minimized by an accurate assessment of the actual market value of the loan's underlying collateral.

c. Most lending institutions have no or little appraisal review capability and, in many cases where such capability does exist, it is largely suspect because it is housed in or passes through officials and departments with a vested interest in seeing a loan transaction through to completion.

8. *Federal bank regulatory agencies:*

a. Among all the Federal banking agencies, only the FHLBB has a highly developed and comprehensive system regarding appraisal policies, practices and procedures. This system includes detailed guidelines for how appraisals are to be performed (Memorandum #R-41b), thorough procedures for reviewing appraisals, and FHLBB staff appraisers in all district offices.

b. The Fed, OCC, FDIC, and NCUA have some appraisal-related policies and procedures, but there is little consistency among them and glaring omissions or gaps exist in key areas. For example, while the FHLBB, Fed, and NCUA require their examiners to verify the existence, accuracy, and adequacy of appraisals as they review real estate loans during regular examinations, neither the OCC nor FDIC have such requirements. Only the FHLBB and OCC require their examiners to undergo training that focuses specifically on appraisals and how to verify their accuracy and adequacy. Similarly, while the FHLBB and Fed require an appraisal for each

real estate loan, neither the FDIC, OCC, nor NCUA have such a requirement. Furthermore, while the Fed and OCC may direct member banks to establish internal procedures regarding an appraisal program, no specific guidance is provided as to how that program should be structured and operated by the institution, or monitored by agency examiners.

c. As a matter of supervisory outlook, the FDIC and OCC place major emphasis on a borrower's apparent creditworthiness, and little emphasis on the value of loan collateral as established by an appraiser. However, in the face of significant, continuing real estate loan losses, borrower insolvencies and appraisal abuses occurring within the institutions they supervise, the FDIC/OCC attitude toward appraisals is at best naive and at worst irresponsible. There is evidence that because bankers, borrowers, and appraisers know of the FDIC/OCC's minimal concern regarding careful review of appraisal accuracy and adequacy during regular examinations, some commercial real estate borrowers have begun to move their business to banks, away from thrifts and their stricter appraisal requirements.

d. None of the bank regulatory agencies have conducted studies specifically directed at appraisal problems and their effects on the institutions they supervise. Nor, with the exception of the FHLBB, do any of them regularly and systematically collect appraisal-related data—either in connection with ongoing examination and supervisory functions or regarding insolvent institutions and any attendant liquidation of the latter's assets. It is not surprising, therefore, that the Fed, FDIC, OCC, and NCUA have been and remain essentially uninformed about the extent and consequences of existing appraisal defects and abuses.

e. None of the bank regulatory agencies have adequate policies and procedures regarding the quality and control of appraisals performed in connection with out-of-area or interstate real estate loan participations, mortgage-backed securities, and other types of mortgage-related investments. Such participations and purchases have proliferated in the present deregulated banking environment, resulting in enormous consequent appraisal-related losses and other major adverse effects.

f. None of the bank regulatory agencies have specific requirements covering the qualifications—education, training, experience, and character references—needed to perform an appraisal on loans underwritten or owned by a supervised institution.

g. The bank regulatory agencies as a rule do not coordinate or share information on problem appraisers with institutions under their respective jurisdictions, among themselves at the supervisory level, with other interested Government agencies such as the VA and FHA, and/or with appraisal industry organizations. Such failure to share information helps to explain, in part, how a certain appraiser—who Federal officials described as having wrought havoc up and down the East Coast for years—can still be performing appraisals for federally insured thrifts and FDIC-insured, OCC-supervised banks.

h. The bank regulatory agencies have been deficient in taking actions—e.g., cease-and-desist orders, civil suits, or criminal referrals—against individual problem appraisers, either because they

don't have sufficient authority or because they choose not to exercise the authority they do possess.

i. The subcommittee's investigation regarding the Bank of America, Continental Illinois Bank, and Sunrise Savings and Loan emphatically show how responsible regulatory agencies have been unaware of serious appraisal problems or have failed to adequately respond to such problems even in cases where they were known to exist:

(1) In the Sunrise case, more than 2½ years elapsed before the FHLBB took decisive enforcement action in response to serious appraisal problems in a number of the association's major commercial real estate loans, initially found in 1982 by its examiners. In the interim, Sunrise's assets grew at an astounding rate, e.g., from $88 million in August 1982 to $1 billion in May 1984—fueled in large part by the same kind of commercial real estate loans already identified as being highly likely to involve major appraisal deficiencies. The FHLBB's delay in responding decisively to this association's major appraisal problems helped to assure its collapse and increase the losses from appraisal-tainted nonperforming loans.

(2) The OCC, per its regulation of national banks, failed to discover the major appraisal abuses that were present in the Continental Illinois Bank's $3.3 billion (as of December 1983) real estate loan portfolio.

(3) Similarly, the OCC failed to discover the fraudulently appraised mortgage-backed securities (amounting to $134 million) sold to investors by the National Mortgage Equity Corporation and backed by the Bank of America and Wells Fargo Bank. The OCC was unaware of this activity, which had begun in 1982, until late in 1984. Indeed, it appears that it was only by virtue of a complaint from an affected savings and loan association that the OCC finally learned of the major problem the Bank of America was facing with regard to these mortgage-backed securities.[4]

9. *Government and private mortgage insurers and secondary market institutions:*

a. The VA, FHA, Fannie Mae, Freddie Mac, and private mortgage insurers are inadequately informed about the nature, extent, and impact of appraisal problems in their respective areas of activity, since none regularly or systematically collect detailed appraisal/appraiser-related data. Nor, with a few exceptions among the private mortgage insurance companies, have any formal or informal studies been conducted of the relationship between faulty and fraudulent appraisals and losses experienced.

b. Significant and widespread problems have resulted from the VA's appraisal-related policies and procedures, especially the failure on the part of responsible officials to effectively monitor and supervise appraiser performance and review the adequacy of their

[4] The FDIC cannot escape responsibility for lax enforcement regarding appraisals. For instance, in connection with the subcommittee's recent investigation of the United American Bank of Knoxville, TN, it was determined that the FDIC failed to take decisive action against this institution's blatant unsafe and unsound banking practices. Included among the latter were a continuous pattern of questionable real estate loans involving missing, outdated, and/or inflated appraisals. FDIC examiners reported such major appraisal deficiencies in each of the regular examinations conducted from 1979 through 1982. See, also, footnote 45, p. 28.

appraisal findings. VA field reviews are not performed as frequently or thoroughly as required; e.g., VA staff reviewed none of the 500 appraisals tied to the fraudulent schemes perpetrated against the FHA in Camden, NJ, in the early 1980's. Furthermore, in many cases where field reviews or other sources disclosed unsatisfactory performance, the VA disciplined the implicated appraiser either insufficiently or not at all.

c. Despite the FHA's repeated failure to respond forthrightly to subcommittee requests for data showing the nature and extent of appraisal problems affecting its mortgage insurance activities, there is strong evidence that such abuses and deficiencies are major and widespread. For instance, the series of schemes involving the fraudulant use of VA appraisal documentation to obtain FHA mortgage insurance—the extent of which was either unknown to or concealed by FHA officials when they testified before the subcommittee—clearly demonstrate how easily their appraisal-related internal controls can be circumvented. Similarly, HUD's Inspector General recently reported that FHA field office personnel failed to adequately discipline appraisers with records of blatantly poor performance and that they inadequately monitored and reviewed Coinsurance Program appraisal activities. The latter has resulted in overvalued properties and correspondingly increased risks of claims losses.

d. Neither Fannie Mae nor Freddie Mac assert direct authority over appraisals and appraisers but, instead, place all such responsibility with the lender. They maintain that lenders have sufficient incentive to be observant because of Fannie Mae/Freddie Mac internal controls—including spot checks and field reviews—and warranty provisions that can require the lender to repurchase a faulty loan. Such procedures, however, are wholly ineffective in cases where a lender no longer has the financial capacity to repurchase a faulty loan. (The latter is precisely the predicament presently facing Fannie Mae in conjunction with its purchase of more than $100 million of questionable loans from the failed Equity Programs Investment Corporation.)

e. In recent years, virtually all private mortgage insurers (PMIs) have failed in varying degrees to effectively control appraisal quality, both in terms of their underwriting procedures and post-transaction review requirements. The failure of the Equity Programs Investment Corporation, in which several PMIs face potential aggregate claims of between $300 and $400 million, amply demonstrates and underscores this pattern of lapses in appraisal quality assurance.

10. *State authority over appraisers:*

a. Only 12 States have appraiser-related licensing or certification procedures. Moreover, even among these 12, their procedures fail to address appraiser qualification and performance standards, in large part, because they are typically included among statutes focusing on the sale of real estate and are under the jurisdiction of a real estate commission.

b. In many States, such as Texas, appraisal quality and accuracy are adversely affected by sparse, non-existent, or not readily available real estate sales and loan origination data. This, for example, can make it difficult to obtain timely information on "compara-

bles"—a critically important feature of the appraisal process in which sales and other relevant data regarding recently sold properties similar to and nearby the one being appraised are used to help establish the latter's comparative worth. Accordingly, appraisers in such States often are forced to rely on inadequate information and/or parties who, in some cases, stand to benefit by passing on incomplete or inaccurate data.

IV. Recommendations

A. Introduction

During or in response to the subcommittee's investigation, a number of promising actions were initiated or completed regarding the various appraisal problems outlined above. Prior to the investigation's start, the VA, FHA, Fannie Mae, and Freddie Mac agreed to develop a common appraisal form, which is likely to be in full use by early 1987. The VA, FHA, Fannie Mae, and the private mortgage insurance companies have lately tightened their appraisal-related underwriting procedures and monitoring requirements. The FHLBB has developed a successor to its Memorandum #R-41b that establishes expanded and more definitive procedures regarding appropriate appraisal practices. Also, an OCC, FDIC, Federal Reserve interagency group developed guidelines—which include information on appraisal approaches and analytical assumptions—to be used by their examiners in reviewing and classifying troubled real estate loans.

Directly in response to the subcommittee's investigative efforts, Fannie Mae and Freddie Mac adopted a stricter definition of market value; requiring that an appraisal performed on a loan they subsequently purchase reflect the property's value exclusive of creative financing, sales concessions or other gimmicks. In addition, the FHLBB has recently submitted a legislative package to the Congress, parts of which seek to add real estate appraisers to the categories of individuals against whom major enforcement actions can be brought.[5] Relatedly, after being informed by subcommittee staff that Freddie Mac had liberalized its appraisal requirements for originator refinanced home mortgages, the FHLBB formally advised its supervisory agents that Freddie Mac's action should in no way affect existing FHLBB insurance regulations that require an appraisal of the security property's contemporary market value. Lastly, leading professional appraisal trade groups have begun to work together to develop uniform appraisal standards and legislative proposals aimed at fleshing out the concept of a self-regulatory system for the appraisal industry.

The above actions constitute positive steps in the right direction. However, as indicated in the recommendations that follow, a great deal remains to done.

[5] This package became the "Savings Institutions Supervisory Amendments of 1986," H.R. 4998, which was introduced on June 11, 1986, by Chairman St Germain of the Committee on Banking, Finance, and Urban Affairs.

B. Recommendations

1. *Banking agency authority over appraisers:*

Congress should provide the bank regulatory agencies with express authority to directly discipline appraisers who have willfully or through gross negligence misrepresented the value of real property serving as collateral for a loan made by a federally insured financial institution. Such discipline should include temporary suspensions or prohibitions from submitting future appraisals to any federally insured financial institution and/or civil penalties.[6]

2. *Banking agency regulation of appraisals:*

a. To reduce the damaging consequences of inconsistent regulatory approaches to and implementation of appraisal policies and procedures, the FHLBB, OCC, FDIC, Federal Reserve, and NCUA should establish uniform requirements regarding appraisals. Such regulations and procedures should include at least the following:

(i) an appraisal for every proposed real estate loan;

(ii) random, but routine, examiner review of appraisal accuracy and overall adequacy during regular examinations of real estate loan portfolio assets, and intensive review, when real estate loans enter "problem" or "classified" status;

(iii) examiner training regarding (1) the components of a good appraisal in order to review them effectively, and (2) internal institutional policies and procedures governing appraisals and appraisers;

(iv) assignment of qualified staff appraisers to regional or district offices and, in conjunction with such assignments, the establishment of comprehensive appraisal review policies and procedures;

(v) development and dissemination of appraisal guidelines utilizing the FHLBB's Memorandum #R-41b, as a model;

(vi) a prohibition against the use of an appraisal provided by the borrower unless a separate independent appraisal of the same property is performed at the lender's direction; and,

(vii) a requirement that a financial institution's policies and internal controls be especially strengthened for appraisals involving out-of-area real estate loans, loan participations, or purchases of mortgage-backed securities (MBS). Specifically, the banking agencies should require that financial institutions involved in such out-of-area activity: secure complete records of underwriting documents, including appraisals; inspect the properties securing such loans and MBS, individually, or jointly with other investing institutions; or, order independent inspections from knowledgeable, reputable appraisers in the locality concerned. Agency examiners should monitor compliance with such requirements during regular examinations.

3. *Lender accountability:*

a. The supervisory activities of the Federal banking agencies should place a substantially increased emphasis on the appraisal process in connection with real estate lending by institutions under their jurisdiction.

[6] Subcommittee Chairman Doug Barnard, Jr., has introduced legislation, H.R. 4956 (99th Congress), which contains such authorizing provisions.

b. The FHLBB, OCC, FDIC, Federal Reserve, and NCUA should promulgate regulations (or seek additional statutory authority to do so, if necessary) to give them direct supervisory authority over the accuracy and overall adequacy of appraisals.[7] This effort should specifically address the actions of a supervised institution's directors, officers, and other relevant personnel or agents, including in-house, affiliated company, and retained independent fee appraisers.

c. In connection with this accountability effort, bank regulatory agency officials should specifically:

(i) add appraisers to the categories of individuals against whom enforcement actions, e.g., cease-and-desist and prohibition and removal orders, can be brought;

(ii) require that loan officers or others responsible for underwriting decisions within financial institutions undergo training regarding appraisals and attendant regulatory requirements;

(iii) develop a new form, as a requisite part of the final loan documentation package, on which a loan officer would certify that the appraisal had been reviewed and complied with applicable Government regulations; and,

(iv) develop appropriate sanctions or penalties for violations of the foregoing measures.

d. Officers and directors of financial institutions involved in real estate lending should initiate or improve already existing internal control and review systems to assure appraisal quality. In order to be maximally effective, any such system must be separated from the institution's loan development and underwriting operations and have direct access to and support from the highest levels of management.

4. *Public/private sector coordination of appraiser certification and review:*

a. A coordinated, concerted effort should be undertaken to establish a national, industry self-regulated appraiser certification and review system, to which all real estate appraisers would be subject.[8] At a minimum, such a system must include:

Uniform professional appraisal standards;

Appraiser qualification/certification requirements—education, experience, and testing;

Stringent recertification procedures, including mandatory review of the appraiser's work product;

Appraiser performance and review criteria; and,

Disciplinary principles and corresponding enforcement procedures.

b. To accomplish this end, a joint public/private sector task force should be constituted, consisting of, but not necessarily limited to, representatives of: the Federal bank regulatory agencies, VA, FHA, and the Federal Trade Commission; financial institution trade associations, secondary mortgage market organizations, and private mortgage insurance companies; and, appraisal industry groups. This task force should build on and/or possibly be merged with the effort already initiated by leading appraisal industry organizations.

5. *Appraisal policies and procedures of government insurers and secondary market institutions:*

a. The VA and FHA should jointly establish procedures to protect against fraud in FHA's single-family insurance program involving the misuse of VA appraisal documentation.

b. The VA and FHA should act to correct ongoing deficiencies in their agencies' existing appraisal review and appraiser monitoring procedures, addressing:

(i) unwarranted and/or improperly documented increases in appraisal value estimates;

(ii) failure to remove or otherwise adequately discipline appraisers for cause; and,

(iii) failure to conduct required reviews of appraisal reports and appraiser performance.

c. The VA and HUD Inspectors General should closely monitor the effectiveness of corrective measures instituted. Furthermore, the committee questions whether the full extent of appraisal deficiencies and abuses affecting the FHA's mortgage insurance programs has been completely revealed and, therefore, recommends that HUD's Inspector General undertake a full-scale review of this situation similar to the one recently completed by the VA's Office of Inspector General.

d. To address weaknesses in their appraisal policies and procedures, Fannie Mae and Freddie Mac should consider reducing their complete reliance on lenders to be responsible for appraisal quality and appraiser selection or performance, in connection with loans packaged for sale to these corporations. Fannie Mae, for instance, should consider reinstituting key elements of its prior system of appraiser selection and control, discontinued in 1981.

6. *Data collection, information sharing:*

a. All Federal agencies concerned with real estate finance or mortgage insurance/investment should collect comprehensive data on appraisals and appraiser performance. Such efforts must be routine and systematic, and should focus particularly on: losses and related problems caused by faulty or fraudulent appraisals; the role of the appraiser in such losses or problems; and, the effectiveness of internal controls in identifying and responding to appraisal/appraiser problems.

b. The Federal bank regulatory agencies, VA, FHA, Fannie Mae, Freddie Mac, and other Government agencies that utilize appraisals—e.g., the Departments of Justice and Transportation and the Internal Revenue Service—should develop procedures for sharing information on problem appraisers with each other and with the appraisal industry. These efforts should concentrate on preventing problem appraisers from being able to continue to work for institutions insured or regulated by these governmental entities, once a pattern of unacceptable performance has been identified. To aid in accomplishing this end, the concerned Federal authorities should require supervised institutions and program personnel to regularly

[7] This recommendation also applies to any individual or concern not directly supervised by any Federal bank regulatory agency that is, nonetheless, involved in originating real estate loans. Two major groups fall into this category—mortgage bankers and mortgage brokers. The activities of both of these groups fall under the Federal Trade Commission's general jurisdiction and, thus, consideration of this recommendation's provisions as they pertain to them is addressed to the Commission.

[8] This system might be patterned after those developed for the accounting profession (the Financial Accounting Standards Board), securities dealers (the National Association of Securities Dealers), and futures brokers/traders (the National Futures Association).

report information on foreclosed properties, which would include the appraiser's name, original appraised value, any subsequent reappraised value, and amount of actual or indicated losses.

7. *State real estate sales and loan origination data:*

To eliminate significant problems with appraisal accuracy caused by the unavailability of full real estate sales and loan origination data in many States, the National Conference of State Legislatures, the National Governors' Association, or some similarly constituted body, should consider the desirability and feasibility of requiring uniform and timely public disclosure of such information.

DISCUSSION

V. Case Studies

A. INTRODUCTION

The subcommittee's examination of a number of savings and loan associations and banks that had either failed and/or experienced major losses conclusively demonstrates the widespread, pervasive, and costly effects of faulty and fraudulent appraisals on the Nation's financial institutions, secondary market, and private mortgage insurers.[9] Indeed, for example, among the four situations studied in detail—Sunrise Savings and Loan Association of Florida, Continental Illinois National Bank and Trust Company, Community Savings and Loan of Maryland/EPIC, and Bank of America/Wells Fargo Bank/NMEC—combined indicated and actual losses caused in part by faulty or fraudulent appraisals range between $750 million and $1 billion! The case studies regarding these financial institutions, moreover, clearly show how inadequate regulatory agency policies, procedures, and practices regarding appraisals, and these agencies' failure to take timely, decisive action when necessary, contributed to the formers' losses, weakened condition, and/or ultimate downfall.

B. SUNRISE SAVINGS AND LOAN ASSOCIATION

1. *Background and underlying causes of appraisal problems:*

The rise and fall of the Sunrise Savings and Loan Association of Florida demonstrates precisely how real estate appraisal problems can weaken and ultimately help to cause a financial institution's collapse. Additionally, it shows how the Federal bank regulatory agency responsible for monitoring and supervising Sunrise's lending activities, the FHLBB, failed to respond adequately to these appraisal problems, thereby unwittingly contributing to its demise.

A publicly held, State-chartered/federally insured savings and loan association, Sunrise was a shooting star among "Sunbelt" financial institutions during its 5-year existence.[10] Its lending philosophy was built on the premise that credit risk was preferable to interest-rate risk in the deregulated, high-interest-rate business environment in which it had to operate. In accordance with this outlook, Sunrise management deemphasized traditional thrift long-term, fixed-interest-rate residential lending, in favor of high-risk, short-term acquisition, development, and construction (ADC) loans. Between 1980 and 1985, Sunrise made hundreds of such ADC loans, fueling a spectacular growth in its assets, from $3 million to $1.5 billion.[11]

To all outward appearances, Sunrise seemed to be a sound, thriving, and well-run association. Based largely on up-front fees and interest income generated by the ADC loans, Sunrise showed profitability sufficient to boost the peak price of its stock to more than $30 a share. However, even as its apparent successes mounted, evidence was accumulating behind the scenes that its lending activities were riddled with questionable practices and procedures. Most notably, for example, borrowers were usually required to have little or no equity in a project financed by a Sunrise ADC loan. Sunrise officials successfully deflected concerns about this dubious practice by asserting that no loan received full financing unless an independent appraisal had determined that the project's value exceeded the loan amount by 25 percent or more. Pointedly, both in terms of what was really happening and Sunrise's ultimate safety and soundness, this explanation was misleading and, in many respects, completely false. Indeed, non-existent, overvalued and otherwise deficient appraisals were rife among Sunrise's loans, as demonstrated in four separate FHLBB examinations of the latter conducted between 1982 and 1985.

2. *Nature and extent of appraisal problems:*

Beginning with the FHLBB's second regular examination in August 1982, significant appraisal deficiencies were found in the review of eight major Sunrise loans ($250,000 or more). The examiner expressed particular concern about two of these loans, which she felt posed a threat of a potential loss of more than $600,000.[12] The next examination in December 1983, disclosed similar, but much more extensive and serious problems, since in the 16-month interval between it and the second examination, Sunrise had originated more than $543 million in loans, 163 of which involved amounts of $1 million or more.[13] The examiners' review of 31 of these 163 major loans (total value, $228 million) showed that two-thirds were based on inflated appraisals and on others either no appraisal had been done, it consisted of only a one- or two-page "letter of opinion," or was received after the loan had been closed.[14] In addition, it was found that appraisals performed in connection with major Sunrise loans were typically: (1) prepared for the borrower, (2) performed by appraisers unknown to association personnel, (3) not reviewed or critiqued internally, even when the properties involved were geographically distant, and (4) replete

[9] The subcommittee also reviewed additional information that confirmed the relationship between faulty and fraudulent appraisals and failures of a number of other federally insured financial institutions, including the Bell Savings Association (Texas) and the Beverly Hills and San Marino Savings and Loan Asocations (California). Relevant documentation regarding these institutions is located in the subcommittee's files.

[10] The FHLBB placed Sunrise in receivership on July 18, 1985, immediately reopened it under an interim contract management arrangement, and finally closed the association for good on September 12, 1986.

[11] Hearings, p. 134.

[12] Ibid., pp. 1535, 1539.

[13] Ibid., p. 1582.

[14] Ibid., pp. 1560, 1583-1585.

with technical deficiencies that violated established FHLBB requirements.[15]

The major appraisal deficiencies and abuses reported in this examination contributed significantly to the determination by the FHLBB examiners that $110 million of the $228 million in loans reviewed should be classified as substandard.[16] In addition, FHLBB officials considered the original appraisals on some of the 31 loans reviewed to have been so unacceptable that they ordered Sunrise to obtain, at its own cost, reappraisals of the properties in question. The reappraisals on four of these loans showed an aggregate decline in value of almost 50 percent from the original appraisal and, not surprisingly, all four of them were in foreclosure by the end of September 1985, with total indicated losses amounting to $18 million.[17]

Subsequent examinations in May and October 1984, disclosed the same disturbing pattern of appraisal problems, albeit with a correspondingly greater amount of assets classified as substandard ($586 million, or 45 percent of the total).[18] Specifically, as a result of these two examinations, major appraisal problems were identified in 53 loans with an aggregate value of $328.5 million.[19] According to the FHLBB, as of the latter part of 1985, 40 of these 53 loans were delinquent or in foreclosure.[20]

3. *Effects of the appraisal problems:*

The effects of the defective appraisals began to be felt as Sunrise's major ADC loans gradually fell due and the interest reserves for them were exhausted. Scores of these loans, a high percentage of which were made possible by defective appraisals,[21] became delinquent or were foreclosed. As a result, Sunrise abruptly found itself in a rapidly deteriorating situation, in response to which, *inter alia*, it voluntarily or at FHLBB direction moved to establish reserves sufficient to cover the anticipated losses from these failing loans. According to the FHLBB, Sunrise's loan-loss reserves, which amounted to just $1.5 million in December 1983, grew to $8.1 million by June 1984; $16.4 million by December 1984; and, $75.1 million by June 1985.[22] In part as a result of these increased provisions for loan losses, by early 1985 Sunrise's net worth had fallen well below the minimum level stipulated in FSLIC insurance regulations. From that point, the situation steadily worsened, and when Sunrise announced early in July that its combined reserves for loan-losses, foreclosed properties, and problem loans had doubled in

[15] Ibid., p. 149.

[16] Ibid., p. 1580.

[17] Ibid., p. 140. The four loans referred to are: Monte Carlo Beach Club, Monte Carlo Country Club, Falls Chase Development Corp., and Masters at the Hills of Lakeway.

[18] Hearings, p. 135.

[19] Ibid., p. 142.

[20] Ibid.

[21] Remarks made by an FHLBB examiner regarding one of Sunrise's more notable defectively appraised ADC loans are illustrative: "In summary, Sunrise had loaned/invested in excess of $33.3 million in a project in which approximately $4.0 million was originally planned. . . . Had this project been adequately and accurately appraised in the beginning, competent management would never have made the first loan since the project likely would have been declared unfeasible." Hearings, p. 157. Similarly, referring to a foreclosed project with indicated losses of almost $4 million, Lamar Heath (Director of Examinations, FHLB Atlanta) declared in his prepared statement that "a competent appraisal at the outset would have kept this loan off the books." Hearings, p. 136.

[22] Memo contained in subcommittee files.

the preceding 3 months from $174 million to $350 million, the association's soon-to-follow demise was all but assured.[23] Again, according to FHLBB sources, as of the end of March 1986, Sunrise's scheduled items amounted to $651 million, with indicated losses of $333 million.[24]

4. *Inadequate FHLBB response to appraisal problems:*

The FHLBB was first obliged to take action in response to reported appraisal deficiencies in connection with the second regular examination of Sunrise, which took place from August through October 1982. As a result of the examination, an informal supervisory letter was written directing Sunrise to inform all appraisers working for it about the requirements of Memorandum #R-41b[25] and that all appraisal reports on association loans be submitted in narrative form.[26] Association officials indicated that they would comply with the requested supervisory actions.

a. *Unacceptable delay between examinations:*

In connection with the subsequent examination, however, the FHLBB made the first in what became a chain of questionable or ill-conceived decisions that allowed Sunrise's appraisal and related lending problems to continue unchecked, thereby contributing directly to the association's decline and ultimate collapse. This decision consisted of the FHLBB agreeing, at Sunrise's request, to postpone the third regular examination, which had been preliminarily scheduled for late July/early August 1983.

This examination, therefore, did not begin until December 2, 1983, a 3- to 4-month delay which, in retrospect, a number of considerations should have worked to prevent. First, in view of the significant deficiencies disclosed in the prior examination,[27] FHLBB officials should have been intrinsically resistant to any delay in the start of the next one. Such initial resistance should have been further reinforced by Sunrise's reason for making the request, i.e., because its public accountants were there at the time auditing the association's records and adequate work space for the Federal examiners was therefore unavailable.[28] Still further reservations in agreeing to Sunrise's request should have arisen simply on the basis of the periodic reports filed by the association, which showed

[23] Hearings, p. 1705.

[24] Memo contained in subcommittee files. In early September 1986, the FSLIC filed a $250 million suit against 27 former Sunrise officers and directors, and the association's former law firm, Blank, Rome, Comisky & McCauley. Among the defendants are Robert C. Jacoby, the former chairman, president and chief executive officer, and Michael D. Foxman, a co-founder and former chairman of Sunrise and partner of the cited law firm.

[25] Memorandum #R-41b provides guidance to lending institution officials and appraisers on FHLBB appraisal requirements and assists the latter's examiners and supervisory personnel in assuring that its provisions are complied with. The memo, in part, states: "The soundness of an association's or service corporation's mortgage loans and real estate investments depends to a great extent upon the adequacy of the appraisals of the real estate. This memorandum provides guidelines for appraisal management and procedures to assist in determining compliance with the appraisal requirements of Insurance Regulation 563.17-1(c)(1)(iii)." On September 11, 1986, the FHLBB approved a successor to R-41b, which establishes expanded and more definitive procedures regarding appraisal requirements and appropriate appraisal practices.

[26] Hearings, pp. 134, 1544, 1547.

[27] In accordance with the evaluation reporting format in use at that time, appraisal and loan underwriting policies and practices were given a "C," the next to lowest rating. A "C" rating means that "material deficiencies" were found in the category or area of activity cited. See, also, Hearings, p. 1538.

[28] In an exchange with Congressman Spratt during the hearings, Lamar Heath (Director of Examinations, FHLB, Atlanta) pointedly acknowledged the mistake in acceding to Sunrise's request, stating that "we will certainly take the blame for it." Hearings, p. 247.

that since the prior examination it had made and was continuing to originate an enormous volume of major loans. Indeed, while it was notable enough that Sunrise's assets increased by more than $300 million between the start of the second examination and the projected start of the third, before the latter finally got underway, total assets had soared to $746 million—a staggering increase of slightly less than $350 million![29] In effect, the decision to postpone the start of the scheduled examination permitted Sunrise's abnormal growth to continue unchecked for an extended period, during which it reached the peak in making the very kind of major ADC loans that ultimately helped to bring about its demise.

b. *The December 1983 examination—major problems, mild response:*

The comparatively mild FHLBB response to the results of the December 1983 examination constitutes another important regulatory decision regarding which questions necessarily arise. This examination, in addition to providing the statistical evidence of extensive and severe appraisal problems (see p. 17 above), yielded a number of important findings on Sunrise's policies and underlying management attitude regarding appraisals. It was found, for example, that staff appraisal reviews occurred almost entirely after-the-fact reflecting, in part, the association's openly acknowledged policy of allowing loans to be closed before the receipt of the supporting appraisal.

In addition, both senior managers and members of the board of directors were shown to have viewed appraisals as being necessary for little more than establishing the maximum loan amount. In an apparently unguarded moment, for example, the head of all Sunrise loan operations told an FHLBB examiner that the closing of a $15 million loan without an appraisal was merely a "technical violation" and that, in any event, management should have the authority "to waive appraisal and other requirements" as it sees fit.[30] Much the same attitude towards appraisals was reflected in the monthly board of directors reports for July 1982 through October 1983, which showed 16 instances of loans approved in amounts exceeding $1 million where the space for appraised value was left blank or checked "verbal," "incomplete," or "not in."[31]

Finally, the results of the December 1983 examination demonstrated conclusively that the significant appraisal deficiencies revealed in the prior examination 16 months earlier had not been corrected as Sunrise officials had vowed. The problems, in fact, had increased markedly, as indicated in the "D" rating assigned by the examiners in their evaluation of the association's appraisal policies and procedures. This rating, the lowest of the four designations used by the FHLBB at that time, indicated that the cited category of lending activity required "immediate forceful supervisory action."[32]

[29] Memo contained in subcommittee files
[30] Hearings, p. 1581
[31] Ibid., p. 1581
[32] The overall composite evaluation of Sunrise declined from a "2" in the August 1982 examination to a "4" in the December 1983 examination. A "4" composite rating indicates that the institution has: "(1) *major and serious* problems which management appears to be unable or un-

Continued

The evidence of the danger posed by these massive appraisal problems was so compelling that even before the December 1983 examination was completed, both the Chief District Appraiser and the Assistant District Director of the Office of Examinations and Supervision of the Federal Home Loan Bank of Atlanta (the FHLBB regional office responsible for the area of South Florida in which Sunrise was located) recommended that formal enforcement action be brought against this association. These officials concluded that "without immediate control mechanisms being implemented," Sunrise's "viability could well be threatened," and, accordingly, urged that the association be ordered to cease and desist from closing all real estate loans until acceptable appraisal reports had been received and an effective "before-the-fact" appraisal review system had been instituted.[33] Essentially the same conclusion regarding the need for formal enforcement action was reached by Florida regulatory officials who, with initial support from their FHLB Atlanta counterparts, issued a temporary cease-and-desist order on April 23, 1984.[34]

In the end, however, FHLBB officials failed to follow through on these strong recommendations and attendant attempt to bring formal enforcement action against Sunrise. The temporary State order was rescinded on April 24, 1984, in favor of a FHLBB/FSLIC Supervisory Agreement which, although it contained many of the same general provisions found in its predecessor, was nonetheless an informal enforcement action that did not have the former's strength of purpose.[35] In this regard, it should be noted that a formal enforcement action, such as a cease-and-desist order, must be disclosed to the stockholders when brought against a publicly owned institution like Sunrise.

In short, in response to a situation that called for "immediate forceful supervisory action," Federal regulatory officials allowed Sunrise to get away with an informal agreement that left its managers comparatively free to go on doing business as they saw fit. Indeed, from management's standpoint the association clearly got the better of the deal, since by accepting the Supervisory Agreement it effectively got off the hook of any public disclosure requirement. Moreover, if that weren't enough, Sunrise officials were also able to neutralize some of the Supervisory Agreement's effect by insisting that it contain a statement that by having agreed to it, they were in no way admitting to any wrongdoing or having engaged in any unsafe or unsound practices.[36]

c. *The May 1984 examination—worsening situation, limited response:*

In conjunction with the institution of the Supervisory Agreement, FHLB Atlanta officials advised Sunrise management that: (1) reappraisals would have to be done on some 10 questionable loans

willing to correct, or (2) problems which pose a threat to its continued corporate existence. In these cases, the problems may not be insoluble, but the situation is of such large dimensions and so critical that urgent corrective action by directorate or FHLBB appears necessary." See, also, Hearings, p. 1575.
[33] Hearings, p. 1556
[34] Ibid., pp. 1602-1603.
[35] Ibid., p. 1604.
[36] Ibid., p. 189.

that were reviewed in the December 1983 examination; and, (2) a special examination would began almost immediately to look further into the association's major real estate loans and to monitor its compliance with said Agreement. This "special, limited" examination, which began on May 7 and was completed on July 11, 1984:

> Confirmed the widespread and increasingly serious appraisal and underwriting problems in the association's major loan activities;
>
> Showed the significant growth in the number and value of substandard assets and scheduled items; and,
>
> Revealed that management had failed to make the changes in lending policies and procedures required by the Supervisory Agreement.[37]

The May 1984 examination also disclosed a clearly defined and premeditated pattern of management attempts to obstruct, disrupt, or otherwise compromise the examiners' efforts. On a scale not previously seen, for instance, Sunrise officials deliberately took weeks to reply to requests for essential documents and/or failed to respond entirely.[38]

As a result of these findings, Sunrise's composite evaluation was again a "4," with appraisals and numerous other categories of lending activities continuing to be rated "D."[39] Perhaps because such a short period of time had passed since the Supervisory Agreement was implemented, the FHLBB response to these examination results was limited, consisting of a lengthy supervisory letter and an announcement that yet another examination would soon follow.[40]

d. *The October 1984 examination—decisive action, too little, too late:*

The announced examination began in October 1984 and yielded much the same findings as the prior ones, as indicated by the following statement contained in an FHLB Atlanta submission to the subcommittee:

> This examination report contains 253 pages of comments on substandard assets which had grown to $586.4 million, or 45.17 [percent] of assets, disclosed that compliance with the supervisory agreement was essentially cosmetic, and was severely critical of management's attempt to cover up problems as well as demonstrating that management could not cope with the mounting problems and should not be trusted to do so.[41]

As a result, Sunrise's composite evaluation remained a "4," with appraisals and many other categories of lending activity still rated "D."

[37] Ibid., p. 178.
[38] Ibid., pp. 1651-1652.
[39] Ibid., p. 1625.
[40] The supervisory letter expressed "grave concern about the [examination] findings and directed Sunrise's Board of Directors to adopt a more sound and conservative corporate strategy." It should also be noted that pursuant to this examination, a formal enforcement proceeding was requested, but quickly withdrawn. Instead, two FHLBB examiners were assigned to work with a Federal Grand Jury that was investigating the activities of Sunrise and certain of its major clients See Hearings, p. 178.
[41] Hearings, p. 178.

Also as before, these results prompted calls for formal enforcement action; this time from a FHLB Atlanta senior supervisory analyst, who outlined a 10-point proposed cease-and-desist order, five of which related directly or indirectly to appraisal-related problems.[42] Shortly afterwards, though, at a high-level meeting in Washington called to discuss what to do about Sunrise, an informal enforcement action was selected as the initial approach, to be followed by a cease-and-desist order held in reserve in case the association's board of directors balked at the measures they intended to impose.[43] The latter, a Supervisory Agreement containing detailed and stringent requirements—foremost among which was the removal of the chief executive officer and other senior association managers—was agreed to on April 30, 1985.[44] It is important to note, however, that from the standpoint of assessing the adequacy of FHLBB actions, this Agreement was formulated in response to examination findings that were virtually the same as those disclosed in the December 1983 and May 1984 examinations, leaving one to wonder why it could not have been instituted at least 8 or 9 months earlier.

e. *Conclusion:*

In conclusion, by the time the second Supervisory Agreement was signed in April 1985, more than 2½ years had elapsed since the recurring pattern of major appraisal and other lending problems had been first identified. In the interim, an unbroken stream of mounting evidence culled from no less than three examinations had emphatically shown that these problems and their effects were ongoing and reaching such proportions that Sunrise's safety and soundness was increasingly at risk. The overall regulatory response to this situation was clearly inadequate, having involved an unacceptable delay between examinations, missed opportunities to confront problems forcefully before they had gone too far, and a decided tendency to focus more on monitoring efforts than timely, decisive corrective action.[45] While it is difficult to know for certain whether earlier, more forceful FHLBB supervisory action could have prevented Sunrise's collapse, the persistent lack of such action over such a lengthy period: (1) allowed a problem situation to enlarge, grow progressively worse, and, finally, get entirely out-of-hand; and, (2) helped to cause tens, and quite likely hundreds, of millions of dollars of unnecessary additional losses. In effect, rather than serving to forestall Sunrise's ultimate failure, the overall regulatory response and specific supervisory actions taken unwittingly contributed to and even hastened the very outcome they were meant to avert.

C. CONTINENTAL ILLINOIS' REAL ESTATE LOANS

1. *Background and summary of appraisal-related losses:*

[42] Ibid., p. 1675.
[43] Ibid., pp. 1683-1685.
[44] Ibid., pp. 200-210.
[45] This pattern—close monitoring, punctuated by a continuing failure on the part of responsible regulatory officials to take decisive, timely action—unfortunately, is a recurrent and long-lived one, having been highlighted in an ongoing series of subcommittee investigations of failed financial institutions conducted over the past 10 years. See, for example, House Report No. 98-573, p. 50, concerning the FDIC's supervision of the United American Bank of Knoxville, TN.

Serious appraisal abuses were found in the Continental Illinois Bank's nonperforming real estate loans assumed by the FDIC. The FDIC acquired approximately $400 million of the $2.5 billion in total real estate loans held by Continental Illinois at the time of its restructuring in the summer of 1984. The FDIC provided the subcommittee with a schedule of 21 of the largest nonperforming real estate loans, which encompassed condominiums, commercial real estate, or undeveloped land, primarily in Florida. The schedule shows that the original appraised value of these 21 properties totaled $518.4 million, while the current value, based on reappraisals ordered by the FDIC, totaled only $184.4 million or 64 percent less than the original value.[46]

The FDIC informed the subcommittee that serious underlying appraisal problems accounted for this huge disparity in appraised values:

> Many of the appraisals reviewed by the FDIC staff appear to have been a function of the deal arrived at between the bank and the workout contractor. Loan presentations noted that appraisals were expected to support the loan balance or that preliminary appraisal estimates support the value and that such reports would be delivered later. In appraising condominium properties, the appraiser typically arrived at a market value for individual units and then multiplied the value by the number of units to arrive at an appraised value. No allowance was made for holding costs, sales costs, or a discount that might be necessary for bulk sale. Similar practices were employed in valuing land holdings. In some cases the appraisals incorporated an assumption of high appreciation rates yielding high market values in 1988 and 1992 when the loans would become due. These appreciation rates, of course, were not supported by current market conditions. No recognition of vacancy rates, unabsorbed inventory or any other market information was included in the reports. Most of the appraisals appeared to have been developed to support the proposed loan rather than give a true current market value of the underlying collateral.[47]

Although many of these problem loans involved Florida properties, most of the faulty appraisals were performed by one Chicago appraisal firm, the principals of which hold the MAI designation of the American Institute of Real Estate Appraisers.[48]

2. *Nature and extent of appraisal abuses:*

At the subcommittee's request, the FDIC reviewed the appraisals and loan files for 10 of the 21 loans listed on its schedule (constituting the top 80 percent of the portfolio) and found, in each case, serious deficiencies unrelated to external factors. Often appraiser assumptions were based on unrealistic projections, prices of properties offered for sale but not sold, or false or irrelevant data. At

[46] The schedules referred to are reprinted in Hearings, p. 1720 and p. 1725.
[47] Hearings, p. 972; also confirmed during the testimony of Steven Seelig, Associate Director, Division of Liquidation, FDIC. Ibid., pp. 251-252.
[48] Hearings, p. 253.

times the appraised value increased, even though the market for some of the properties had collapsed. On some occasions, the appraisals were furnished after the loans were made.

The FDIC's evaluations of the appraisals for each of these 10 loans illustrate the flagrant and serious appraisal problems. Set forth below are some representative cases taken from the FDIC's summary (with assets unidentified).

Asset No. 6: The total original appraised value in 1983 was $9.5 million, while its reappraised value in 1985 was $8.8 million. FDIC told the subcommittee:

> . . . this asset was appraised three times between the end of March 1980 and November 1, 1983. The appraisals on a per acre basis ranged from a high of $26,000 per acre on the first appraisal down to $15,600 per acre in 1983. The same appraiser was used for updating the appraisals rather than changing appraisers to verify values. Additionally, the bank accepted letter appraisals and relied on appraisals that were prepared after the loans were made. [The appraisal reports] assumed away problems that might surround the sale of the property. Market data was either ignored or not obtained at all, and there was a lack of discounting or inadequate discounting for holding periods. Unit values were used and then multiplied by the number of units in order to obtain a higher large scale value. In those reports where market data was included distant comparables were used to increase the appraised value.[49]

Asset No. 18: FDIC Associate Director Seelig testified that this was one of the more blatant cases "where the appraiser took the amount of the loan, added the amount of the tax shelter to the amount of the loan and said that is the value of the property," as the instruction directed the appraiser to do.[50] This property, a group of condominium units, was originally appraised at $101 million, while the FDIC's reappraisal came in at $27.2 million.[51] The FDIC's summary of the appraisal abuses is, to put it succinctly, "mindboggling":

> . . . In an appraisal done in 1983 the appraiser based his value on a retail price list for the individual units sold as individual units, not sold as a group. The retail marketing period of 18 months was assumed with an appreciation rate of 10% occurring during this 18-month period. An 18-month sales period was used as an assumption despite the fact that the inventory of unsold units in that area was somewhat higher than the previous peak and that condo sales in the previous year were the lowest in ten years. The appraiser went on to rely on 39 reported contracts at a price of $93.64 per square foot to substantiate an appraised value of $92.08 per square foot. The appraiser treated these contracts as firm and used them to support market activity at high prices. *Subsequent events showed*

[49] Ibid., p. 1721.
[50] Ibid., pp. 253-254.
[51] Ibid., p. 1725.

> *that these contracts were not bonafide [sic] and that they failed to close. The same appraiser reappraised the properties a year later, in March of 1984, and arrived at an appraised value of $136.87 per square foot. Again, the appraiser noted that vacant condos were at an all time high and that prices had in fact declined in the subject complex by 14% between 1982 and 1983. However, the appraiser used the $92 per square foot price for 1984 as a starting price, and assumed a 9% inflation rate for the purpose of arriving at a 1992 value.* Income from rental operations is projected by the appraiser despite the fact that units were *losing money.* . . . In no sense was this a market value of the underlying real properties securing the loan. Rather it was a value essential to support the size of the loan.[52] (Emphasis added.)

Asset No. 11: Several groups of condominium units, originally appraised at $9.3. million in mid-1983, were reappraised for the FDIC at $4.7 million in 1985. The comments in FDIC's evaluation of the appraisals are striking and also typical of other appraisals:

> . . . The bank relied upon the gross sell out value as the basis for the loan. . . . [T]he appraiser made no adjustments for holding, marketing, or closing costs. Additionally, market data on rentals and sales within the project appear to have been ignored. . . . However, it should be noted that the appraisal report clearly indicates that the function of the appraisal is to support the efforts of the borrower and the lenders in syndicating the units. With hindsight, this was clearly quite accurate. No mention is made in the statement of "purpose of the analysis" that the report is attempting to arrive at an appraised fair market value.[53]

As FDIC Associate Director Seelig testified:

> . . . I think what you had here is you had account officers getting appraisals to support whatever the purpose was, whether it was to put the loan on the books, whether it was to get an updated appraisal because the Comptroller of the Currency requested they get appraisals to support the values they were carrying.[54]

As a consequence of these disparities in real market value based on extremely faulty and meaningless appraisals, the FDIC's losses will probably be in the "neighborhood of $200 million." [55]

3. *OCC's lack of supervision of Continental's real estate loans and appraisal practices:*

The Office of the Comptroller of the Currency (OCC) was the principal supervisory agency for Continental Illinois. The OCC has denied the existence of any serious appraisal problems or abuses.[56]

[52] Ibid., pp. 1721-1722.
[53] Ibid., pp. 1722-1723.
[54] Ibid., p. 253.
[55] Ibid., p. 253.
[56] In its February 19, 1986, follow-up response to the subcommittee, the OCC finally conceded that true market values did not always match appraised values, while it still continued to deny fraudulent or abusive appraisal practices. Ibid., p. 727.

In its November 25, 1985, response to the subcommittee, the OCC stated:

> OCC examinations did not disclose any real estate appraisal abuses warranting disciplinary action or criminal referral. Examiners did question certain real estate appraisals during their review of Continental's loan portfolio, but the questions arose primarily from external factors that had changed subsequent to the appraisal date, and not from appraisal abuses.[57]

While OCC contends that it was on "top" of the situation at Continental, its examination and supervisory actions concerning the real estate portfolio were unclear, and it did little to clarify them for the subcommittee. All of the evidence provided by both the OCC and the FDIC strongly indicate that OCC examiners either did not review or were not concerned about the appraisals on Continental's real estate loans.

OCC's second response, its formal submission at the subcommittee's December 1985 hearing, stated that: (1) all real estate credits over $10 million would have been reviewed by OCC examiners (it appears that 12 of the 21 properties listed on FDIC's schedule fall within this category); (2) the June 30, 1980, OCC examination found documentation deficiencies, although none relating to the absence of such documentation regarding the collateral; [58] and (3);

> Examiners assessed the adequacy of overall bank policies, practices, procedures, and internal controls and reviewed the Real Estate Internal Control Questionnaires as part of the examinations of Continental Illinois conducted during the period January 1, 1980 through July 1, 1984. As a result of this process, no special review of the bank's real estate and real estate construction policies, practices, procedures, or internal controls was deemed necessary.[59]

After persistent inquiries from the subcommittee, the OCC did finally admit that nine of the ten assets examined in-depth by the FDIC for appraisal problems had been "classified either substandard, doubtful, or loss in at least one of the three examinations cited [1982, 1983, and 1984]." Yet, holding fast to its position, it further stated that, "no fraudulent appraisal practices were noted." [60]

This case study, together with the one concerning the Bank of America (see below, p. 33), suggests a number of conclusions. First, the OCC has placed minimal importance on adequate and sound appraisals. Second, it does not have nearly enough experienced ex-

[57] Hearings, p. 1011.
[58] It is important to remember that, unlike the Federal Home Loan Bank Board, the OCC does not require that an appraisal be obtained for a real estate loan.
[59] Hearings, pp. 495-496. An OCC supervisory memo *set out below calls into question this assertion.* The memo demonstrates that the OCC knew in late 1982 that Continental's internal controls on real estate loans were deficient. In a November 15, 1982, memorandum to the Deputy Comptroller for Multinational Banking, Senior National Bank Examiner, Richard Kovarik (assigned to Continental), commented on the causes of increasing levels of nonperforming loans and noted that new controls were needed. (See Hearings, pp. 1727-1728.) However, this management review had little effect on these appraisal abuses, as seven of the ten properties' appraisals in which the FDIC found poor *appraisal practices* were performed in 1983 or later. (Assets numbered 6, 11, 14, 15, 16, 18, and 20, from the FDIC's schedule to the subcommittee, reprinted in Hearings, p. 1725.)
[60] Ibid., p. 727.

aminers—an assertion by OCC staff made "off the record" because the Office of Management and Budget frowns on disclosures reflecting the effects of such staffing problems. Third, due to this examiner shortage, the OCC relies on member bank internal audit staffs and does little "hands-on examination of loans" for the larger national banks. Fourth, OCC's examination manual directives[61] either were not followed at Continental, were inadequate, or both. Finally, both the OCC's general directive that banks should utilize an appraisal program and its internal control questionnaire during examinations[62] are completely inadequate, since they furnish little guidance to examiners as to what is specifically required regarding appraisals.[63]

D. APPRAISAL ABUSES IN CONNECTION WITH MORTGAGE-BACKED SECURITIES

The subcommittee found substantial evidence of defective appraisals used to support real estate loans packaged and sold as mortgage-backed securities (shares or participations in pools of mortgage loans) to financial institutions and other investors around the country. The safety and soundness of mortgage-backed securities (MBS) not guaranteed by an agency of the Federal Government (VA or FHA) depends, in large measure, on the aggregate value of the real estate collateralizing the mortgages comprising the securities. This is even more so for private conduit MBS—those not issued by Fannie Mae or Freddie Mac, for example—where the underwriting standards may not be as high and the reputation (and clout) of the issuer/packager uncertain.[64]

The subcommittee came across several situations in which issues of nonfederally insured MBS were collateralized by properties that had been grossly overvalued. In two of these situations, numerous thrift institutions, usually located in States far from the properties involved, invested heavily in private conduit MBS and suffered losses as a result of fraud and inadequate collateral. These case studies demonstrate both the importance of accurate and legitimate appraisals to the MBS market and the need for the bank regulatory agencies to take more effective action to determine whether a valid appraisal was made and whether financial institutions' procedures concerning MBS-related appraisals are adequate.

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[61] OCC examiners should perform special reviews of each national bank's (1) policies, procedures, and internal controls regarding real estate loans, including appraisals, and (2) method for selecting appraisers.

[62] The OCC Examination Manual's "Internal Control Questionnaire" for Real Estate Loans states:

> 15. Regarding appraisals:
> a. Are appraisals required to be in writing, dated and signed?
> b. Is sales price and loan application information withheld from the appraisers?
> c. Are appraisers paid the same fee whether or not the loan is granted?
> d. If staff appraisers are used, does the bank periodically have test appraisals made by independent appraisers to check the bank's knowledge of trends, values, etc.?
> e. Does the bank follow a formal reappraisal program?
> f. If appraisers who are not employees of the bank are used, does the bank investigate their quality and reputations?

Reprinted from Hearings, p. 1024.

[63] For contrast, see the Federal Home Loan Bank Board's Memorandum #R-41b, Hearings, pp. 824 et seq.

[64] While no one has a complete grasp on the amount of such MBS issued in the last few years, it is at least $5 billion. They are very popular with financial institutions because they offer higher yields without all the work and expense of writing new mortgages.

1. Impact of fraudulent appraisals on Community Savings and Loan (Maryland) and Equity Programs Investment Corporation (EPIC)

a. *Background:*

The September 1985 collapse of the Community Savings and Loan—a thrift chartered and insured by the State of Maryland—and its real estate investment affiliate, the Equity Programs Investment Corporation (EPIC),[65] involved endemic appraisal deficiencies and abuses. EPIC was primarily concerned with setting up tax sheltered investment partnerships to buy single-family houses, financing such purchases by mortgage loans or mortgage-backed securities that were, in turn, sold to institutional investors. By the time of its collapse, somewhere between 6,000-7,000 investors had interests in some 350 EPIC partnerships worth between $175 and $200 million.[66] By the same time, the partnerships had purchased approximately 20,000 houses, the mortgages for which were sold to scores of federally insured financial institutions, Fannie Mae, et al. In addition, a number of private mortgage insurance companies (PMIs) became guarantors of a significant portion of the purchased mortgages and mortgage-backed securities.

In connection with these EPIC activities, the Community Savings and Loan provided capital for several purposes, foremost among which was to service debt the partnerships' income-generating capacity could not meet. From the time of its purchase by EPIC in 1982, Community advanced hundreds of millions of dollars to the partnerships, an estimated $100 million of which were outstanding at its demise.[67]

b. *The role of inflated appraisals:*

By design, the EPIC partnerships bought single-family houses—initially, model homes and unsold units in developments—to be rented out and then resold several years later. To finance these purchases, low down-payment loans were obtained through a sister company, which effectively acted as a mortgage broker. The amount of these loans systematically exceeded the houses' sales price, since the latter excluded discounts or rebates routinely provided by the seller.[68] In one recent case, for example, the purchase of a group of 45 houses with an aggregate sales price of $3.54 million was financed by a $3.52 million mortgage loan. The seller, however, rebated almost $700,000, so that the net loan amount exceeded the actual price by slightly more than $670,000.[69] In effect, by financing the partnerships' purchases with loans that exceeded the actual acquisition price, EPIC managers were thereby able to cover all loan origination and closing costs, as well as provide the promised tax benefits to the investors.[70] (This strategy—borrowing

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[65] EPIC purchased Community Savings and Loan in 1982 and subsequently restructured their corporate relationship so that the latter became the nominal parent. Effective control of both entities remained in the hands of EPIC's founders and senior managers.

[66] Memos contained in subcommittee files.

[67] Presentation to the State of Maryland Deposit Insurance Fund Corporation and the Unofficial Committee of Investors by Coldwell Banker Real Estate Group and Dean Witter Reynolds, Inc., November 1, 1985, p. 1.

[68] Hearings, p. 1518.

[69] Ibid., p. 1522.

[70] EPIC's prospectuses frequently advertised that for every $1 invested, $2 in deductions would be realized.

to purposely create large-scale mortgage debt—is widely regarded as being unacceptable, since it intrinsically involves major corresponding risks, e.g., if a property doesn't appreciate in value either quickly enough or by a sufficient amount to cover the loan amount and any other requisite expenses.)[71]

EPIC's borrowing strategy could not have been practiced effectively without appraisals capable of justifying the prototypical loans obtained pursuant to it. However, given these loans' extremely high loan-to-value ratio (95 percent and higher) and seller discounts/rebates, a supporting appraisal as a matter of course would have to have been significantly inflated. Just how EPIC obtained such appraisals is suggested by the following exchange from the December 1985 hearings between Chairman Barnard and Richard Hewitt, former Chief District Appraiser of the FHLB, Atlanta:

> Mr. BARNARD. Mr. Hewitt, I understand that you had an encounter with an independent appraiser who had been removed from EPIC's appraiser list. Why had he been removed and what did this reveal about the appraisers EPIC was using in connection with its real estate ventures?
>
> Mr. HEWITT. We were retained by the Bank Board in the eligibility exams and asked to look at the various portfolios of those Maryland associations, one of them being Community. Part of that review was to determine the viability of appraisals, which we did, and also to try to get an estimate of the risk in the portfolio. Part of the information we looked over was the approved list of appraisers that EPIC maintained. There were a series of appraisers from all over the country, since they were involved in loans on single-family residences all over the country. I noticed that in some cases you would have an appraiser's name marked out and "Do not use" written in the margin.
>
> Interestingly enough, I found what I considered to be, based on my experience, some of the most proficient appraisers in the country being crossed out, "Do not use." One of these formerly worked with Freddie Mac who I knew and I called and asked him if he remembered any situation where he worked with EPIC, et cetera. His response was, "Yes, they asked me to appraise out of context." Essentially, it was a situation where he was asked to appraise 1 condominium unit in a total complex of some 200 and appraise it ignoring the influence of the other empty units in the entire complex. When he said that he could not very well do that, particularly in view of the fact that appraisal ethics would tell him he had to consider the impact of the other vacancies in that project as well as the general market area, they decided not to utilize him for the assignment. That was the story on that.[72]

[71] This is precisely what happened in connection with the EPIC partnerships' loans, as reflected in comments from the FHLBB report written pursuant to its May 1985 examination regarding Community Savings and Loan's eligibility for Federal insurance: "The success of the 'EPIC Product' syndicated partnerships is predicated upon a minimum yearly appreciation in the market place of 8%. This has not occurred in the last year nor is it expected to do so in the next year." Hearings, p. 1519. See, also, footnote 75, p. 31 below.

[72] Hearings, p. 246.

In addition, according to the FHLBB, the appraisers retained by EPIC consistently engaged in a number of other practices that violated appraisal industry standards and Federal regulations. For example, in selecting the approach to be used to help determine the appraised value of a property, the EPIC appraisers failed to choose the most appropriate one.[73] Relatedly, the discounts/rebates provided by the seller were systematically excluded from the appraisers' cash equivalency analysis, which is one of the most important steps in determining a property's appraised value. This latter practice, in particular, made it possible for a typical "EPIC Product" purchase to be financed by a loan amount commonly at least 25 percent in excess of its actual market value, as shown by the following illustration:

TYPICAL PURCHASE OF "EPIC PRODUCT"

Seller

Purchase price	$50,000
Less:	
6.8 percent sales commission	$3,400
Three months advanced rent	1,500
Rental deficit contribution	*7,100
Less total discounts (24.0 percent)	12,000
Net to seller	38,000

*Represents market interest rate paid to investor on mortgage plus maintenance costs of dwelling unit less rent received over a four year period which results in a deficit carrying cost.

Purchaser

Purchase price	$50,000
Less: Discounts from seller (24.0 percent)	12,000
Adjusted purchase price	38,000
Less: Mortgage (95 percent of purchase price)	47,500
Cash contributed to limited partnership	[74] 9,500

c. *Impact of the EPIC/Community Savings and Loan collapse:*

In combination with the high-risk nature of the EPIC mortgage loans, a number of unanticipated events[75] brought some of the partnerships to the point where they were unable to meet their monthly debt service payments. From the point of these initial delinquencies, the EPIC/Community problem snowballed, prompting, among other things, a run on the latter's deposits. In response, the State of Maryland first acted to halt the withdrawals taking place as a result of the run and, on September 5, 1985, placed Community under its conservatorship. These actions effectively reduced EPIC/Community's status to that of a failed institution, with at-

[73] Of the three major appraisal approaches—market, cost, and income—the latter is the one most suitable for determining the value of properties that are primarily or solely to be used for rental purposes. As the FHLBB's examiners noted in connection with their May 1985 review of "a large sample of properties" owned by the EPIC partnerships: ". . . never was the income approach used," even though ". . . all of 17,689 dwellings owned by the 357 limited partnerships are for rental purposes." Hearings, p. 1517.

[74] Hearings, p. 1517.

[75] Two of these bear mention: (1) high vacancy rates among some EPIC partnership properties, caused by stagnant economic conditions and/or a glut in available rental units; and, (2) as a result of a crisis among Maryland thrift institutions, the Community Savings and Loan was required to undergo—and failed to pass—the previously cited FHLBB examination to see if it could qualify for Federal insurance.

tendant consequences that have been strongly felt throughout the financial services sector, secondary market, and real estate finance industry. The effects of EPIC/Community's collapse include:

(1) aggregate potential losses, in the hundreds of millions of dollars,[76] involving some or all of the following:

94 federally insured savings and loans, holding more than $700 million of EPIC mortgages/MBS;[77]

18 FDIC-insured financial institutions, holding just under $250 million of EPIC mortgages/MBS;[78]

Fannie Mae, holding slightly more than $100 million of EPIC mortgages/MBS;

The State of Maryland, with indicated losses of as much as $80 million; and[79]

The 6,000-7,000 limited partners, who hold interests in the EPIC partnerships amounting to between $175 and $200 million.

(2) a major upheaval in the private mortgage insurance industry, as reflected in:

The failure of TICOR,[80] the fourth largest PMI, as a result of its inability of cover its EPIC-related loss exposure of $166 million;

Significant potential losses regarding two other major PMIs—Mortgage Guaranty Insurance Company and Republic Mortgage Insurance Company—based on loss exposures of $75 million and $100 million,[81] respectively; and,

Diminished investor and public confidence in the PMIs, with the consequent effect, among others, of making it harder for them to obtain needed capital from domestic and foreign sources.

(3) reduced public confidence in the private secondary market which, for example, has forced sellers of private MBS to offer higher interest rates to attract investors.

(4) further indication of major financial institution problems concerning out-of-area loan participations and investments in MBS, which regulatory authorities continue to address ineffectively.

[76] This estimate takes into account the anticipated benefits of a workout plan developed by an informal group of EPIC's creditors, chaired by Fannie Mae. As approved by a Federal bankruptcy judge in April 1986, the plan provides for the orderly sale of the 20,000 EPIC properties over a 5- to 7-year period. The proceeds realized from these sales are to be used first to satisfy EPIC's creditors and, then, if funds are available, to reimburse the limited partners for their investments. Actual losses will naturally depend on the degree of success achieved in disposing of the properties; but, at least for the near-term, the workout plan has helped forestall the development of a far more serious and costly situation.

[77] Hearings, p. 1519.

[78] Ibid.

[79] In March 1986 the Mellon Bank Corp. agreed to take Community Savings and Loan off Maryland's hands for some $130 million in cash and a further commitment from State authorities that another $40 million would be made available to offset any other future losses arising from the thrift's holdings. Via this sale, Maryland officials believe they have reduced the State's ultimate loss potential from the EPIC/Community collapse by as much as $60 million. Maryland's final loss, however, will depend on the success of the previously mentioned workout plan, to which it is also a party.

[80] TICOR, now called TMIC Insurance Company, was placed under the conservatorship of the California Department of insurance on April 10, 1986, and is currently operating under a court-approved "rehabilitation plan." See, also, Hearings, p. 1532.

[81] Hearings, p. 1520.

2. Impact of fraudulent appraisals on NMEC-packaged securities involving Bank of America, Wells Fargo Bank, and 21 thrift institutions

a. *Background:*

Highly inflated and fraudulent appraisals underlying MBS were essential to an intricate pyramid scheme that almost resulted in losses of at least $95 million to 21 thrift institutions in the Northeast and Middle West that had invested in these securities. If Bank of America had not assumed liability, six of the thrifts would have had a negative net worth[82] and others could have become problem institutions.

The participants in the scheme included a real estate company (West Pac), a finance company (Western Pacific Financial), two insurance companies (Pacific American and Glacier), all of which were owned or indirectly controlled by Kent Rogers; and, a packager associated with him, National Mortgage Equity Corporation (NMEC), owned by David Feldman.[83] West Pac/Kent Rogers would buy properties and become the mortgagor/borrower on a number of single loans for many of them, with Western Pacific Financial (of Nevada) providing the temporary financing. NMEC then packaged the mortgages into pools, shares in which were sold as securities to investors, with the Bank of America and Wells Fargo Bank acting as trustee/escrow agents for them. A brokerage firm in New York City sold portions of the pools to various thrift institutions.

Normally, financial institutions would be reluctant to buy non-Government guaranteed mortgage securities. However, because Bank of America's name or Wells Fargo's name was on the securities and the mortgage payments were insured by either the Pacific American or Glacier insurance companies, they did not hesitate to buy them. Indeed, such was their assurance in this regard, that they purchased the securities without inspecting the properties collateralizing the loans, checking on the principals involved, or investigating the financial conditions of the insurers.[84]

b. *The appraisals and the properties:*

I

The scheme involved expensive single family homes, apartments, and townhouse condominiums in Southern California and Texas. The appraised values of these properties were 2½ times higher than the actual purchase price. One witness, H.G. Icenhower, who worked with and sold other properties to Kent Rogers, was familiar with the role of fraudulent appraisals in connection with three properties in Houston:

[82] Hearings, p. 469.

[83] Both of these individuals at the time of the scheme had been convicted in Federal court, sentenced to prison, and had appeals pending—Kent Rogers for bankruptcy fraud and David Feldman for mail and wire fraud.

[84] Evidence obtained by the subcommittee from the Delaware Insurance Commissioner shows that Pacific American was undergoing severe financial problems in the spring of 1983 and 1984, before being placed in receivership in late Summer 1984. Also, this documentation confirms that Kent Rogers controlled Pacific American, first by lending it money and then by acquiring it. This resulted in expedited insurance for these mortgage pools because they were not required to undergo customary underwriting procedures.

> . . . West Pac would purchase property for *x* amount of money; they would obtain a mortgage from a sister company for 2½ *x*, then obtain an appraisal at approximately 2½ to 3 *x*, then receive an insurance bond from the mortgage company for the amount of the loan, then sell the mortgage to a related company, National Mortgage, for 2½ *x*. West Pac would put the difference or 1½ *x* in its pocket. National Mortgage would sell the mortgage package to the financial institution S&L. In the case of the Houston properties, . . . the *x* in that case equaled $10 million for the three Houston properties; thus West Pac pocketed 1½ *x* or $15 million by buying these three properties simultaneous almost with the purchase of the properties.[85]

Mr. Icenhower provided the following data, which helps to illustrate how the scheme worked regarding the three Houston apartment complexes and what the consequent losses would be based on:

	Estimated Tuttle Appraised Value	Approx. West Pac Loans	West Pac Purchase Pric	1983 Market Value
Oxford Court	$17,500,000	$14,000,000	$6,000,000	$5,000,000
Bing'am Manor	5,100,000	4,200,000	2,150,000	1,300,000
Park Place	4,000,000	3,200,000	1,650,000	[86] 1,400,000

Mr. Icenhower also described how the appraisals were obtained through an appraiser, Dale Tuttle, who was from Southern California and therefore, unfamiliar with the Houston real estate market.[87] In connection with the Oxford Court complex, for example, Mr. Icenhower testified that Tuttle:

> . . . valued them as condominiums when actually they were an apartment complex. Where it was a 302-unit complex, he set up 302 different loans, 302 different properties, and then he used three comparables for all 302 of those units, and the comparables he used were anywhere from 4 to 8 miles away.
>
> When there were very good comparables within half a mile or actually within blocks of there. But he had to go that far away to get appraisals that would justify the numbers that he used. What he compared those to [sic] were new condominiums 4 to 8 miles away where these [properties] were an apartment complex 17 years old in a much poorer location, and his appraisal was based on the contingency that these would be completely renovated and of course that was never done.
>
> The same happened in the case of Bingham Manor [and Park Place Apartments] . . .[88]

It is worth noting, moreover, that Mr. Tuttle was not an inexperienced appraiser, as indicated in an April 2, 1984, letter he sent to a company associated with Pacific American, which stated:

> My appraisal experience spans approximately thirty (30) years covering the Chicago area, Beverly Hills, Orange County and other sections of Southern California. I am primarily residential-orientated and hold an S.R.A. designation with the Society of Real Estate Appraisers of Chicago, Illinois. I am also qualified for V.A. and F.H.A. appraisals. Additionally, I have a Fanny Mae appraisal number.[89]

At the time this scheme was disclosed, only 43 of the 640 units in Houston were occupied. Indeed, West Pac had no intention of operating and maintaining these complexes after their acquisition and, accordingly, the units had been stripped of appliances, cabinets, carpets, etc. The City of Houston condemned one or more of the complexes, and another turned into a slum.[90] A special representative sent to Houston by some of the investing thrifts testified that he found that the properties were "suffering from a long period of neglect" and contained mostly "vacant units," in which appliances were missing, windows were broken, and vandalism was extensive.

II

Tuttle's name came up in connection with another West Pac property—Cabelleros Estates Condominiums in Palm Springs, CA—which collateralized part of the Bank of America/Wells Fargo MBS pools. In this case, apartments converted to condominiums were appraised at $300,000 as "time share units," even though the units were not sold as such. Based on telephone discussions with some of the owners, the subcommittee staff found that West Pac sold the units in the $90,000 to $125,000 price range, not for $200,000 or more which, according to Tuttle, was their market value. West Pac obtained the units for much less—some in the $50,000 range.[91] As with the Houston properties, West Pac (as borrower) was involved in paper transactions, not actual sales, in which it bought low, borrowed high from an affiliate on the basis of inflated appraisals, and then obtained surplus funds through a packager who sold investors securities collateralized by the overvalued properties. Once again, most of the units went unsold, and no

[85] Hearings, p. 256. With some of the extra money from the inflated appraisals, Kent Rogers allegedly bought a large pleasure boat and homes in Southern California and Mexico, placed funds in England, Mexico, Switzerland, and elsewhere, and otherwise lived very well. Moreover, according to Icenhower, Rogers intended to use fraudulent appraisals to buy more properties, from which they could "have pocketed about $150 million more than they did pocket in their scheme. I heard them refer to this as the second year of their 5-year pyramiding scheme." (Hearings, p. 257.)

[86] Ibid., p. 263.

[87] The fact that Tuttle was not from Houston is something that the trustee/escrow agents should have questioned immediately. As thrift representative Cecil Akre testified: The trustee bank "should have approached the deal as if they were advancing their own funds for the mortgages. This may have caused them to ask why a California appraiser is used for Houston property." Hearings, p. 275.

[88] Hearings, p. 269.

[89] Ibid., 1791. Attached to his letter was a resume, listing present clients, including Western Pacific and several thrifts and other financial institutions in Southern California.

[90] Hearings p. 264.

[91] Ibid., pp. 1791-1804. Additional documents are in the subcommittee's files.

one—neither the investing thrifts nor the two national banks acting as escrow agents—inspected the properties.[92]

III

The servicer, i.e., the collector of the mortgage payments, on some of the better single family homes in California that collateralized the Wells Fargo MBS, wrote a letter to Wells Fargo on December 17, 1982. In that letter, the servicer, Advance Mortgage (now part of Llomas and Nettleton), indicated that it wanted out of the deal because there were a high number of delinquencies, defaults, and foreclosures on these properties, and that the appraisals were highly inflated:

> Advance has ample reason to question the integrity of a number of the mortgage loans comprising the subject pools and therefore has grave doubts about the soundness of the pools themselves. We are sharing our concerns with you in order that you may assess your position in this matter and formulate your course of action.
>
> As a matter of illustration, Advance . . . recently commissioned a reputable appraiser to reappraise six properties which were randomly selected from the pool loan portfolios. All six loans were originated . . . between March and July, 1982, while the reappraisals were performed during the first two weeks of November, 1982. Although only four to eight months had passed between the original appraisals and the new ones, the reappraisals reflected property values from twenty-five to fifty percent less than those shown in the originals. In every case, assuming . . . an accurate assessment of the property values, the loans are substantially unsecured. . . . Advance is convinced that its investigation reveals material irregularities which demonstrate a sound basis for concern that the certificates are not fully secured.[93]

In subsequent correspondence, Wells Fargo denied the existence of the problem, refused to investigate, and turned to the packager (NMEC) to service the loans, although the latter had been implicated in possible wrongdoing.[94]

c. *Potential impact on investor savings and loans and the FHLBB's supervisory responsibilities:*

[92] The private placement memoranda given to the investors indicated that the properties would be 1-4 unit residential dwellings. This was not the case for the Houston properties, a fact that could have been quickly verified through one or two phone calls.

[93] Hearings, pp. 1808-1809.

[94] Unlike Bank of America which accepted its share of the blame, Wells Fargo has denied its responsibility, and three investor-thrifts are suing it for breaching its fiduciary and other responsibilities. The Bank of America's own internal investigation—done only after the OCC and the FHLBB became involved and not in response to Mr. Icenhower's continued attempts to stimulate their interest—confirmed the appraisal abuses. The Bank of America found: "Large numbers of loans were not accompanied by a written appraisal based on the appraiser's personal inspection of the property. When appraisals were provided, most were fraudulently inflated far beyond true market value." P. 16, National Mortgage Equity Corporation Mortgage Pool Scheme—Bank of America's Summary.

I

The 21 savings and loans holding $128.5 million in NMEC mortgages were, for the most part, made whole because the Bank of America accepted responsibility.[95] However, according to the FHLBB, if the Bank of America had not accepted responsibility, 6 of the 21 institutions would have suffered losses in excess of their net worth and another holding $20 million worth of securities would have been severely impacted.[96] The three thrifts holding Wells Fargo/NMEC MBS have filed suit against Wells Fargo, but the solvency of none of them hinges on the success of the lawsuit.[97]

II

The FHLBB's overall response to this situation has been mixed. On the one hand, after one of the affected thrifts brought the matter to the attention of New York Federal Home Loan Bank officials in October 1984, onsite examinations of all the other involved thrifts within that district were conducted and supervisory staff held discussions with the institutions' management, the FDIC, the OCC, FBI officials, and various attorneys. On the other hand, the FHLBB was unable to inform us about what actions it took concerning the 10 thrift institutions outside of the New York district bank's region.

Relatedly, the FHLBB's examination policy concerning documentation supporting MBS has been totally inadequate. For several of these institutions, the investments in the NMEC MBS were their largest assets. Yet, while FHLBB examiners are charged with verifying the accuracy/adequacy of appraisals during their review of an institution's real estate loans, no such requirement is imposed concerning large MBS investments.[98] Indeed, the absence of an appraisal review requirement regarding MBS, may partially explain why the FHLBB was unable to tell the subcommittee about the status of the above-mentioned thrifts outside the New York Federal Home Loan Bank's purview, i.e., the matter had not been brought to anyone's attention by an involved thrift as was the case in New York and examiners in other district banks had no specific reason to carefully review the MBS and supporting appraisals in question.

III

According to the FHLBB, insured member institutions own approximately $4.333 billion of nonfederally guaranteed MBS.[99] The amount of these securities and the need to treat them the same as real estate loans requiring examiner review of underwriting documents and appraisal practices, has prompted the FHLBB to pro-

[95] The Bank of America likely assumed liability because: it had failed to carry out the terms of the escrow agreement, such as releasing funds to NMEC before all documents were received; its trust department and branch employees were implicated; and the possibility that other breaches of its fiduciary duties as trustee would be found. See, Hearings, pp. 271 and 1770.

[96] Hearings, p. 469 and 1770. The FHLBB estimate assumes that the potential losses would have been equal to the total amounts of the pass-through securities purchased by the investing institutions.

[97] Ibid.

[98] As discussed below, the FHLBB has proposed a rule aimed at increasing its control over MBS.

[99] Hearings., p. 469.

pose a rule requiring: (1) closer monitoring of out-of-area lending and loan participations by member institutions; and, (2) better and more complete recordkeeping regarding underwriting documents, including appraisals.[100] Specifically, the FHLBB proposal would: (1) limit an insured institution's purchase of nationwide loans/participations, if the institution was or would be placed beyond its regulatory capital requirements or had a ratio of 4 percent or more of scheduled items/assets classified as "doubtful" or "loss"; (2) require insured institutions to purchase nationwide loans only from "approved lenders;" (3) require prior supervisory approval of an institution's purchases of loan participations; and (4) require that insured institutions keep more complete and better records, including an appraisal report,[101] both for all loan participations and for all loans made or purchased that are secured by real estate.

The FHLBB rule, if implemented, clearly will make it harder for persons to perpetrate future West Pac/NMEC type frauds, particularly if examiners carefully scrutinize both the institutions' compliance with the rule and the actual underlying appraisal reports and other documents. However, there are a number of important elements missing. For example, several categories of participations are exempt from these requirements, including Fannie Mae and Freddie Mac participations or participation interests that are in a pool of loans secured by first liens on homes at least 80 percent of which are owner-occupied.

In the case of the latter exemption, even if the rule containing it had been in effect, most of the thrift institutions participating in the West Pac/NMEC pools could still have purchased the MBS without any FHLBB oversight or review, as long as West Pac or NMEC had structured the loan documents to show that 80 percent of the loans were secured by owner-occupied homes. Clearly, this is a gap that the FHLBB should close, by requiring for instance, that the originator of loans/participations must be an "approved lender" retaining an unsubordinated interest in a home amounting to at least 10 percent of the outstanding loan balance if the loan is not owned by Freddie Mac or Fannie Mae.

Failure to require an actual inspection of this property is perhaps the most important element missing in the FHLBB proposal. As Cecil Akre, an attorney for one of the participating thrifts in this scheme, testified, "I was told of one investor, who after an inspection, decided he did not want the [NMEC/West Pac] deal." Akre further stated:

> I think a lending institution, making a loan, shouldn't take that appraisal as if it is gospel. Appraisals are, after all, an interpretation of some facts which he, the appraiser, sets forth. It is not an exact science, as has been said here before. I think a lending institution should have an officer look at the security that they are lending on. I have ridden around, worn out many a suit of pants looking at houses around this country. You can see the good ones and you can see the bad ones and you don't have to know a lot about the appraisal. You can just say hey, that one isn't worth it. Something might have happened from the time the appraisal was made——
>
> Mr. BARNARD. You think, though, that the initial lending institution has got to make that determination?
>
> Mr. AKRE. I think the initial lending institution should do that; yes, sir. And an officer should do that, someone responsible to the institution. An investor in the secondary market should also make an inspection.[102]

The FHLBB's proposed rule states that the appraiser is liable to the lender for grossly negligent or fraudulent appraisals, but that the lender must be ultimately responsible for assuring that such appraisals are either rejected or otherwise not relied upon. In line with this view, we believe that the FHLBB—and the other bank regulatory agencies—should require lenders to verify property values and conditions. Agency rules could be amended to require that: (1) all lenders actually inspect out-of-territory properties securing either real estate loans or participations in MBS pools; (2) lenders order their own independent appraisals, separate from the appraisal done by the initial lender and packager; and/or (3) lenders order a reputable appraiser or real estate firm located in or near the same city as the subject property to inspect it and possibly provide a curbside appraisal. Of course, agency rules could give lenders discretion in selecting one or more of these three inspection alternatives, evidence of which would have to be maintained in the institutions' files.

d. *Mortgage backed securities activity by national banks and the OCC's supervisory responsibility:*

I

The subcommittee asked the OCC about the extent of national bank involvement with MBS, particularly where national banks were acting as trustees or escrow agents, as in the case of the Bank of America and Wells Fargo Bank's involvement with NMEC/West Pac. The OCC responded that, except for the Bank of America situation, it was unaware of any significant problems concerning properties collateralizing MBS handled by national banks. Beyond this, however, the OCC refused to name any large national banks involved in such activity, stating that:

> . . . there is no statutory requirement that banks notify the OCC of their entry in that market. While we are aware of several multinational banks engaged in the mortgage-backed securities business, we do not maintain aggregate statistics on this activity and cannot provide an exact number.[103]

[100] Federal Register, Wednesday, May 14, 1986, p. 17634 et seq.

[101] The proposed rule states that an insured institution must maintain "one or more written appraisal reports, prepared at the request of the lender . . . and signed prior to the approval of such application by a person or persons duly appointed and qualified as appraisers by the board of directors of such lender . . . " Ibid., p. 17642. The Bank Board's further explanation of this requirement states that: "Emphasis on the fact that appraisals are made for and upon the request of the insured institution gives notice that the lender is entitled to rely upon the appraisal and *that the appraiser will be liable to the lender* if loss occurs as a result of reliance on [a] grossly negligent or fraudulent appraisal." Ibid., p. 17638. (Emphasis added.)

[102] Hearings, p. 280.

[103] Ibid., p. 497.

II

The OCC was similarly uncooperative with regard to the subcommittee's specific questions concerning the Bank of America/Wells Fargo's involvement with the NMEC/West Pac securities.[104] Indeed, in only one instance did it provide complete information, and even this appeared to have been done begrudgingly. Specifically, in its initial response to the subcommittee (November 1985), the OCC indicated that its examiners had not visited the Bank of America's Los Angeles District Trust Office "for the purpose of reviewing escrow/documentation files for any NMEC related security." [105] Later, however in its formal hearing statement, it did finally admit that it:

> . . . was not aware of activities of Bank of America and Wells Fargo involving National Mortgage Equity Corporation until November 1984 when a complaint was filed against Bank of America by an institutional investor.[106]

III

There are two reasons why the OCC's examination procedures would not uncover this type of activity in the Bank of America, Wells Fargo Bank, and other large regional or multinational banks. First, the OCC's examination of large banks is very limited, both because of its insufficient and relatively inexperienced examination staff,[107] and its practice of relying heavily on member banks' own internal auditors. OCC staff advised us that its examination of the Bank of America would normally entail reviewing only 80 to 100 loans valued at $5 million or more each and that it would not be unusual for examiners not to visit any of its branches or district trust offices, absent an indication of a problem. Second, it was repeatedly emphasized that a bank is not required to notify the OCC that it is engaging in mortgage-backed securities business and that it is up to the examiner to gauge the scope of the review to uncover this activity.

IV

In response to the Bank of America and Wells Fargo situations, in June 1985 the OCC issued a supplement to its Handbook for National Trust Examiners, which added a number of questions to the agency's, "Internal Control Questionnaire for Corporate Trusts And Agencies." In accordance with this addition, it is expected that in situations where substantial MBS activity is uncovered, OCC examiners will review such activity to ensure that the bank's MBS

[104] The OCC simply ignored two sections of questions, one dealing with the Bank of America and the other with Wells Fargo, contained in the subcommittee's invitation to testify at the December hearings. OCC staff informally advised us that they would provide no information on these situations, and there were no references to the questions or the information requested in the formal hearing statement. While the OCC's behavior is highly unusual, we leave to others to speculate on its motivation and purpose.

[105] Hearings, p. 1012.

[106] Ibid., p. 499.

[107] Because of Federal salary ceilings, the OCC is unable to retain a large pool of experienced examiners and supervisory personnel. There have been attempts in Congress to exempt OCC examiners from these salary ceilings.

operations are conducted in a "safe and sound manner." [108] One of the added questions, it should be noted, requires the examiner to determine "whether the bank reviews the loan documentation and verifies the appraisal of the underlying properties." [109]

While the OCC is to be commended for recognizing the gap in its examination procedures regarding MBS, we believe that knowing when to implement these additional questions will be difficult, if not impossible, without a corresponding requirement that national banks inform the examiners about any MBS activity in which they are involved prior to the start of an examination. Without such required notification, for example, the questions posed in the examination manual would not have uncovered the Bank of America's and Wells Fargo's involvement in the West Pac/NMEC situation; nor, would they uncover a similar situation involving any large multinational bank. In short, unless the OCC addresses the problem of prior notification, its added requirements regarding MBS could have very little effect.

5. *Conclusion:*

The experiences of the financial institutions cited in the foregoing case studies should have alerted the bank regulatory agencies to the scope and national impact of MBS problems. It is clear that they did not and, thus, loan participations and MBS based on fraudulent appraisals have adversely affected many financial institutions around the country. Moreover, with the singular exception of the FHLBB, which is attempting to address the problem through its recent proposal, the FDIC, Federal Reserve, and OCC appear to be willing to let the banks they supervise continue to assume such risks without any requirements that they even obtain the appraisal and other underwriting documents, let alone conduct an inspection of the collateral property.

VI. Real Estate Appraising: A Troubled Profession

A. Introduction

In recent years, the real estate appraisal industry has been beset by serious problems and subjected to increasing criticism. The harmful effects of faulty and fraudulent appraisals—major losses, insolvencies, etc.—are described at length elsewhere in this report. However, what is less well-known or understood are the underlying causes of the problems that have helped to bring about the industry's present troubled state and well-earned notoriety.

B. Causes of the Problems

At least five factors have contributed significantly to the appraisal industry's present state:

1. *Lender ignorance/misunderstanding of appraisal role:*

Many lending institution executives, directors and loan officers are either essentially ignorant of or ill-informed about the proper role of the real estate appraisal in loan underwriting. The prevailing attitude among them is that the appraisal is simply an obstacle

[108] Hearings, p. 728.

[109] Ibid., p. 500.

to overcome or a rubberstamp needed to establish the maximum amount of a loan.[110] Worse still, many such officials maintain that it is not difficult to find an accommodating appraiser who can be counted on to come up with whatever results are desired.[111] Indeed, some of these same officials are among those who sarcastically refer to the prestigious "MAI" designation earned by members of one of the leading appraisal industry organizations as meaning "made-as-instructed."[112] Also, appraisals are often relegated to a comparatively minor status in the loan underwriting process, because among lenders there is far more interest in the up-front fees, interest income, and other tangible benefits accruing from a completed loan transaction than there is in assuring that the institution's risk exposure is minimized.

2. *Pressure on appraisers by lenders, borrowers, et al.:*

Borrowers, particularly developers seeking to minimize or eliminate their personal equity investment in a proposed commercial venture, will often pressure appraisers into rendering estimates substantially above the project's actual value. Similarly, lenders may tend to exert pressure on appraisers to overvalue property collateralizing a loan, since the amount of the up-front fees the institution receives depends on the size of the loan—the bigger the loan, the greater the attendant fee income.[113] In the case of both borrowers and lenders, the implicit, and sometimes explicit, threat underlying the pressure brought to bear is that if the appraiser fails to "come up with the numbers," he or she will not get additional business from them.

The effects of such pressure are far-reaching and enormously harmful. For example, one witness at the hearings testified that he finds one major consequence, "client advocacy," in the reports of as many as 75 percent of the real estate appraisers with whom his institution works.[114] In addition, studies made regarding residential appraisal reports reveal that in as many as 98 percent of the cases reviewed, the appraised value of the property was identical to the sales price. In commenting on the latter, one knowledgeable appraisal industry source raised the obvious follow-on question: "If sales price is market value, the lender doesn't need the appraiser;"[115] i.e., why go to the trouble and expense of having an appraisal done in the first place?

3. *Fragmentation/disarray within the industry:*

Of the estimated 150,000 to 250,000 individuals performing appraisals on a full- or part-time basis, only a maximum of one-third of them are affiliated with a legitimate trade organization possessing professional standards and certification criteria, codes of conduct, and disciplinary procedures.[116] The remaining two-thirds of the appraisers are not affiliated with any such organization and, therefore, are neither necessarily subject to any education or training requirements, guided by any professional standards and ethics, nor accountable for their performance and behavior.[117]

[110] Hearings, pp. 1556 and 1560. See also Sunrise Savings and Loan case study discussion, p. 34 above.
[111] Hearings, pp. 60 and 78.
[112] Ibid., p. 58.
[113] Ibid., p. 133.
[114] Ibid., p. 67.
[115] Fayette F. Arnold, "You Can't Have Fraud Without an Appraisal," Appraisal Review Journal, Winter, 1985, p. 54.
[116] Hearings, p. 349.

Adding to the degree of fragmentation within the industry are dozens of so-called "diploma mills" that offer legitimate sounding professional credentials for a fee. Unlike their reputable counterparts, these organizations typically have minimal or no professional standards, ethics, or disciplinary procedures and their certification criteria are so general that it is possible for virtually anyone wishing to call himself an appraiser to qualify.

Further compounding this confusion and disarray, until quite recently the relationship among the leading appraisal groups was characterized by intra- and inter-organizational rivalry, squabbling, and mistrust. While this state of noncooperation and mistrust has by no means disappeared, these groups within the last year or two have made significant progress in beginning to work together on the common issues and problems facing them.[118]

4. *Grossly inadequate enforcement of professional standards and codes of conduct:*

Inadequate efforts to monitor and enforce existing codes of conduct and standards of professional practice have played a major part in diminishing the appraisal industry's overall credibility and professional standing. For many years, leading appraisal groups have had procedures for disciplining their members for cause, including admonishment, censure, reprimand, suspension, and expulsion. These procedures, however, have been applied so sparingly that they have become almost meaningless as an effective enforcement tool. Indicative of this industry-wide failure to deal with poor performance and misconduct, out of some 1,600 complaints screened and submitted for further consideration within four of the leading appraisal groups (combined membership about 40,000) between 1983 and 1985, just 40 or so resulted in suspension or expulsion and another 125 ended up in milder penalties such as admonishment or censure. In effect, only about 10 percent of the complaints resulted in meaningful disciplinary action; which translates to a minuscule four-tenths of 1 percent in terms of the total membership!

5. *Lack of regulation:*

Real estate appraisers are completely unregulated at the Federal level and only minimally so at the State level. Just 12 States have any form of appraiser licensing or certification and, moreover, in all but a very few of these the effects of such regulations are limited because they are essentially an extension of principles and standards applicable to real estate salespersons and brokers.

[117] It should also be noted that appraisal problems are not the sole province of either group; i.e., faulty and fraudulent appraisal work is done both by appraisers holding designations from legitimate professional organizations, as well as those not affiliated with any such group.
[118] *Inter alia*, representatives of some of the leading appraisal groups have been working jointly with the FHLBB since 1984 on issues of mutual concern and, especially, on ways to promote appraisal quality in thrift lending activities. Similarly, appraisal group representatives have worked together with Fannie Mae, Freddie Mac, VA, and FHA officials on developing a uniform single family residential appraisal form. Also, as of February 1986, the eight largest appraisal groups met jointly and formed a so-called Ad Hoc Committee on Uniform Standards of Professional Appraisal Practice. This committee has met several times since to consider the establishment of uniform standards of appraisal practice and a possible system for appraisal industry self-regulation. These latter efforts have taken place in concert with the subcommittee's investigation and are being coordinated with Chairman Barnard.

Indeed, that most State regulations place appraisers within the real estate licensing framework is fraught with potential problems since: (1) real estate sales stress wholly different legal, contractual, and client-agent relationships than those involved in an appraisal assignment; and, (2) unlike the appraiser, a real estate agent or broker has a vested interest in seeing that a sale/loan transaction is consummated.[119]

C. APPRAISER INCOMPETENCE/MISCONDUCT—AN INDIVIDUAL CASE STUDY

Illustrative of both the degree to which appraisers fail to be disciplined/regulated and the effect incompetent, negligent, or dishonest appraisers can have on financial institutions, is the performance of one appraiser who Federal regulators say has "wrought havoc up and down the East Coast" for years. Grossly inflated and otherwise defective appraisals by this individual, who at the time of the subcommittee's investigation held senior designations from three of the leading appraisal industry organizations, have been found in work he did for at least two failed federally insured savings and loan associations. Federal authorities assert that one of these institutions was declared insolvent as a direct result of losses incurred in connection with a major real estate project that had been grossly misappraised by this individual.[120] The actual losses sustained by the FSLIC on this project have passed $11 million, exceeding even the $7 million projected at the time of the institution's demise.[121] As of August 1986, this appraiser was still a member in good standing of the three industry groups whose designations he holds,[122] even though the above-mentioned institution had failed nearly 4 years earlier and his role in that situation had resulted in his being named in a criminal referral to the Justice Department and a $10 million suit brought by the FSLIC.[123] The disturbing, but not surprising, result of the total lack of disciplinary action against this appraiser,[124] is that he is still very much in business doing work for federally insured banks and thrifts, Federal and local government agencies, and other State and local lending institutions and private businesses.

[119] Hearings, pp. 106 and 124.

[120] Letter in subcommittee files dated January 17, 1983, from Rosemary Stewart, Acting Director of the Enforcement Division, Office of General Counsel, FHLBB, to Elsie L. Munsell, U.S. Attorney for the Eastern District of Virginia.

[121] Memo contained in subcommittee files.

[122] While officials of these respective organizations are bound by their rules not to disclose any information regarding a pending disciplinary proceeding against a member, it is clear that this appraiser is presently under investigation in all of them. The added problem in this respect is that the due process safeguards built into these organizations' disciplinary procedures make the effort a protracted one that may result in a year or two passing before a final decision is reached and action taken.

[123] According to FHLBB officials, the criminal referral failed to result in an indictment, and the civil suit was settled in de minimus fashion, with a payment by the appraiser to the FSLIC of about $5,000.

[124] As indicated in the Hearings (p. 654), subcommittee staff learned that this same individual was also on the VA's approved list of appraisers. Having been informed of this fact, the VA initiated an inquiry that resulted in his being removed from its appraiser roster on February 11, 1986. In addition, this appraiser's example raises further questions of how he is able to continue to find work in federally insured financial institutions and why no action has been taken against him by the concerned regulatory authorities. See related discussion below, p. 48.

D. NATIONAL REGULATION NEEDED

Among the differing views and ideas presented in the hearings testimony and separate documentary submissions to the subcommittee on how to address the appraisal industry's problems, a broad consensus emerged that the time has come for some form of national action to regulate appraiser performance and appraisal quality. Within this consensus, which reflects the views of individual appraisers, appraisal organization leaders, mortgage insurance industry officials, and Federal regulators,[125] there was almost unanimous further agreement that what they had in mind was a system patterned after the one established by and for the accounting profession in cooperation with the U.S. Securities and Exchange Commission.[126] While the details of such a self-regulatory system have yet to be worked out, several points regarding its general outline are often mentioned, including that it be applicable to anyone performing real estate appraisals and contain uniform appraisal standards, appraiser qualification/certification requirements, appraiser performance and review criteria, and disciplinary/enforcement procedures.

VII. Appraisal Problems Are Everyone's Fault

A. INTRODUCTION

In addition to the appraisal industry's obvious responsibility for many of the problems described elsewhere in this report, the other private sector institutions that use appraisals and the public sector agencies that oversee or regulate such usage are equally culpable.[127] In other words, literally all the organizations that came under scrutiny in the course of our investigation—the Federal bank regulatory agencies and the institutions they supervise, VA, FHA, Fannie Mae, Freddie Mac, and the PMIs—bear some responsibility for the appraisal problems extant in the real estate finance and mortgage insurance and investment communities.

B. REASONS

These organizations are responsible for appraisal problems to the extent that they have:

Treated appraisals as a secondary and comparatively unimportant aspect of sound loan underwriting practice;

Not developed adequate appraisal/appraiser-related policies and procedures or ignored, overlooked, or simply did not comply with the ones they had; and,

Failed to anticipate recent appraisal problems and to respond effectively once they became apparent.

[125] See, for example, Hearings, pp. 21, 79, 109, 296, 307, 411, and 621.

[126] Under the general oversight of the Securities and Exchange Commission, the accounting profession's self-regulatory system is organized around the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA). Created in 1973, FASB is an independent body that is responsible for establishing and improving financial accounting and reporting standards. The AICPA, the major public accounting membership organization, is responsible for professional certification and disciplinary procedures and actions.

[127] See, for example, Hearings, p. 287.

The subcommittee's findings along these lines are summarized in the following table:

	Lenders[1]	FHLBB	OCC	Fed	FDIC	NCUA	VA	FHA	/Fannie Mae	Freddie Mac	PMIs
Appraisals secondary/ comparatively unimportant	X		X	X	X		X				
Inadequate policies/ procedures or non-compliance with same	X	X	X	X	X	X	X	X	X	X	X
Appraisal problems not anticipated or dealt with effectively	X	X	X	X	X	X	X	X	X	X	X

[1] Lenders include banks, savings and loans, mortgage bankers and brokers.

1. *Appraisals are secondary/unimportant—the OCC/FDIC view:*

While appraisal-related policies and procedures among the bank regulatory agencies—with some exceptions in the case of the FHLBB—are inconsistent and filled with gaps, such is particularly true of the OCC and FDIC. In contrast to the other regulators, however, that the OCC and FDIC neither require an appraisal for each real estate loan nor that their examiners verify appraisal accuracy/adequacy during regular examinations,[128] reflects their view that appraisals are secondary to and far less important than the borrower's apparent creditworthiness. This outlook was evident at the hearings, as demonstrated in the following testimony by John F. Downey, Chief National Bank Examiner, OCC and Robert Miailovich, Associate Director, Division of Bank Supervision, FDIC:

> Mr. BARNARD. That brings up this question: Do the OCC, FDIC, and Federal Reserve feel that bad appraisals are not that much of a problem and appraisals in general are not that important? I mean, is it your judgment that because the institution you supervise doesn't make a lot of real estate loans, therefore this matter is not as important to you as some other things?
>
> Mr. DOWNEY. I think appraisal of collateral is important to all of us. I will speak for the OCC, it's important as one more element of a good——
>
> Mr. BARNARD. But it's not what you consider a loan to be based upon?
>
> Mr. DOWNEY. A loan should be based on the borrower's ability to repay that loan——
>
> Mr. BARNARD. And so the appraisal is secondary?
>
> Mr. DOWNEY. Yes, sir.
>
> Mr. MIALOVICH. Absolutely. The most important thing is evaluating the ability to repay and according to specified terms. The value of the collateral becomes increasingly important as one has to consider perhaps taking possession of that collateral and liquidating it as a fallback. Collateral and its value is what you have in the background, should the real source of repayment fail on you. So, the important thing is evaluating the borrower and the ability to repay.[129]

[128] Hearings, pp. 964-965, 1007-1008.

In our view, this outlook is at best naive and at worst grossly irresponsible. No matter how carefully loans are screened some fail, and even borrowers with spotless credit records can unexpectedly fall victim to circumstances that result in their being unable to meet their payment obligations. Moreover, in the highly competitive lending environment of recent years, the fact is loans are commonly not screened carefully, resulting in their being approved for far too many unqualified and disreputable borrowers. Thus, poor quality and risky loans—many of which were made possible by inaccurate or otherwise defective appraisal documentation—have become commonplace and, correspondingly, have appeared in steadily increasing numbers among the scheduled items of the Nation's financial institutions, including those supervised by the OCC and FDIC. In effect, the only way the OCC/FDIC appraisal outlook could possibly make sense is if none of their member banks had experienced significant losses or been otherwise damaged either as a direct result of faulty or fraudulent appraisals or circumstances in which the latter had played a meaningful role. Indeed, as has been shown previously, the Bank of America loss and Continental Illinois Bank and EPIC failures, demonstrate that precisely the opposite is true.

2. *Inadequate policies and procedures—appraisal information/ data are lacking:*

The absence of adequate appraisal information and data was one of the more glaring deficiencies found in the operations and activities of almost every organization surveyed by the subcommittee. With some exceptions among the PMIs and FHLBB, no other Government or private sector agency or institution systematically and regularly collect appraisal information; nor, have any of them informally or formally studied the relationship between faulty and fraudulent appraisals and problems—e.g., losses—they've experienced.

To the extent that these various agencies and institutions have failed to collect appraisal information or study the effects of appraisal deficiencies and abuses, questions necessarily arise as to assertions made by some of them—namely, the OCC, FDIC, FHA, and Freddie Mac—that they have experienced few, if any, appraisal problems.[130] Such was our concern in this regard, that after the hearings, Chairman Barnard raised it again in follow-up correspondence with the FHA—the Federal agency with the most flagrant appraisal data deficiencies—and Freddie Mac, respectively:

> Additionally, we are troubled by some apparent inconsistencies between your public testimony and your prior written submission (November 25, 1985). In the former, you minimize the impact of faulty and fraudulent appraisals and, yet, in your prior submission (p. 7, item #7) you appear to have no basis for such a contention, since you state that no specific analysis of the relationship between

[129] Ibid., p. 458.

[130] Hearings, pp. 967-968, 1009, 1147-1148, and 1259.

appraisal problems and claims has been done and, moreover, that the data that would enable you to do so has only just begun to be collected. Also, while you conceded, in response to my question at the hearing, that it would be reasonable to assume that appraiser suspensions or removals would likely involve losses, you did not indicate that you had any idea how extensive this might be.[131]

2d (i) Concerning the response to question 5 (page 8 of your November 15, 1985 submission), why is the requested appraisal-related data on Freddie Mac REO properties unavailable; does such data exist, for example, as a partial result of the reviews conducted of properties acquired through foreclosure?

(ii) If such data is either not available or does not exist, how is Freddie Mac able to confirm or deny the existence of some relationship between appraisals and losses experienced in its mortgage purchase activities?[132]

Further illustrating the impact of incomplete or wholly absent data, the FHA is still unable, even after the completion of a lengthy investigation, to provide an estimate of any projected and/or actual losses resulting from the fraudulent scheme perpetrated against it in Camden, NJ.[133] Underscoring the significance of this point, investigations of activities strikingly similar to those involved in the Camden scheme are in progress in at least five other major metropolitan areas: Washington, DC, Nashville, Atlanta, Houston, and Seattle. In effect, unless FHA data collection policies and procedures improve significantly, there is little reason to expect that it will be any more able in the future than it is now to accurately estimate projected or actual losses arising in the context of such investigations.

Finally, it is important to note that when such information is available—either in the form of regularly collected data or special studies—it can graphically show both the nature/extent of appraisal problems and their harmful effects. For example, a leading PMI, the Mortgage Guaranty Insurance Company, recently conducted a study of 300 pairs of appraisals on defaulted loans it had insured. In their review of these loans' appraisals—the original one and the one performed as part of the claims process—40 percent were found to have dropped in value by more than 20 percent due to appraiser incompetence, negligence, or fraudulent conduct.[134]

3. *Failure to anticipate/address appraisal problems—inadequate coordination and communication:*

During the hearings, no single issue excited more discussion and attendant indignation than the example of the appraiser who for years had "wrought havoc" in various savings and loan associations, but was still working steadily because no effective action had been taken against him, either by his professional peers or the regulatory authorities responsible for supervising the financial institutions he'd harmed.[135] The testimony presented by appraisers, regulatory officials, and others indicates that several points help to explain how such situations can arise and persist.

[131] Ibid., p. 737
[132] Ibid., p. 762
[133] Ibid., p. 744.
[134] Ibid., p. 1392.
[135] See above, p. 44.

First, and perhaps foremost, there are always lenders who will seek out such appraisers, as is reflected in the following exchange with former FHLB Atlanta Chief District Appraiser, Richard Hewitt:

Mr. BARNARD. Did it appear there was a pattern of this appraiser being employed by an institution in order to get an appraisal that would support a projected loan?

Mr. HEWITT. Yes, sir. As a practical matter those institutions would seek out this individual to hire him, to use him to get the numbers where they needed them to be.

Mr. BARNARD. And the banks or savings and loans were not suspicious or did not hesitate to accept his appraisal?

Mr. HEWITT. No, sir. As I indicated, usually there is quite a correlation between poor underwriting practice and the appraisal, but the sad part is that someone with that kind of image, that kind of background, experience and et cetera, was providing the numbers that needed to be there.[136]

Second, reflecting the effects of apparent legal constraints, inadequate authority, and/or a lack of resolve, public and private sector agencies and institutions have failed to establish procedures to share information with one another regarding problem appraisers. While the VA and FHA communicate with each other on appraisers suspended or removed for cause, for example, no such ties exist between them and the Federal bank regulatory agencies. This, in part, helps to explain why the VA remained ignorant of this particular appraiser's long history of unprofessional performance in connection with federally insured savings and loan associations.[137]

Similarly instructive in this regard are two exchanges that occurred at separate intervals during the hearings. The first of these was between Chairman Barnard and Steven Doehler, executive vice president of the Mortgage Insurance Companies of America:

Mr. DOEHLER. Mr. Chairman, the association did a survey of the counsels in the various companies and asked them what legal actions they have taken. The problem in many cases is that you don't have an effective remedy to take against an appraiser. Especially one that you can address at the stage that the problem is uncovered. In other words, the cost of going through the legal process in all but cases of blatant fraud or misrepresentation is not an economic course of action. Putting an appraiser on a watch list is more practical.

Mr. BARNARD. So, you all are just rolling the dice as far as appraisals are concerned.

Mr. DOEHLER. And the unfortunate thing, Mr. Chairman, is that what happens is that appraiser, who may not be acceptable to mortgage insurer A, will then be sending his business or through the lender they will be sending

[136] Hearings, pp. 78-79.
[137] See p. 44, above for related discussion and action taken by the VA.

their business to other mortgage insurers in the industry.[138]

The second was with FHLBB Associate General Counsel, William K. Black:

> Mr. BARNARD. I think someone said just awhile ago that it would be a cause of legal action against you if you blacklisted this individual within your own agency or in another one.
>
> Mr. BLACK. Well, I think we would draw a suit, frankly, if we tried to do something like that. I know one of our district heads raised yesterday the problem of civil suit in this regard. One of my trial attorneys has a $1 billion suit pending against her in an individual capacity simply because she helped put an association run by some crooks into receivership. That has been pending for quite some time. It is difficult to buy your house when you have that.
>
> So, yes, there are significant problems to try to do something that would be portrayed as a blacklisting.[139]

Finally, among virtually all of those who perform, use, or oversee appraisals, it is accepted as a matter of fact that ". . . the appraisal industry, as it is presently structured, is ill-prepared to control abusive appraisal practices" on the part of its members.[140] This, in turn, helps to explain why Federal regulatory authorities and others have referred so few complaints concerning problem appraisers to the professional organizations whose certification they hold. Indeed, the disciplinary procedures among the reputable industry organizations are so encumbered by "due process" requirements that even in the comparatively few cases that do end in meaningful action, years may pass before the results are achieved and publicized adequately. Moreover, on top of this lengthy interval between complaint and remedy, virtually nothing stands in the way to prevent an appraiser, who has been severely disciplined, from continuing to seek out and/or be hired by accommodating clients willing to overlook his past record.

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[138] Hearings, p. 296. The PMIs also maintain that they are unable to share information on problem appraisers among one another for fear of violating Federal antitrust statutes. However, according to the testimony presented (p. 295), the industry's association has not asked the Department of Justice for an opinion on this matter.

[139] Hearings, p. 454.

[140] Ibid., p. 106.

PUBLIC AND PRIVATE CONTROL OF
APPRAISAL PROCUREMENT

THE PROGRAM

See V. C. 1. a. of the James A. Graaskamp Collection of Teaching Materials for Barnard's speech in Baltimore, MD on 4/23/87. See V. C. 2. a. for text of the legislation

8:30 - 9:00 a.m.	--Registration
9:00 - 9:15 a.m.	--Introductory Comments James A. Graaskamp Ph.D.
9:15 - 10:15 a.m.	--The Federal Initiative From the Viewpoint of the Committee on Government Operations Hon. Douglas Barnard
10:15 - 10:30 a.m.	--Coffee Break
10:30 - 11:30 a.m.	--Perspectives on the Federal Initiative from an Appraisal Practitioner Carl Schultz MAI SRPA
11:30 - 12:00 a.m.	--Questions and Answers
12:00 - 1:00 a.m.	--Lunch
1:00 - 2:00 p.m.	--Letters of Engagement to Control Appraisal Procurement Professor James A. Graaskamp Chairman, Real Estate and Urban Land Economics
2:00 - 3:00 p.m.	--The Real Estate Appraiser--The Elusive Goal of Professionalism John R. White MAI
3:00 - 3:15 p.m.	--Break
3:15 - 4:00 p.m.	--Critical Implications of Control and the Concept of an Appraisal Standards Board William Kinnard Ph.D. MAI SRPA
4:00 - 4:30 p.m.	--Questions and Answers

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QUALIFICATIONS OF J. CARL SCHULTZ, JR., MAI, SREA, CRE

Principal of Schultz, Martin, Carr & Associates (formerly Albritton, Schultz & Associates) and an associated principal of The Real Estate Counseling Group of America. Exclusively engaged in real estate consulting and valuation for the past 22 years. Was a Partner in Wight, Couch & Schultz and Vice President of Landauer, national appraisal and consulting firms.

TYPE OF WORK PERFORMED:

Experience has involved most types of real estate, including commercial, multi-family, and special purpose properties, with major involvement in recent years in the valuation and analysis of numerous southeastern and Caribbean resorts and recreational properties including condominiums, timeshare developments, golf courses, hotels, marinas, and coastal islands. Has also performed loan and property portfolio analyses of several major mortgage companies and real estate investment trusts for banks and accounting firms. Has been engaged in the acquisition estimates for the Metropolitan Atlanta Rapid Transit Authority, airport expansion, and proposed tollroads, as well as the valuation of rural and timber lands.

EDUCATION/TEACHING:

Graduate of University of Georgia in 1963. Received BBA Degree with major in Real Estate. In addition to completing numerous courses offered by the American Institute of Real Estate Appraisers, has attended the American Land Development Association conference on Recreation, Resort, and Community Development and the House and Home Recreation Resort Seminar. Has taught appraisal courses nationally for the American Institute of Real Estate Appraisers, Society of Real Estate Appraisers, and the Mortgage Bankers Association.

MEMBER OF:

- American Institute of Real Estate Appraisers--MAI #4478. (Pres., Georgia Chapter, 1980; Board of Directors, 1981-1983; National Professional Recognition Award, 1976-81; Certified through Education Program until 12/31/86; Member of National Governing Council, 1982-1985; Chairman, National Professional Standards Committee, 1985 and 1986)
- American Society of Real Estate Counselors--CRE (Georgia Chapter Chairman 1986)
- Society of Real Estate Appraisers--SREA #510. (Senior Real Estate Analyst; Pres., Atlanta Chapter, 1972-73)
- Atlanta Board of REALTORS, (President, 1984; REALTOR of the Year, 1978; Board of Directors, 1980-86)
- Georgia Association of REALTORS (Board of Directors, 1978-1986; Metro Regional Vice President, 1984; Secretary, 1986)
- National Association of REALTORS (Board of Directors 1986-1987)
- Rho Epsilon National Real Estate Fraternity (National President, 1974-1976)
- Georgia Land Development Association
- Distinguished Practitioning Lecturer, University of Georgia College of Business Administration, 1975-76

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PUBLIC AND PRIVATE CONTROL OF APPRAISAL PROCUREMENT

January 8, 1987
Atlanta, Georgia

10:30--11:30 Perspectives on the Federal Initiative from an Appraisal Practitioner--Carl Schultz, MAI, SREA, CRE

I. INTRODUCTION

A. Estimated 250,000 to 300,000 appraisers nationwide.

B. Very little current control. Several states require real estate brokerage license:

California--Certified appraisals.

Nebraska--licenses appraisers under the real estate commission. They just included standards in their law.

Louisiana--recently passed a bill to certify appraisers, which includes appraisal standards similar to those of the American Institute of Real Estate Appraisers.

C. Professional organizations--numerous with only a few requiring education, exams, experience, continuing education, along with standards and ethics enforcement.

D. Public confused over designations. Many require only application and a fee.

E. Professional organizations with standards enforcement find it difficult, extremely expensive, and time consuming in their attempts to discipline or expel members. Expulsion from the most prominent organizations almost always result in a law suit.

F. Many procurers of appraisal services look upon the appraisal as a burden that may kill a deal rather than a document to be relied upon. These clients frequently have a financial interest in the deal. The reference here is to the individual controlling the procurement of the appraisal assignment and not necessarily the corporate or financial entity that the appraisal is supposed to protect.

G. Historically many appraisers have been pressured to come up with the "right number" or you won't do any more of our work. This does not excuse the appraisers for unethical conduct but is considered by many to be the primary reason some appraisers force valuations.

II. Possible Solutions

A. DO NOTHING. Some professional organizations are saying, "If it ain't broke, don't fix it." Maybe it's not broken but it sure isn't well. Doing nothing is no solution. Most leaders of responsible appraisal organizations recognize the likelihood of some form of regulation of appraisers in the near future.

B. LICENSING--similar to real estate, barbers, beauticians, etc. This type regulation is usually state sponsored, mandatory, and therefore requires grandfathering. This is no solution if it would automatically certify or license many unqualified appraisers. Would further confuse the public for many years. Strict enforcement of standards would give the profession another black eye and further discredit the appraisers that are competent and abide by meaningful standards. Most proponents of licensure and grandfathering are the professional organizations that sell designations and persons who do an occasional appraisal, therefore, would find it difficult to pass an meaningful exam.

C. FEDERAL LEGISLATION. The real estate reform act of 1987, as proposed by Congressman Douglas Bernard of Augusta, Georgia, was introduced into the United States Legislature November 20, 1987.

1. BRIEF SUMMARY

a. Establishes a Federal Interagency Appraisal Council with absolute power over Certified Appraisers, State Certification Boards and Appraisal Standards where federally covered transactions are affected (See Section 103. Functions of Council).

b. Twelve voting members representing 12 Federal Agencies (FHLBB, FDIC, Federal Reserve, National Credit Union, SEC, VA, FHA, FNMA, FHLMA, Farmers Home Administration, and GSA). Non-voting members are the IRS and Secretary of Transportation.

c. Federal agencies transfer authority to establish and regulate appraisal standards and appraiser qualification requirements to the Federal Interagency Appraisal Council (Federal Bank Regulatory Agencies, VA, FHA, FNMA, FHLMC, SEC, Federal Financial Institutions Examination Council, GSA, and the Farmers Home Administration).

d. Advisory--Real Estate Appraiser Committee (12 members) and Real Estate Appraisal User Committee (14 members), all appointed by the Chairman of the Interagency Council.

e. Full time for three years, then part time.

f. Funding--Maximum $100 per certified appraiser and transaction fee based on a graduated basis with respect to the value of the transaction not to exceed $5,000.

2. BENEFITS OF FEDERAL LEGISLATION

a. Requires uniformity among states.

b. May be the most expiditious way to certify appraisers, if passed.

c. Requires all federal agencies to have similar standards (May become a problem since the various agencies have dissimilar appraisal needs, i.e. the appraisal for mortgage loan purposes usually has different requirements than an appraisal for disposition purposes.)

d. Requires states to assure the ready availability to appraisers of adequate and reliable information regarding property values and the terms and conditions of real estate sale transactions.

e. The threat of federal legislation is forcing professional appraisal organizations to join together to suggest meaningful regulation. Without this threat in all likelihood very little would have been accomplished for many years.

3. PROBLEMS/OBJECTIONS FROM A PRACTIONER VIEWPOINT

a. Bill does not specify any appraisal standards--left up to 12 representatives of federal agencies.

b. Significant concern about federal agencies establishing standards. Several agencies, such as GSA and to some extent the Federal Home Loan Bank Board, have established meaningful standards. Other agencies, however, have no appraisal standards. Will the standards developed by the 12 representatives be meaningful or political?

c. Standards and qualification requirements for appraisers will be controlled by non-appraisers. Could cause substantial problems such as was recently encountered with attempts to write a federal regulation to replace Memorandum R41c of the Federal Home Loan Bank Board.

d. Could appraisal standards be modified to accomplish some type of social reform, i.e., establish special standards in certain situations to force feasibility/value.

e. Cost--federal and state agencies are bound to cost substantially more than a state agency. Can the typical appraiser afford the administrative cost of a federally controlled system.

f. Non-qualified members on the Interagency Council. There will be no appraisers. I know of no state board or commission that is totally controlled by persons not involved in the profession.

g. The Interagency Appraisal Council transforms into a part-time position after three years. The appraisal profession should not be regulated by part-time participants.

D. APPRAISAL PROFESSION SOLUTION. Proposed by several of the leading professional organizations--State Certification of Appraisers similar to the Certified Public Accountants with a Standards Board and an Appraiser Qualification Board established by the "Appraisal Foundation".

1. Nine organizations have developed Uniform Appraisal Standards including The American Institute of Real Estate of Appraisers, the American Society of Appraisers, the American Society of Farm Managers and Rural Appraisers, the International Association of Assessing Officers, the International Right-of-Way Association, the National Association of Independent Fee Appraisers, the National Society of Real Estate Appraisers, the Society of Real Estate Appraisers, and the Appraisal Institute of Canada.

2. The "Appraisal Foundation" was incorporated November 30, 1987, and the public trustees were selected at a meeting on December 7, 1987. The Foundation was formed by eight of the organizations involved in the establishment of Uniform Appraisal Standards excluding the Appraisal Institute of Canada. The main purposes of the Foundation are "To establish and improve uniform appraisal standards...; and to establish appropriate criteria for the certification and recertification of qualified appraisers..." The Foundation's organizational meeting will be held January 11, 1988. To date the Foundation has been formed and the 20 trustees have been selected including three public trustees. Twelve of the trustees represent the eight appraisal organizations and five represent industry related and educational organizations. The initial members of the special class of membership which have voting rights but no financial requirements shall be a representative from the American Bankers Association, the American Real Estate and Urban Economics Association, the Mortgage Bankers Association, the Real Estate Educators Association, and the Urban Land Institute. Initial funding will be provided by the eight appraisal organizations. A.I.R.E.A. and S.R.E.A. have each committed one million dollars to the Foundation.

3. Two appraisal organizations have been working closely on a model state certification bill. Separate drafts from each organization are extremely similar with only insignificant differences, if any. A copy is included with the handout material.

BRIEF SUMMARY--State Certified Real Estate Appraiser Law (AIREA AND SREA)

a. Definitions

"Appraisal" or "real estate appraisal" means an analysis, opinion or conclusion relating to the nature, quality, value or utility of specified interests in, or aspects of, identified real estate. An appraisal may be classified by subject matter into either a valuation or an analysis. A "valuation" is an estimate of the value of real estate or real property. An "analysis" is a study of real estate or real property other than estimating value.

"Appraisal report" means any communication, written or oral, of an appraisal.

"Appraisal Foundation" means the Appraisal Foundation that was incorporated as an Illinois Not for Profit Corporation on November 30, 1987.

"Certified Appraisal" or "certified appraisal report" means an appraisal or appraisal report given or signed and certified as such by a state certified real estate appraiser. When identifying an appraisal or appraisal report as "certified", the State certified real estate appraiser must indicate which type of certification is held. A certified appraisal or appraisal report represents to the public that it meets the appraisal standards defined in the Act.

"State certified real estate appraiser" means a person who develops and communicates real estate appraisals and who holds a current, valid certificate issued to him or her for either general or residential real estate under the provision of the Act.

b. Certification Use

Only State certified real estate appraisers may identify a report as "certified". This does not preclude a person not certified from appraising real estate in the State for compensation. Certification is, therefore, voluntary on the part of the appraiser but can be required by the client.

c. Real Estate Appraiser Board

Established as an adjunct to the appropriate regulatory commission or department an independent Real Estate Appraiser Board appointed by the Governor of seven members, two of whom shall be public members and five of whom shall be real estate appraisers. NOTE: The number may vary from state to state depending upon the needs of the particular state.

The real estate appraiser members first appointed shall be designated members in good standing of nationally recognized real estate appraisal organizations that require appraisal experience, education, and testing in order to become a designated member, and require adherence to standards of professional practice in order to retain such designation.

Some states may want to set up an independent board or commission.

d. Powers of the Board

1. To define the type of education experience, appraisal experience, and equivalent experience that will meet the statutory requirements of the Act.

2. To establish the examination specifications for each category of State certified appraisers.

3. To approve or disapprove applications for certification and issue certificates.

4. To define the continuing education requirements for the renewal of certification.

5. To review the standards for the development and communication of real estate appraisals and to adopt regulations explaining and interpreting the standards.

6. To establish administrative procedures for all disciplinary proceedings.

7. To censure, suspend, and revoke certificates pursuant to disciplinary proceedings.

8. To perform such other functions and duties as may be necessary in carrying out the provision of the Act.

e. Powers of the Commission

1. To receive applications for State certification.

2. To establish the administrative procedures for processing applications for State certification.

3. To maintain a registry of names and addresses of people certified under the Act.

4. To retain records and all application materials submitted to it.

5. To assist the Board in such other manner as the Board may request.

f. Fees

To be established by the Commission to include an application fee, an examination fee, a reexamination fee, a fee for renewal of certification, and a delinquent renewal fee. (The fees established by the Louisiana Bill include an application fee of $200, an examination fee of $100, an annual certification renewal fee of $100, and a delinquent renewal fee of $25.

g. Certification Process

Includes an application, appropriate fees, and a signed pledge to comply with the standards set forth by the Act and that he or she understands the types of misconduct for which disciplinary proceedings may be initiated against a state certified real estate appraiser.

h. Classes of Certification

Two classes:

1. The state certified residential real estate appraiser shall consist of those persons meeting the requirements for certification relating to the appraisal of residential real property of one to four units, and up to twelve units when a net income capitalization analysis is not required by the terms of the assignment. (NOTE: This should allow where secondary mortgage market terms permit appraisals of up to 12 units.)

2. The state certified general real estate appraiser shall consist of those persons meeting the requirements for certification relating to the appraisal of all types of real property.

3. Other classifications could be added in those states were classifications are deemed appropriate, such as an agricultural classification.

i. Examination Requirement

An original certification shall not be issued except to those who possess the following:

1. Knowledge of technical terms commonly used in or related to real estate appraising, appraisal report writing, and economic concepts.

2. Understanding of the principles of land economics, real estate appraisal processes, and of problems likely to be encountered in gathering, interpreting, and processing data in carrying out appraisal discipline.

3. Understanding of the standards for the development and communication of real estate appraisal as provided in the Act.

4. Knowledge of theories of depreciation, cost estimating, methods of capitalization, and the mathematics of real estate appraisal that are appropriate for the classification of certificate applied for.

5. Knowledge of other principles and procedures as may be appropriate for the respective classifications.

6. Basic understanding of real estate law.

7. Understanding of the types of misconduct for which disciplinary proceedings may be initiated against a State certified real estate appraiser.

j. Examination Prerequisites

1. General Classification--A college degree or successful completion of not less than 150 classroom hours of courses in subjects related to real estate appraisal from a nationally recognized appraisal organization or a college or university approved by the Board, plus 15 classroom hours related to standards of professional practice and the provisions of the Act.

2. Residential Classification--A college degree or successful completion of not less than 60 classroom hours of courses in subjects related to real estate appraisal from a nationally recognized appraisal organization or a college or university approved by the Board, plus 15 classroom hours related to standards of professional practice and the provisions of the Act.

k. Experience Requirement

The equivalent of two years of experience in the appropriate real property appraisal supported by adequate written reports or file memoranda. Such experience acquired within a period of five years immediately preceding the filing of the application for certification. Each applicant must furnish under oath a detailed list of appraisal reports or file memoranda and upon request a sample of appraisal reports which the applicant has prepared in the course of his or her appraisal practice.

l. Term of Certification

Three years.

m. Nonresident Certification

Includes provisions for nonresidents to become certified.

n. Reciprocity

Provides for reciprocity among states who have similar certification requirements.

o. Use of Term

The term "State certified real estate appraiser" may only be used to refer to individuals who hold the certificate and may not be used following or immediately in conjunction with the name or signature of a firm, partnership, corporation, or group; or in such manner that it might be interpreted as referring to a firm, partnership, corporation, group, or anyone other than an individual holder of the certificate.

p. Continuing Education

Not less than 30 classroom hours of instruction (equivalent to ten hours per year for the three year certification period).

q. Disciplinary Proceedings

The rights of any certified appraiser may be revoked or suspended, or the holder may be otherwise disciplined in accordance with the provisions of the Act. The Board may investigate and may revoke or suspend the rights of a certificate holder or otherwise discipline a State certified real estate appraiser for various acts or omissions, such as:

1. Procuring or attempting to procure a certificate by false statement, fraud or misrepresentation.

2. Failure to meet the minimum qualifications established by the Act.

3. Paying money other than provided by the Act to procure a certificate.

4. A conviction, including a conviction based upon a plea of guilty or nolo contrendre, of a crime which is substantially related to the qualifications, functions, and duties of a person developing real estate appraisals and communicating real estate appraisals to others.

5. An act or omission involving dishonesty, fraud, or misrepresentation with the intent to substantially benefit the certificate holder or another person or with the intent to substantially injure another person.

6. Violation of any of the standards for the development or communication of real estate appraisals.

7. Failure or refusal to exercise reasonable diligence in developing an appraisal, preparing an appraisal report or communicating an appraisal.

8. Negligence or incompetence in developing an appraisal, in preparing an appraisal report, or in communicating an appraisal.

9. Willfully disregarding or violating any of the provisions of the Act or the regulations of the Board.

10. Accepting an appraisal assignment when the employment itself is contingent upon the appraiser reporting a predetermined estimate, analysis, or opinion, or where the fee to be paid is contingent upon the opinion, conclusions, or valuation reached, or upon the consequences resulting from the appraisal assignment.

11. Violating the confidential nature of governmental records to which he or she gained access through employment or engagement as an appraiser by a governmental agency.

12. Entry of a final civil judgment against the person on grounds of fraud, misrepresentation or deceit in the making of an appraisal of real property.

NOTE: In a disciplinary proceeding based upon a civil judgment, the State certified real estate appraiser shall be afforded an opportunity to present matters in mitigation and extenuation, but may not collaterally attack the civil judgment.

q. Due Process--provided by the Act.

r. Hearing and Judicial Review--provided by the Act.

s. Standards of Practice

A state certified real estate appraiser must comply with the Uniform Standards of Professional Appraisal Practice promulgated by the Appraisal Standards Board of the Appraisal Foundation.

t. Classification of Services

Permits the certified appraiser to accept an "appraisal assignment" which means an engagement for which an appraiser is employed or retained to act, or would be perceived by third parties or the public as acting, as a disinterested third party in rendering an unbiased analysis, opinion, or conclusion relating to the nature, quality, value, or utility of specified interests in, or aspects of, identified real estate, or "specialized services" which means all services which do not fall with the definition of an "appraisal assignment". The term "specialized services" may include valuation work and analysis work. Regardless of the intention of the client or employer, if the appraiser would be perceived by third parties or the public as acting as a disinterested third party in rendering an unbiased analysis, opinion, or conclusion, the work is classified as an "appraisal assignment" and not "specialized services".

Examples of "specialized services" include specialized marketing, financing, and feasibility studies which may include estimates of value, analyses, opinions, and conclusions given in connection with activities such as real estate brokerage, mortgage banking, real estate counseling, and real estate tax counseling.

u. Contingent Fee

A State certified appraiser may not accept a fee for an "appraisal assignment" that is contingent upon the appraiser reporting a predetermined estimate, analysis, or opinion or is contingent upon the opinion, conclusion, or valuation reached, or upon the consequences resulting from the appraisal assignment. A State certified real estate

appraiser who enters into an agreement to perform specialized services may be paid a fixed fee or a fee that is contingent on the results achieved by the specialized services provided this fact shall be clearly stated in each written or oral report in a prominent location in such report and also in each letter of transmittal and in the certification statement made by the appraiser in such report.

v. Retention of Records

Three years from submittal of the report or the final disposition of any litigation, whichever is longer, including copies of all written contracts engaging his or her services and all reports and supporting data assembled and formulated by the appraiser.

III. SUMMARY OF CONCLUSIONS

A. Some form of appraiser regulation is probable.

B. The threat of the Barnard Bill has encouraged various professional appraisal organizations to adopt uniform Standards and the Appraisal Foundation.

C. A system of State Certification utilizing the Appraisal Foundation as the basis for Standards and Qualification of Appraisers should be given an opportunity similar to the Certified Public Accountants.

D. Federal legislation or a joint resolution of Congress supporting the Appraisal Foundation, State Certification of Appraisers, and requiring the various federal agencies to adopt the Uniform Standards, would enhance the probability of success.

E. In whatever system is adopted, grandfathering should not be allowed. If we are going to certify appraisers, they should be qualified by testing and experience.

STATE CERTIFICATION FOR REAL ESTATE APPRAISERS

Model Legislation

Proposed By:

American Institute of Real Estate Appraisers
and
Society of Real Estate Appraisers

December 24, 1987

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MODEL CERTIFICATION LEGISLATION

AN ACT

To enact Chapter ( ) of the State of _____, relative to real estate appraisers; to provide for the certification of real estate appraisers; to create the real estate appraisers Board; to provide for membership, compensation, powers, and duties; to provide for certification requirements and for the renewal, suspension, and revocation of certification; to provide for fees; to provide for penalties; and to provide for related matters.

Be it enacted by the Legislature of _____

Section 1. Chapter ( ) is hereby enacted to read as follows:

Chapter ( ). State Certified Real Estate Appraisers Law

Sec. 0001. Short title

This Chapter shall be known and may be cited as the "State Certified Real Estate Appraisers Law".

Sec. 0002. Definitions

The following terms as used in this Act have the following meaning:

(1) "Appraisal" or "real estate appraisal" means an analysis, opinion or conclusion relating to the nature, quality, value or utility of specified interests in, or aspects of, identified real estate. An appraisal may be classified by subject matter into either a valuation or an analysis. A "valuation" is an estimate of the value of real estate or real property. An "analysis" is a study of real estate or real property other than estimating value.

(2) "Appraisal report" means any communication, written or oral, of an appraisal.

(3) "Appraisal Foundation" means the Appraisal Foundation incorporated as an Illinois Not for Profit Corporation on November 30, 1987. The purposes of the Appraisal Foundation are:

(a) To establish and improve uniform appraisal standards by defining, issuing and promoting such standards;

(b) To establish appropriate criteria for the certification and recertification of qualified appraisers by defining, issuing and promoting such qualification criteria; to disseminate such qualification criteria to States, governmental entities and others; and

(c) To develop or assist in the development of appropriate examinations for qualified appraisers.

(4) "Board" means the Real Estate Appraisal Board established pursuant to the provisions of this Act.

Explanatory Note: This board would be within the Executive Branch of the State under which it is constituted.

(5) "Certified appraisal or Certified appraisal report" means an appraisal or appraisal report given or signed and certified as such by a state certified real estate appraiser. When identifying an appraisal or appraisal report as "certified", the State certified real estate appraiser must indicate which type of certification is held. A certified appraisal or appraisal report represents to the public that it meets the appraisal standards defined in this Act.

(6) "Commission" means the [insert the appropriate state regulatory Commission or Department].

(7) "Real Estate" means an identified parcel or tract of land, including improvements, if any.

(8) "Real Property" means one or more defined interests, benefits, and rights inherent in the ownership of real estate.

(9) A "State certified real estate appraiser" means a person who develops and communicates real estate appraisals and who holds a current, valid certificate issued to him or her for either general or residential real estate under the provisions of this Act.

Sec. 0003. Certification use

A. No person, other than a State certified real estate appraiser, shall assume or use that title or any title, designation, or abbreviation likely to create the impression of certification as a real estate appraiser by this state. A person who is not certified pursuant to this Act shall not describe or refer to any appraisal or other evaluation of real estate located in this state by the term "certified".

B. This shall not preclude a person who is not certified as a state certified real estate appraiser from appraising real estate for compensation.

Sec. 0004. Real Estate Appraiser Board

A. There is hereby established as an adjunct to [insert the appropriate regulatory Commission or Department] an independent Real Estate Appraiser Board which shall consist of seven members, two of whom shall be public members and five of whom shall be real estate appraisers.

> Explanatory Note: The number of members of the Board may vary depending on the needs of the particular state.

B. The Governor shall appoint the members of the Real Estate Appraiser Board.

> Explanatory Note: The state legislature may be involved in the appointment and/or confirmation of the Board, if desirable.

C. The real estate appraiser members first appointed to the Board shall be designated members in good standing of a nationally recognized real estate appraisal organization that as of June 1, 1987, required appraisal experience, education, and testing in order to become a designated member, in addition to adherence to standards of professional practice in order to retain such designation.

D. Each real estate appraiser member of the Board appointed after January 1, 199_, must be a State certified real estate appraiser. At least one-half of the appraiser members shall hold the general appraisal certificate.

E. The term of each member shall be three years; except that, of the members first appointed, two shall serve for two years and two shall serve for one year.

F. Upon expiration of their terms, members of the Board shall continue to hold office until the appointment and qualification of their successors. No person shall serve as a member of the Board for more than two consecutive terms. The appointing authority may remove a member for cause.

G. The public members of the Board shall not be engaged in the practice of real estate appraising.

H. The Board shall meet not less frequently than once each calendar quarter to conduct its business. Places of future meetings shall be decided by the vote of members at meetings. Written notice shall be given to each member of the time and place of each meeting of the Board at least 10 days before the scheduled date of the meetings.

I. The members of the Board shall elect a chairperson from among the members to preside at Board meetings.

> Explanatory Note: Sections G, H, and I have been included as suggestions. Actual meeting schedules and operating procedures will vary depending on state requirments.

J. A quorum of the Board shall be four members. At least three of these four members shall be appraiser members.

K. Each member of the Board shall be entitled to a per diem allowance of _____ dollars ($___) for each meeting of the Board at which the member is present and for each day or substantial part thereof actually spent in the conduct of the business of the Board, plus all appropriate expenses.

Sec. 0005. Powers of the Board

A. The Board shall adopt rules and regulations in aid or in furtherance of this Act.

B. The Board shall have the following powers and duties:

(1) to further define by regulation and with respect to each category of State certified real estate appraiser the type of educational experience, appraisal experience, and equivalent experience that will meet the statutory requirements of this Act;

(2) to establish the examination specifications for each category of State certified real estate appraiser, to provide or procure appropriate examination questions and answers, and to establish procedures for grading examinations;

(3) to approve or disapprove applications for certification and issue certificates;

(4) to further define by regulation and with respect to each category of State certified real estate appraiser, the continuing education requirements for the renewal of certification that will meet the statutory requirements provided in this Act;

(5) to review from time to time the standards for the development and communication of real estate appraisals provided in this Act and to adopt regulations explaining and interpreting the standards;

(6) to establish administrative procedures for disciplinary proceedings conducted pursuant to the provisions of this Act;

(7) to censure, suspend and revoke certificates pursuant to the disciplinary proceedings provided for in Sec. 0022 of this Act; and

(8) to perform such other functions and duties as may be necessary in carrying out the provisions of this Act.

C. Actions of the Board shall not be reviewable by the Commission.

Sec. 0006. Powers of the Commission

A. The Commission shall have the following powers and duties:

(1) to receive applications for State certification;

(2) to establish the administrative procedures for processing applications for State certification;

(3) to maintain a registry of the names and addresses of people certified under this Act;

(4) to retain records and all application materials submitted to it; and

(5) to assist the Board in such other manner as the Board may request.

Sec. 0007. Fees

A. The Commission shall charge and collect fees not in excess of the following:

(1) An application fee for certification of $_____.

(2) An examination fee of $_____.

(3) A reexamination fee of $_____.

(4) A fee for renewal of certification of $_____.

(5) A delinquent renewal fee of $_____.

Sec. 0008. Certification Process

A. Applications for original certification, renewal certification and examinations shall be made in writing to the Commission on forms approved by the Board.

B. Appropriate fees, as fixed by the Commission pursuant to Sec. 0007 must accompany all applications for original certification, renewal certification and examination.

C. At the time of filing an application for certification, each applicant shall sign a pledge to comply with the standards set forth in this Act and state that he or she understands the types of misconduct for which disciplinary proceedings may be initiated against a State certified real estate appraiser, as set forth in this Act.

Sec. 0009. Classes of Certification

A. There shall be two classes of certification for State certified real estate appraisers:

(1) The State certified residential real estate appraiser classification shall consist of those persons meeting the requirements for certification relating to the appraisal of residential real property of one to four units, and up to twelve units when a net income capitalization analysis is not required by the terms of the assignment.

Explanatory Note: This should be allowed where secondary market forms permit appraisals of up to twelve units and a net income capitalization analysis is not required.

(2) The State certified general real estate appraiser classification shall consist of those persons meeting the requirements for certification relating to the appraisal of all types of real property.

Explanatory Note: Other classifications could be added in those states where such classifications are deemed appropriate.

B. The application for original certification, renewal certification and examination shall specify the classification of certification being applied for and previously granted.

Sec. 0010. Examination requirement

A. An original certification as a State certified real estate appraiser shall not be issued to any person who has not demonstrated through a written examination process that he or she possesses the following:

(1) Appropriate knowledge of technical terms commonly used in or related to real estate appraising, appraisal report writing, and economic concepts applicable to real estate;

(2) Understanding of the principles of land economics, real estate appraisal processes, and of problems likely to be encountered in gathering, interpreting, and processing of data in carrying out appraisal disciplines;

(3) Understanding of the standards for the development and communication of real estate appraisals as provided in this Act;

(4) Knowledge of theories of depreciation, cost estimating, methods of capitalization, and the mathematics of real estate appraisal that are appropriate for the classification of certificate applied for;

(5) Knowledge of other principles and procedures as may be appropriate for the respective classifications;

(6) Basic understanding of real estate law; and

(7) Understanding of the types of misconduct for which disciplinary proceedings may be initiated against a State certified real estate appraiser, as set forth in this Act.

Sec. 0011. Examination Prerequisites

A. General Classification - As a prerequisite to taking the examination for certification as a State certified general real estate appraiser, an applicant shall present evidence satisfactory to the Board that he or she has a college degree or has successfully completed not less than 150 classroom hours of courses in subjects related to real estate appraisal from a nationally recognized appraisal organization or a college or university approved by the Board, plus 15 classroom hours related to standards of professional practice and the provisions of this Act.

B. Residential Classification - As a prerequisite to taking the examination for certification as a State certified residential real estate appraiser, an applicant shall present evidence satisfactory to the Board that he or she has a college degree or has successfully completed not less than 60 classroom hours of courses in subjects related to real estate appraisal from a nationally recognized appraisal organization or a college or university approved by the Board, plus 15 classroom hours related to standards of professional practice and the provisions of this Act.

[Explanatory Note: The Appraisal Foundation will assist in development of additional criteria and qualifications for appraiser classifications.]

Sec. 0012. Experience requirement

A. An original certification as a State certified real estate appraiser shall not be issued to any person who does not possess the equivalent of two years of experience in real property appraisal supported by adequate written reports or file memoranda. Such experience, or the equivalent thereof, must be acquired within a period of five years immediately preceding the filing of the application for certification.

B. Each applicant for certification shall furnish under oath a detailed listing of the real estate appraisal reports or file memoranda for each year for which experience is claimed by the applicant. Upon request, the applicant shall make available to the Board for examination, a sample of appraisal reports which the applicant has prepared in the course of his or her appraisal practice.

Sec. 0013. Term of Certification

A. The term of a certificate issued under the authority of this Act shall be three years from the date of issuance. The expiration date of the certificate shall appear on the certificate and no other notice of its expiration need be given to its holder.

Sec. 0014. Nonresident certification

A. Every applicant for certification under this Act who is not a resident of this state shall submit, with the application for certification, an irrevocable consent that service of process upon him or her may be made by delivery of the process to the Secretary of State if, in an action against the applicant in a court of this state arising out of the applicant's activities as a State certified real estate appraiser, the plaintiff cannot, in the exercise of due diligence, effect personal service upon the applicant.

Sec. 0015. Nonresident certification by reciprocity

A. If, in the determination by the Board, another state is deemed to have substantially equivalent certification requirements, an applicant who is certified under the laws of such other state may obtain a certificate as a State certified real estate appraiser in this state upon such terms and conditions as may be determined by the Board.

Sec. 0016. Renewal certificate

A. (1) To obtain a renewal certificate as a State certified real estate appraiser, the holder of a current, valid certificate shall make application and pay the prescribed fee to the Board not earlier than 120 days nor later than 30 days prior to the expiration date of the certificate then held. With the application for renewal, the State certified real estate appraiser shall present evidence in the form prescribed by the Board of having completed the continuing education requirements for renewal specified in this Act.

(2) If the Board determines that an applicant has failed to meet the requirements for renewal of certification through mistake, misunderstanding, or circumstances beyond the control of the applicant, the Board may extend the term of the certificate for a period not to exceed six months, upon payment by the applicant of a prescribed fee for the extension.

(3) If the applicant satisfies the requirements for renewal during the extended term of certification, the beginning date of the new renewal certificate shall be the day following the expiration of the certificate previously held by the applicant.

B. If a person fails to renew a certificate as a State certified real estate appraiser prior to its expiration or within a period of extension granted by the Board pursuant to this Act, the person may obtain a renewal certificate by satisfying all of the requirements for renewal and by the payment of a late renewal fee.

Sec. 0017. Basis for denial

A. (1) The Board may, in accordance with the provisions of this Act relating to hearings, deny the issuance of a certificate as a State certified real estate appraiser to an applicant on any of the grounds enumerated in this Act.

(2) To assist in determining whether grounds exist to deny the issuance of certification to an applicant, the Board may require the fingerprinting of every applicant for an original certificate.

Sec. 0018. Principal place of business

A. (1) Each State certified real estate appraiser shall advise the Board of the address of his or her principal place of business and all other addresses at which he or she is currently engaged in the business of preparing real property appraisal reports.

(2) Whenever a State certified real estate appraiser changes a place of business, he or she shall immediately give written notification of the change to the Board and apply for an amended certificate.

(3) Every State certified real estate appraiser shall notify the Board of his or her current residence address. Residence addresses on file with the Board are exempt from disclosure as public records.

Sec. 0019. Certificate

A. (1) A certificate issued under authority of this Act shall bear the signatures or facsimile signatures of the members of the Board and a certificate number assigned by the Board.

(2) Each State certified real estate appraiser shall place his or her certificate number adjacent to or immediately below the title "State Certified Residential Real Estate Appraiser" or "State Certified General Real Estate Appraiser" when used in an appraisal report or in a contract or other instrument used by the certificate holder in conducting real property appraisal activities.

Sec. 0020. Use of term

A. (1) The term "State certified real estate appraiser" may only be used to refer to individuals who hold the certificate and may not be used following or immediately in connection with the name or signature of a firm, partnership, corporation, or group; or in such manner that it might be interpreted as referring to a firm, partnership, corporation, group, or anyone other than an individual holder of the certificate.

(2) No certificate shall be issued under the provisions of this Act to a corporation, partnership, firm or group. This shall not be construed to prevent a State certified real estate appraiser from signing an appraisal report on behalf of a corporation, partnership, firm or group practice.

Sec. 0021. Continuing Education

A. As a prerequisite to renewal of certification, a State certified real estate appraiser shall present evidence satisfactory to the Board of having met the continuing education requirements of this Article.

B. The basic continuing education requirement for renewal of certification shall be the completion by the applicant, during the immediately preceding term of certification, of not less than 30 classroom hours of instruction in courses or seminars which have received the approval of the Board.

C. In lieu of meeting the requirements of subdivison (B) an applicant for re-certification may satisfy all or part of the requirements by presenting evidence of the following:

(1) Completion of an educational program of study determined by the Board to be equivalent, for continuing education purposes, to courses approved by the Board pursuant to subdivision (B); or

(2) Participation other than as a student in educational processes and programs approved by the Board which relate to real property appraisal theory, practices or techniques, including, but not necessarily limited to, teaching, program development and preparation of textbooks, monographs, articles, and other instructional materials.

D. The Board shall adopt regulations for implementation of the provisions of this article to the end of assuring that persons renewing their certifications as State certified real estate appraisers have current knowledge of real property appraisal theories, practices, and techniques which will provide a high degree of service and protection to those members of the public with whom they deal in a professional relationship under authority of the certification. The regulations shall prescribe the following:

(1) Policies and procedures for obtaining Board approval of courses of instruction pursuant to subdivision (B);

(2) Standards, policies, and procedures to be applied by the Board in evaluating applicant's claims of equivalency in accordance with subdivision (C);

(3) Standards, monitoring methods, and systems for recording attendance to be employed by course sponsors as a prerequisite to Board approval of courses for credit.

E. In adopting regulations pursuant to Subpart 1 of paragraph (D), the Board shall give favorable consideration to courses of instruction, seminars, and other real property appraisal educational courses or programs previously or hereafter developed by or under the auspices of professional appraisal organizations and utilized by those associations for purposes of designation, or indicating compliance with the continuing education requirements of such organizations.

F. No amendment or repeal of a regulation adopted by the Board pursuant to this section shall operate to deprive a State certified real estate appraiser of credit toward renewal of certification for any course of instruction completed by the applicant prior to the amendment or repeal of the regulation which would have qualified for continuing education credit under the regulation as it existed prior to the repeal or amendment.

G. On or after January 1, 19__, a certification as a State certified real estate appraiser that has been revoked as a result of disciplinary action by the Board shall not be reinstated unless the applicant presents evidence of completion of the continuing education required by this Act. This requirement of evidence of continuing education shall not be imposed upon an applicant for reinstatement who has been required to successfully complete the examination for State certified real estate appraiser as a condition to reinstatement of certification.

Sec. 0022. Disciplinary Proceedings

A. The rights of any holder under a certificate as a State certified real estate appraiser may be revoked or suspended, or the holder of the certificate may be otherwise disciplined in accordance with the provisions of this Act, upon any of the grounds set forth in this Section. The Board may investigate the actions of a State certified real estate appraiser, and may revoke or suspend the rights of a certificate holder or otherwise discipline a State certified real estate appraiser for any of the following acts or omissions:

(1) Procuring or attempting to procure a certificate pursuant to this Act by knowingly making a false statement, submitting false information, refusing to provide complete information in response to a question in an application for certification or through any form of fraud or misrepresentation;

(2) Failing to meet the minimum qualifications established by this Act;

(3) Paying money other than provided for by this Act to any member or employee of the Board to procure a certificate under this Act;

(4) A conviction, including a conviction based upon a plea of guilty or nolo contendre, of a crime which is substantially related to the qualifications, functions, and duties of a person developing real estate appraisals and communicating real estate appraisals to others;

(5) An act or omission involving dishonesty, fraud, or misrepresentation with the intent to substantially benefit the certificate holder or another person or with the intent to substantially injure another person;

(6) Violation of any of the standards for the development or communication of real estate appraisals as provided in this Act;

(7) Failure or refusal without good cause to exercise reasonable diligence in developing an appraisal, preparing an appraisal report or communicating an appraisal;

(8) Negligence or incompetence in developing an appraisal, in preparing an appraisal report, or in communicating an appraisal;

(9) Willfully disregarding or violating any of the provisions of this Act or the regulations of the Board for the administration and enforcement of the provisions of this Act;

(10) Accepting an appraisal assignment (as defined in Sec. 0026 of this Act) when the employment itself is contingent upon the appraiser reporting a predetermined estimate, analysis or opinion, or where the fee to be paid is contingent upon the opinion, conclusion, or valuation reached, or upon the consequences resulting from the appraisal assignment;

(11) Violating the confidential nature of governmental records to which he or she gained access through employment or engagement as an appraiser by a governmental agency; or

(12) Entry of a final civil judgment against the person on grounds of fraud, misrepresentation or deceit in the making of any appraisal of real property.

B. In a disciplinary proceeding based upon a civil judgment, the State certified real estate appraiser shall be afforded an opportunity to present matters in mitigation and extenuation, but may not collaterally attack the civil judgment.

Sec. 0023. Due process

A. Before suspending or revoking any certification, the subcommittee shall notify the appraiser in writing of any charges made at least twenty days prior to the date set for the hearing and shall afford him or her an opportunity to be heard in person or by counsel.

B. The written notice may be served either personally or sent by registered or certified mail to the last known business address of the appraiser.

C. The Board shall have the power to subpoena and issue subpoenas duces tecum and to bring before it any person in this state, and to take testimony by deposition, in the same manner as prescribed by law in judicial proceedings in the courts of this state.

Sec. 0024. Hearing and Judicial Review

A. The hearing on the charges shall be at a time and place prescribed by the Board and in accordance with the provisions of the Administrative Procedures Act of this state.

B. If the Board determines that a State certified appraiser is guilty of a violation of any of the provisions of this Act, it shall prepare a finding of fact and recommend that the appraiser be reprimanded or that his or her certification be suspended or revoked. The Decision and Order of the Board shall be final.

C. Any final Decision or Order of the Board shall be reviewable by a Court of appropriate jurisdiction as to questions of law only. Any application for review made by an aggrieved party shall be filed within thirty days after the final Decision or Order of the Board.

D. If an application for review of a final Decision or Order of the Board is filed, the case shall be fixed for trial within thirty days from the filing of an answer by the Board. If the court finds that the Board has regularly pursued its authority and has not acted arbitrarily, it shall affirm the Decision or Order.

Sec. 0025. Standards of practice

A. A State certified real estate appraiser must comply with the Uniform Standards of Professional Appraisal Practice promulgated by the Appraisal Standards Board of the Appraisal Foundation.

Explanatory Note: If certification legislation is passed or will become effective before the above described Standards are issued, the Uniform Standards of Professional Appraisal Practice that have been approved by the eight major appraisal organizations should be substituted in the interim period.

Sec. 0026. Classification of Services

A. A client or employer may retain or employ a State certified real estate appraiser to act as a disinterested third party in rendering an unbiased estimate of value or analysis. A client or employer may also retain or employ a State certified real estate appraiser to provide specialized services to facilitate the client's or employer's objectives. In either case, the appraisal and the appraisal report must comply with the provisions of this Act.

B. For the purposes of this Act, the term "appraisal assignment" means an engagement for which an appraiser is employed or retained to act, or would be perceived by third parties or the public as acting, as a disinterested third party in rendering an unbiased analysis, opinion, or conclusion relating to the nature, quality, value, or utility of specified interests in, or aspects of, identified real estate.

C. For the purposes of this Act, the term "specialized services" means those appraisal services which do not fall within the definition of appraisal assignment. The term "specialized services" may include valuation work and analysis work. Regardless of the intention of the client or employer, if the appraiser would be perceived by third parties or the public as acting as a disinterested third party in rendering an unbiased analysis, opinion or conclusion, the work is classified as an appraisal assignment and not "specialized services".

Explanatory Note: Examples of specialized services include specialized marketing, financing, and feasibility studies and may include estimates of value, analyses, opinions and conclusions given in connection with activities such as real estate brokerage, mortgage banking, real estate counseling, and real estate tax counseling.

Sec. 0027. Contingent fees

A. A State certified real estate appraiser may not accept a fee for an appraisal assignment (as defined in Sec. 0026 of this Act) that is contingent upon the appraiser reporting a predetermined estimate, analysis or opinion or is contingent upon

the opinion, conclusion or valuation reached, or upon the consequences resulting from the appraisal assignment.

B. A State certified real estate appraiser who enters into an agreement to perform specialized services (as defined in Sec. 0026 of this Act) may be paid a fixed fee or a fee that is contingent on the results achieved by the specialized services.

C. If a State certified real estate appraiser enters into an agreement to perform specialized services for a contingent fee, this fact shall be clearly stated in each written and oral report. In each written report, this fact shall be clearly stated in a prominent location in such report and also in each letter of transmittal and in the certification statement made by the appraiser in such report.

Sec. 0028. Retention of records

A. A State certified real estate appraiser shall retain for three years, originals or true copies of all written contracts engaging his or her services for real property appraisal work, and all reports and supporting data assembled and formulated by the appraiser in preparing the reports.

B. This three year period for retention of records is applicable to each engagement of the services of the appraiser and shall commence upon the date of the submittal of the appraisal to the client unless, within such three year period, the appraiser is notified that the appraisal or report is involved in litigation, in which event the three year period for the retention of records shall commence upon the date of the final disposition of such litigation.

C. All records required to be maintained under the provisions of this Act shall be made available by the State certified real estate appraiser for inspection and copying by the Board on reasonable notice to the appraiser.

Sec. 0029. Partial invalidity

A. If any provision of this Act or its application to any person or in any circumstance is declared by a court of competent jurisdicition to be invalid or unenforceable, provisions constituting the remainder of the Act and the application of those provisions to other persons and in other circumstances shall not be affected.

APPRAISAL PROCUREMENT SEMINAR

James A. Graaskamp

I. The traditional approaches as a simple , idealistic logic and economic rationale are based on the principle of substitution--specifically that buyers and sellers have alternatives of nearly equal acceptability, or sentiment, not to mention access to cash capital and freedom from irritation and duress.

A. MARKET COMPARISON methods are preferred, but the appraisal profession has found it difficult to develop objective methods for neutralizing differences and selecting properties objectively. Moreover, prices on investment properties are engineered to accomplish accounting objectives of the parties.

B. The INCOME APPROACH is schizophrenic as to whether it is measuring economic productivity, the sum of liability, or the change in spendable cash for ownership through control of property rights.

C. The COST APPROACH has moved from unethical according to the National Association of Realtors (NAR) in 1925, to pivotal in 1935, to embarrassing in 1985 since no one is sure if fiduciary responsibility requires a cost approach to avoid a sin of omission in the event of unforeseen disputes about value.

II. However, none of these methodologies as logic systems structure the behavioral process required of the appraiser and his client. The client assumes that the task is defined when you ask for an appraisal and the appraiser assumes the client understands the rationale and appropriate application of fair market value or probable price. Both are more concerned with form than the substance of careful recognition of the problem for which the appraisal will serve as a benchmark.

A. Objective appraisal

1. Validate purchase price as appropriate.
2. Identify change in price over time, if any.
3. Independent inspection of property and review of property management effectiveness.
4. Liquidating value of asset currently.
5. Future value of present assets.
6. Historical return on investment or future return on investment, real or nominal.

B. Definition of value to be sought

1. Alternative definitions of value and related assumptions.
2. Which definition of value is to be applied to which problem.
3. Market value vs. probable price.

C. Definition of assets to be valued

1. Property rights to be appraised
2. Accounting rules to defining assets, collectively (going concern) or individually (liquidating).

D. Definition of methods to be used

1. What constitutes comparative market data?
2. What constitutes objective market comparisons?
3. What constitutes an income approach to value?
4. Relevance of the cost approach to appraisal and appraisal adjustments?
5. Which appraisal methods are appropriate to which appraisal functions?

E. Definition of elements income approach

1. Cash or accrual accounting.
2. Going concern value or value attributed to land and buildings.
3. Accounting rules for income.
4. Forecasting rules for changing income and expenses.
5. Estimating rules for changing income and expenses.
6. Provision for resale cost.
7. Conformity with historical pattern and leases in place for project.

F. Definition of appraiser/client relationship

1. Who is considered an independent participant for preparation of financial data, asset management plans, and engineering disclosure?
2. Frequency of appraisal and volume of business as source of bias.
3. Who is the arbiter of methods for integrating information into cohesive standardized formats suitable for measuring comparative performance?

III. Ironically, quality control of the appraisal process is in the hands of the customers for appraisal services, specifically those who stand to lose by permitting current conditions to continue. Historically, reform of the appraisal process has always been in the control of the customer who invests or guarantees real estate capital.

A. Historical origins of the three approaches

1. The cost approach and the life insurance industry.
2. The income approach, academia, and the FHA.
3. The market approach and the National Association of Realtors.

B. Standardized reporting requirements of the American Institute of Real Estate Appraisers begin with Canon 5 of their Code of Ethics.

1. The Institute has never issued white papers on specific appraisal problems to standardize professional response to changing issues of common interest.

2. Recently the Institute has tried to issue white papers as guidelines.

C. More recent efforts at quality control include:

1. The Home Loan Bank redirecting appraisal attention to R-41-b.

2. FNMA and FHLBMC and requirements for appraising multi-family development.

3. Residential form appraisal for FNMA, VA, FHA, and FHLBMC.

D. The Royal Institute of Chartered Surveyors and the European Common Market Accountants have been developing a standardized language and procedure for the valuation of and reporting balance sheet assets.

E. Development of consistent appraisal performance standards for pension programs requires a six-step process:

1. Development of written policy statement by pension fund trustees relative to reporting of real estate asset values by money managers responsible for real estate.

2. A written appraisal standard followed by a specific real estate fund manager's report covering both minimum standards shared with an association of managers and unique features believed to provide better communication to fund trustees of important underlying facts and assumptions inherent in the appraisals.

3. A standard letter of engagement when contracting for appraisal services implementing the written policies of sponsor and money manager.

4. A standard procedure for in-house appraisal reviews in the interim between independent outside appraisal reviews, including tolerance for variance before reporting changed values.

5. Auditing and monitoring of appraisal reports by specially trained, CPA reviewers as part of the accounting audit process.

6. Spot checking of appraisal procedures and a review process for disapproval of appraisal firms found to be likely of misinformation or misapplication of technique by ERISA.

F. An early effort at appraisal control was a Letter of Engagement used at First Asset Realty Advisors (FARA) together with knowledgeable efforts to select the best local assessors.

1. The best appraisers are difficult to pick by reputation as the big names delegate their work to apprentices.

2. Some appraisers admit to being intimidated and avoiding the assignment or charging extra for the assignment, anticipating that FARA will be more demanding.

3. On balance, we are getting better appraisals than most of the funds we have seen in our research but at a higher average cost.

G. The FARA letter was followed by an effort by the National Council of Real Estate Investment Fiduciaries (NCREIF) to develop guidelines.

IV. Appraisal procurement must address three major areas of concern:

A. Policy directs from board of directors resolution controlling

1. decisions for which appraisal data will be a bench mark,

2. selection of appraisers to eliminate business bias, and

3. priority of appraised value by independents relative to inside appraisal procedures.

B. Protocol for providing professional information to the appraiser and production of data sources within appraisal.

1. Accounting for revenues and expenses.

2. Role of property management program.

3. Details for future appraisal budgets.

4. Disclosure of negative data on tenant, toxic materials, life safety systems, or engineering issues.

C. Control of content and quality of appraisal reports through purchasing policies.

EXHIBIT 1

DEFINITION OF MARKET VALUE
AND
MOST PROBABLE PRICE

CURRENT OFFICIAL DEFINITION OF MARKET VALUE

The most probable price in cash, terms equivalent to cash, or in other precisely revealed terms, for which the appraised property will sell in a competitive market under all conditions requisite to fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress.

Fundamental assumptions and conditions presumed in this definition are:

1. Buyer and seller are motivated by self-interest.

2. Buyer and seller are well informed and are acting prudently.

3. The property is exposed for a reasonable time on the open market.

4. Payment is made in cash, its equivalent, or in specified financing terms.

5. Specified financing, if any, may be the financing actually in place or on terms generally available for the property type in its locale on the effective appraisal date.

6. The effect, if any, on the amount of market value of atypical financing, services, or fees shall be clearly and precisely revealed in the appraisal report.

(1) American Institute of Real Estate Appraisers, The Appraisal of Real Estate, Eighth Edition, Chicago, IL, 1983, p. 33.

CONTEMPORARY DEFINITION OF MOST PROBABLE PRICE

"Most Probable Selling Price", as defined by Professor Richard U. Ratcliff:

> The most probable selling price is that selling price which is most likely to emerge from a transaction involving the subject property if it were exposed for sale in the current market for a reasonable time at terms of sale which are currently predominant for properties of the subject type. [1]

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[1] Unpublished quotation, Richard U. Ratcliff speaking on his book Valuation for Real Estate Decisions, Santa Cruz, CA, Democratic Press, 1972.

EXHIBIT 2

REPORTING REQUIREMENTS OF THE
AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS

4

Reporting Requirements of the American Institute of Real Estate Appraisers

Canon 5 of AIREA Regulation 10 (Code of Professional Ethics and Standards of Professional Conduct) establishes the minimum requirements for both written and oral appraisal reports prepared by members and candidates of the Institute. The explanatory comments for Canon 5 state:

> The Institute requires its Members, in arriving at an analysis, conclusion or opinion concerning real estate, to employ all of the recognized appraisal methods and techniques that will materially contribute to a proper evaluation of such real estate or to a solution of the real estate problem under consideration. As a corollary to this rule, the Institute also requires that the appraisal process contain a clear statement of all of the assumptions made, together with a reasonably complete summary of the work done in arriving at each analysis, conclusion or opinion concerning real estate contained in the report. . . . A Member of the Institute must preserve his or her supporting data relating to a written appraisal report.

There are a number of specific reporting rules; some are obligatory and others are recommendations that should be followed unless there are substantial reasons, disclosed in the report, for not doing so.

PROPERTY DESCRIPTION

A clear and reasonably complete description of the property may include the street address, legal description, ownership, building name, and any other information that will assist in identifying the property. The identification may be part of the larger property description section of the report or a separate one- or two-sentence capsule included in the introduction to the report.

Property Identification

A complete address may suffice for a conforming residential property. For other properties an address should be included if one is available; if there have been recent changes in the street names or numbering schemes, both the present and prior addresses should be included. If the property is a vacant lot, the property address might be "the lot lying between or adjacent to" a property with an assigned street address. If only a part of the

address is the subject of the report, or if the report covers a project identified by the address plus adjacent excess land, the address portion of the property identification should make this clear. For example:

1250 Sleepy Hollow Lane
Centerland, California 92660

1250 Sleepy Hollow Lane
(previously known as 940 Tallow Street)
Centerland, California 92660

The 50' by 120' lot situated between
1050 and 1056 Main Street
Centerland, California 92660

456 Main Street
Centerland, California 92660
except for the rear 75 feet of
that address facing on the alley

320 Main Street
Centerland, California 92660
plus the rear 75 feet of
318 Main Street

Legal Description

A legal description of the property, if available, should be included. A reasonably short description can be included in the body of the report; a lengthy legal description may be placed in the addenda. If the description is at all complex, it is advisable to provide the source of the description—e.g., deed, title policy, assessor's records, or record of survey. If a legal description is not available, the report should say so and a clear map identifying the property should be included in the report. For example:

Lot 23 of Tract 4630 per map recorded in Page 23 of Book 4215 on July 15, 1957, in the Official Records of Simon County.

Exhibit B in the Addenda of this report contains a metes and bounds legal description as it appeared on the Grant Deed transferring ownership of the subject property to the Cowly Corporation on July 15, 1978.

As of the date of this appraisal, a legal description conforming to the portion of the Smith Ranch that is the subject of this appraisal had not been prepared. The subject property is outlined in red on the map labeled "Plat of Land" on page 23 of this report. It is assumed that a legal description that is adequate for the transfer of real property and that conforms to the property delineated on this map will be prepared.

Ownership data assist in the clear identification of property. For example:

The subject property consists of that 42.5 acres of vacant unimproved land which was acquired by Mr. Frank L. Smith on December 30, 1979, by Grant Deed recorded in Page 1521, Book 43762 of Deeds, in the Collins County Courthouse.

Even if there is a six-page detailed description of the property elsewhere in the report, the property identification and description portion is enhanced by a concise description of the property, such as:

The subject property is a six-year-old, three-story office building containing 24,320 square feet of gross building area. It is located on a 52,320-square foot parcel of land with 126 feet of frontage on Main Street.

STATEMENT OF FACTS, CONDITIONS, AND ASSUMPTIONS

It is good business practice for the appraiser and the client to agree in advance on the assumptions and limiting conditions that will apply to the report. Many appraisers include a copy of assumptions and limiting conditions with the appraisal proposal or contract. This portion of the report sets forth not only general assumptions and conditions that would apply to every report, but also any specific assumptions that apply to the particular appraisal.

Some assumptions and limiting conditions make a report a limited appraisal report; in such cases, there are additional requirements, which will be discussed and illustrated later in this chapter.

STATEMENTS RELATIVE TO NEIGHBORHOOD DECLINE

All written appraisal reports concerning residential real estate that state that a neighborhood is undergoing decline or is about to undergo decline must contain the specific facts or reasoning from which the opinion or conclusion of neighborhood decline is drawn.

DATE OF VALUE

The date of value is usually included in the letter of transmittal, in the introductory section of the report, and in the concluding valuation statement. This date is not to be confused with the date the transmittal letter was prepared, the date the assignment was started, or the date of inspection. Any or all of these dates may be the same as the date of value, but they usually are not. The only mandatory date is the date of value, but good business practice dictates that other significant dates also be identified, e.g., the transmittal date (the date the completed report is transmitted to the client), the date of inspection, the date of verification, and the date of photographs.

REASONING THAT SUPPORTS THE VALUATION

Unless the appraisal report is a limited report—one that does not show all of the appraiser's reasoning—and has been properly qualified as such, the reader must be able to follow the appraiser's thought processes from the data presented to the conclusions formed. A "limited report" must comply with the special requirements of a limited report (see pp. 27-28).

SPECIAL DISCLOSURES

Fractional Interests

All appraisal reports that involve a valuation of a fractional interest, i.e., less than the whole fee simple estate, must clearly state that the value reported relates only to a fractional interest in the real estate involved, and that the value of this fractional interest plus

the value of all other fractional interests may or may not equal the value of the entire fee simple estate. Typically, this is included in the statement of assumptions and limiting conditions. A common example is a report of a leasehold interest appraisal. The qualifying statement is required to demonstrate to the reader that the sum of the lessor's and lessee's interests is not necessarily equal to the fee simple estate.

Larger Parcel

All appraisal reports relating to the valuation of a geographic portion of a larger parcel or tract of real estate must clearly state that the value reported is for that portion only and should not be construed as applying with equal validity to other portions of the larger parcel or tract. In addition, it must be clear that the value reported for the portion plus the value of all other geographic portions may or may not equal the value of the entire parcel or tract. This statement typically appears in the assumptions and limiting conditions section of the report.

Personal Interest or Bias

All written appraisal reports must state that the appraiser has no present or contemplated future interest in the property appraised, and that the appraiser has no personal interest or bias with respect to the subject matter or the parties involved in the appraisal. If a statement of this nature cannot be made, the report must clearly and frankly disclose all such personal interest or bias.

PROFESSIONAL CONTRIBUTION OF OTHERS

Written appraisal reports are to acknowledge the professional contributions of others in arriving at the analyses, conclusions, or opinions concerning real estate contained in the appraisal report or state that no one other than the person or persons signing the report prepared the analyses, conclusions, and opinions therein.

If several professional appraisers work on a report, and all agree to and sign it, they include a statement similar to the following in their certificate:

> No one other than the appraisers whose signatures appear below has prepared the analyses, conclusions, and opinions concerning real estate which are included in this report.

If the appraisers were assisted by a cost estimator who worked only on the cost portion of the report, they may use something similar to the following:

> The assistance of John A. Doe, who prepared the cost estimate used in this report, is acknowledged. Except for Mr. Doe's assistance, no one other than the appraisers whose signatures appear below prepared the analyses, conclusions, and opinions concerning real estate which are included in this report.

If another appraiser, who asks not to be identified because of personal or policy considerations, was consulted and contributed substantially to the report, the statement might be:

> The assistance and counsel of another appraiser not employed by this firm and who

> requests that he not be identified is hereby acknowledged. Except for this appraiser's assistance, no one other than the undersigned prepared these analyses, conclusions, and opinions concerning real estate contained in this report.

Canon 5 does not require a member of the Institute to acknowledge assistance received in obtaining the data on which the appraisal report is based, assistance received in the physical preparation of the report (e.g., taking photographs; preparing charts, maps, or graphs; or typing or printing), or any other assistance that does not directly involve the exercise of judgment in arriving at the analyses, opinions, or conclusions concerning real estate.

The rule requiring acknowledgment of the professional contributions of others does not reduce the responsibility of those who sign a written appraisal report; in evaluating such reports, clients, mortgage lenders, and other users are entitled to rely on the signatures of all who sign. Therefore, although others may participate in the preparation of a written appraisal report, any member of the Institute who signs or cosigns a report must accept responsibility for the contents of the entire report.

PUBLIC DISCLOSURE

The recommended public disclosure statement of the Institute's Code of Ethics (Canon 7, Regulation 10) is:

> Disclosure of the contents of this report is governed by the Bylaws and Regulations of the American Institute of Real Estate Appraisers of the National Association of Realtors. Neither all nor any part of the contents of this report (especially any conclusions as to value, the identity of the appraiser or any reference to the American Institute of Real Estate Appraisers or to the MAI or RM designation) shall be disseminated to the public through advertising media, public relations media, news media, sales media or any other public means of communication, without the prior written consent and approval of the author.

This statement is meant to preclude the potential misuse of the Institute's name and professional designations that can arise when a member's client elects to publicize the results of an appraisal report. Excessive or exploitative use of designations, sometimes out of appropriate context, does not serve the interests of the Institute, which its members should seek to protect. A client may be inclined to excerpt or quote portions of the report in promotional literature, and such practices are a potential source of great damage.

The language of a report can be misquoted, used out of context, or printed without reference to the assumptions or limiting conditions contained in the report, and may thus give a false impression of the report, the appraiser, or the profession. Although the specific use of a report is generally a matter of negotiation between the appraiser and the client, the Institute encourages its members to be aware of potential abuses and, whenever possible, to include appropriate contractual restrictions on a client's freedom to reproduce or republish an appraisal report.

CERTIFICATE

According to the Institute's Code of Ethics, all written reports must contain a certificate substantially in the following form:

> I (we), the undersigned, do hereby certify that I (we) have (or have not) inspected the subject property and that to the best of my (our) knowledge and belief, the statements

of fact contained in this report, upon which the analyses, opinions, and conclusions expressed herein are based, are true and correct; also, this report sets forth all of the limiting conditions affecting the analyses, opinions, and conclusions contained in this report; also, this report has been made in conformity with and is subject to the requirements of the Code of Professional Ethics and Standards of Professional Conduct of the American Institute of Real Estate Appraisers of the National Association of Realtors.

The American Institute of Real Estate Appraisers conducts a voluntary program of continuing education for its designated members. MAIs and RMs who meet the minimum standards of this program are awarded periodic educational certification.

One of the following statements also must be included:

I am certified under this program through_____.
I was last certified under this program through_____.
I have not been certified under this program.

LIMITED APPRAISAL AND REPORT

A distinction is made between a limited appraisal, as defined by Canon 4 of Institute Regulation 10, and a limited report, as defined by Canon 5 of Regulation 10. In Canon 4 limitations on the scope of the appraisal process are treated; in Canon 5 limitations on the completeness of the report are addressed.

A limited appraisal could consist of an investigation and analysis that do not meet the requirements of established procedures of the Institute. For example, when a limited time schedule is required by the client, portions of the investigation and analysis may be curtailed or omitted. One of the approaches to value that would normally be included may be omitted, or certain reasonable assumptions may be made relative to highest and best use without the full investigation normally undertaken. However, before an appraiser can accept and perform such an assignment, three important requirements must be met.

1. Prior to accepting a limited assignment, the member must advise the client that the assignment calls for something less than the work required for a full and complete appraisal and that the appraisal report will be qualified to reflect the limited scope of the assignment.
2. The limited scope of the assignment must be sent forth in the appraisal report (and in any testimony concerning the appraisal) in a clear, precise manner.
3. The scope of the assignment must not be so limited that the results obtained are meaningless or could mislead the client or the public.

These requirements deal with a limitation on the scope of the appraisal process; Canon 5 deals with a limitation on the completeness of the report. It is quite possible that a complete investigation and analysis were undertaken but, by prior agreement, only the conclusions are set forth and the data and reasoning are retained in the appraiser's file. The result is what is typically referred to as a letter report (see Chapter 5).

Although part or all of the data and reasoning can be omitted, the following must be included: the certificate of appraisal, an adequate identification of the property, a date of value, the required limiting conditions referred to in the certificate of appraisal statement, acknowledgment of the contributions of others, and the statement of nonbias. To omit any of these items would make the report meaningless or misleading.

A limited report must meet the same three conditions listed above for a limited appraisal. There are also requirements for preparing an expanded appraisal report, which contains more than is required by Institute standards. In these cases, the same three rules apply.

The first condition of prior client advice is best met by an agreement in writing. This can be part of the proposal letter or can be contained in a specific instruction from the client or the attorney of the client.

THE EVALUATION REPORT

The preface to the Institute's Regulation 10 clearly states that it applies to both valuation and evaluation reports. The word *valuation* is used to refer to the estimate of the value of a particular parcel of real estate at a particular point in time. The word *evaluation* is used in the broader sense as an evaluation of the nature, quality, or utility of any parcel of real estate. Examples of evaluation reports include marketability studies, feasibility reports, land-use studies, investment decision analyses, and cost-benefit studies.

When the reporting rules of Canon 5 apply to valuation assignments only, the qualifying phrase "a valuation of a particular parcel or tract of real estate" is used. In all other instances, the reporting rules apply equally to evaluation and valuation reports as do the general considerations of good communication.

7

The Narrative Report

In a narrative appraisal report, the appraiser is afforded the best opportunity to present data and reasoning that support the conclusions reached. As stressed earlier, good organization is essential.

LETTER OF TRANSMITTAL

Transmittal letters introduce the report and present it to the client. A good transmittal letter should be concise and in compliance with accepted standards of business correspondence. It is useful to begin the letter with a reference to the terms and circumstances of the authorization of the assignment. Important points that may be included in a transmittal letter are:

1. Date of the letter (not necessarily or usually the same as the date of value).
2. Client name and address; if it is a corporate client, a reference to the individual who will receive the report should be included. Include the person's title.
3. A reference that will identify the property by name or street address and possibly a file or purchase order reference.
4. Appropriate salutation.
5. Reference to the authorization that initiated the assignment.
6. Reference to the inspection, investigation, and analyses undertaken by the appraiser for the purpose of forming an opinion of value.
7. A concise statement of the value conclusion and the date of value.
8. An indication that the value conclusion is subject to certain assumptions and limiting conditions set forth in the body of the accompanying report.
9. A clear reference that the letter itself is not the appraisal but that it merely serves to transmit the appraisal report that follows.
10. The signatures of all appraisers who bear responsibility for the analyses and conclusions within the report.

Some appraisers choose to incorporate the certificate of value within the transmittal letter; others choose to include it within the body of the report. A typical transmittal letter is presented in Example 7.1.

EXAMPLE 7.1. Transmittal Letter

(Appraiser's Letterhead)

May 13, 1981

Our File No. 758.3
Your Reference No. 8046-C-52

Universal Investment Company
123 Main Street
Middletown, CA 99990

Attn: Mr. William D. Jones, President

Re: Appraisal Report
Office Building at 300 Broad Street
Middletown, California

Gentlemen:

In response to your authorization letter of March 1, 1981, we have conducted the required investigation, gathered the necessary data, and made certain analyses that have enabled us to form an opinion of the market value of the fee simple interest in the above-captioned subject property.

Based on the inspection of the property and the investigation and analyses undertaken, we have formed the opinion that, as of April 8, 1981, and subject to the assumptions and limiting conditions set forth on page 8 of this report, the subject has a market value of:

FOUR MILLION SEVEN HUNDRED FIFTY THOUSAND DOLLARS
$4,750,000

The narrative appraisal report that follows sets forth the identification of the property, the assumptions and limiting conditions, pertinent facts about the area and the subject property, comparable data, the results of the investigations and analyses, and the reasoning leading to the conclusions set forth.

Respectfully submitted,

Jane A. Adams
John B. Roe, MAI

INTRODUCTION TO REPORT

The opening section of the report sets forth the purposes and objectives of the appraisal, an identification of the property and the property rights appraised, and a definition and explanation of important concepts fundamental to the report. Many appraisers list the assumptions and limiting conditions of the report in this section.

Purpose of Report or Objective of Appraisal

The purpose of the report is to communicate the data and reasoning leading to a conclusion. The purpose of the appraisal, or objective of the assignment, is usually to arrive at a supportable opinion. In a simple assignment, the appraiser may express both ideas in a brief paragraph such as:

> The objective of this appraisal is to estimate the market value of the City National Bank Building as of April 5, 1981. The purpose of this report is to present the data and reasoning that the appraiser has used to form the opinion of value.

Other, more complex appraisal assignments require a more detailed statement of the appraisal problem as illustrated in Example 7.2.

Property Rights Valued

If the assignment concerns the appraisal of a fee simple estate interest, it may be sufficient to describe the property rights in the statement of purpose. A separate statement may be required for more complex fractional interests.

Identification of Property

The property should be clearly and unambiguously identified by as many different means as possible, including:

1. Legal description (if lengthy, it may be put in the addenda and referred to within the identification section of the report).
2. Street address, including any qualifiers if the parcel is more or less than that encompassed by the street number.
3. Assessor's parcel number if numbers tend to remain the same from year to year in the jurisdiction involved.
4. Reference to the nearest intersection (e.g., "the parcel with 100 feet of frontage on the north side of Main Street, located 360 feet west of the centerline of the intersection of Main Street and Baldwin Avenue").
5. Reference to any common name for the property, such as the "City National Bank Building."
6. Identification by property type, such as "the three-story, wood-frame office building at the southwest corner of Pierce and Franholm Avenues."
7. Reference to ownership and transfer such as "the 20-acre portion of the southwest quarter of Section 15, Range 10 N. Township 5 S, transferred to Frank Smith by deed recorded November 10, 1980, in Book 3516, Page 431 of Official Records."

EXAMPLE 7.2. Statement of Objective

The objective of this appraisal assignment is to undertake the investigations and analyses required to reach four supportable estimates for each of the following premises:

Premise A

Assuming the lawsuit to overturn the county's approval of Environmental Impact Report No. 568 is unsuccessful and the joint venture is permitted to proceed with development of the Moonrise Bay Hotel and commercial project described herein,

A-1. Estimate the market value of the site "as is."
A-2. Estimate the market value of the project, assuming completion in accord with the plans and specifications identified and described herein.
A-3. Estimate the market value of the project, assuming completion in accord with the plans and specifications identified and described herein and also assuming completion of the leasing of the commercial space at market rent levels.
A-4. Estimate the amount of time after completion of construction for the commercial space to be leased.
A-5. Estimate the occupancy level and average daily rate for the hotel during its first full year of operation and estimate the time after completion for the hotel to achieve stabilized occupancy.

Premise B

Assuming the decision of the court is to sustain the Environment Alliances lawsuit to overturn Environmental Impact Report No. 568 on the basis of the arguments in their petition,

B-1. Estimate the highest and best use of the subject site as is.
B-2. Estimate the market value of the subject site as is.
B-3. Estimate the highest and best use of the subject site as if joined with the adjacent 12.5-acre Coffin parcel described herein.
B-4. Estimate the market value of the subject site and the adjacent 12.5-acre Coffin site as if they were joined.

Ownership and Recent History

It is good practice to list current ownership and the date, price, and terms of acquisition. If there have been several transfers in recent years, it is also helpful to mention these. If the appraisal is of a parcel seriously encumbered by other rights created by easements or deed reservations, these must be clearly explained. Some corporations, lenders, and public agencies require a five- or ten-year property history as a part of their appraisal requirements. Salient facts can be enumerated as follows:

> This appraisal is of the leasehold estate created by the ground lease executed December 31, 1947, between the Crafton Estate Company, as lessor, and the Loomis Company, as lessee. Through successive assignments of the leasehold interest, the leasehold estate is now vested in the name of Donbrow Realty Company, a California corporation. The lease and assignments of lease are reproduced as Exhibit D in the Addenda of this report. A synopsis and analyses of the lease begins on page 53 of this report.

Definitions of Significant Terms

Appraisal terms and legal concepts should be defined early in the report. In almost every instance, there should be a definition of *market value,* perhaps with a discussion of significant elements of the definition.

The appraiser should use the definition of market value appropriate to the particular assignment. In condemnation work, market value may be defined by statute or legal precedent in the jurisdiction involved. Assignments for lending institutions may require a definition imposed by one or more regulatory agencies. The appraiser may prefer to use the definition of market value in *Real Estate Appraisal Terminology.* Example 7.3 shows one way of presenting a definition of market value.

Other terms that may require definition include *highest and best use, market rent, market feasibility,* and, in condemnation work, *special benefits, severance damages, the part taken,* and *the larger parcel.* The authority or source of any definitions should be cited. Some appraisers incorporate the definitions in the "Assumptions and Limiting Conditions."

Assumptions and Limiting Conditions

Canon 5 of the Code of Professional Ethics and Standards of Professional Conduct of the American Institute of Real Estate Appraisers requires the appraiser to "clearly and unequivocally set forth all facts, assumptions and conditions upon which the appraisal is based." A variety of assumptions and limiting conditions might apply, depending on the appraisal. A list of those the appraiser may require appears in Example 7.4. Alternate wordings as used by different appraisers are given.

This section of the report may be called "Contingent and Limiting Conditions" or "Premises, Assumptions, and Limiting Conditions." Some appraisers prefer to place the entire section at the end of the report near the certificate of value. Others prefer to put specific conditions in the introductory section and general assumptions and limiting conditions at the end of the report. By placing all assumptions and limiting conditions early in the report, the reader is alerted to the premises underlying the data analysis and reasoning of the appraisal.

EXAMPLE 7.3. Market Value Definition and Implications

Market value is defined in *Real Estate Appraisal Terminology*[1] as:

"The most probable price in terms of money which a property should bring in competitive and op: market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, 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 o' ·le from seller to buyer under conditions whereby:

"1. buyer and seller are typically motivated.

"2. both parties are well informed or well advised, and each acting in what they consider their own best interest.

"3. a reasonable time is allowed for exposure in the open market.

"4. payment is made in cash or its equivalent.

"5. financing, if any, is on terms generally available in the community at the specified date and typical for the property type in its locale.

"6. the price represents a normal consideration for the property sold unaffected by special financing amounts and/or terms, services, fees, costs, or credits incurred in the transaction."

An understanding of the most likely segment of the investment submarket capable of bidding on the property is essential. Appraisers study and adopt the motivations of the potential buyer group which will exert the greatest pressure on the price structure.

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1. American Institute of Real Estate Appraisers and Society of Real Estate Appraisers, *Real Estate Appraisal Terminology*, revised edition, ed. Byrl N. Boyce (Cambridge, Mass.: Ballinger Publishing Company, 1981), pp. 160-161.

EXAMPLE 7.4. Assumptions and Limiting Conditions

GENERAL CONDITIONS

1. That the term *fair market value,* as herein used, is defined as "the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available" (Cal. Code of Civ. Proc., Title 7, Sec. 1263.320).
2. That the date of value to which the opinions expressed in this report apply is set forth in the letter of transmittal. The appraiser assumes no responsibility for economic or physical factors occurring at some later date which may affect the opinions herein stated.
3. That no opinion is intended to be expressed for legal matters or that would require specialized investigation or knowledge beyond that ordinarily employed by real estate appraisers, although such matters may be discussed in the report.
4. That no opinion as to title is rendered. Data on ownership and the legal description were obtained from sources generally considered reliable. Title is assumed to be marketable and free and clear of all liens and encumbrances, easements, and restrictions except those specifically discussed in the report. The property is appraised assuming it to be under responsible ownership and competent management and available for its highest and best use.
5. That no engineering survey has been made by the appraiser. Except as specifically stated, data relative to size and area were taken from sources considered reliable, and no encroachment of real property improvements is assumed to exist.
6. That maps, plats, and exhibits included herein are for illustration only, as an aid in visualizing matters discussed within the report. They should not be considered as surveys or relied upon for any other purpose.
7. That no opinion is expressed as to the value of subsurface oil, gas, or mineral rights and that the property is not subject to surface entry for the exploration or removal of such materials except as is expressly stated.

FOR COURT OR HEARING TESTIMONY

8. That testimony or attendance in court or at any other hearing is not required by reason of rendering this appraisal unless such arrangements are made a reasonable time in advance.
9. That, because the date of value used herein is the date of trial, the appraiser reserves the right to consider and evaluate additional data that become available between the date of this report and the date of trial and to make any adjustments to the value opinions that may be required.

FOR DISCLOSURE OF PROFESSIONAL ASSISTANCE

10. That, although the valuation contained in this report is the work product of the appraiser, specialized professional studies relating to the engineering cost estimate prepared by Frank L. Doe, Registered Land Engineer, have been relied on in formulating conclusions.

FOR DISCLOSURE OF PERSONAL INTEREST

11. That the appraiser acknowledges personal interest, limited to ownership of ten shares of stock in the American Telephone and Telegraph Company, in the subject of this appraisal, but concludes that such interest will not affect his professional judgment, and that he has made full disclosure of such interest to the client.

continued

FOR TITLE REPORT NONAVAILABILITY

12. That, because no title report was made available to the appraiser, she assumes no responsibility for such items of record not disclosed by her normal investigation.

FOR QUESTIONABLE SOIL OR GEOLOGIC CONDITIONS

13. That no detailed soil studies covering the subject property were available to the appraiser. Therefore, premises as to soil qualities employed in this report are not conclusive but have been considered consistent with information available to the appraiser.

14. That, since earthquakes are common in the area, no responsibility is assumed due to their possible effect on individual properties unless detailed geologic reports are made available.

FOR A LIMITED APPRAISAL

15. That, at the request of the client, the scope of this appraisal report has been limited to include the valuation of only the land and/or improvements that the appraiser considers to have been affected by the proposed taking and construction.

16. That, at the request of the client, the valuation herein reported relates to only a fractional interest in the real estate involved, and that the value of all other fractional interests may or may not equal the value of the entire fee simple estate considered as a whole. The fractional interest appraised relates to only the leasehold estate.

FOR IMPROVED PROPERTY

17. That the appraiser has personally inspected the subject property and finds no obvious evidence of structural deficiencies except as stated in this report; however, no responsibility for hidden defects or conformity to specific governmental requirements, such as fire, building and safety, earthquake, or occupancy codes, can be assumed without provision of specific professional or governmental inspections.

18. That, although no termite inspection report was available, the appraiser personally inspected the subject property and found no significant evidence of termite damage or infestation.

19. That no consideration has been given in this appraisal to personal property located on the premises, or to the cost of moving or relocating such personal property; only the real property has been considered.

20. That consideration has been given in this appraisal to certain items of equipment located on the property and itemized herein, which, in the opinion of legal counsel, are to be considered in the property valuation.

21. That rental areas herein discussed have been calculated in accord with standards developed by the American Standards Association as included in *Real Estate Appraisal Terminology.*

22. That income and expense data herein relied upon were provided by Realty Management Corporation but do not represent an audited return.

FOR PROPOSED CONSTRUCTION

23. That the plans and specifications furnished by the client and prepared by Franklin Jones, AIA, March 10, 1979, upon which this valuation is predicated, are assumed to show the intent of the builder, but the appraiser assumes no responsibility for their correctness or for undisclosed modifications. A copy of the plans and specifications is in the appraisal files.

continued

FOR AGRICULTURAL PROPERTY

24. That no consideration has been given in the appraisal to the value, if any, attributable to growing crops on any portion of the property appraised.
25. That the present owner will be allowed to harvest the current crop.

FOR PARTIAL TAKING

26. That this project will be constructed in the manner proposed as described briefly in this report and in detail in the condemnor's construction plans.
27. That during the proposed construction, existing access and utilities will remain usable by properties presently dependent upon them, or these will be rerouted without disruption in service during the proposed construction, after which they will be replaced to provide usage equal to or better than previously existed.

FOR PIPELINE CONSTRUCTION UNDER AN EASEMENT

28. That the top of the proposed pipeline will have sufficient cover to permit any legal use not specifically prohibited by the wording of the acquisition easement deeds. Copies of these deeds are included in this report.
29. That topsoil replaced after construction will be equal to or better than displaced topsoil.
30. That the excess subsoil will be removed from each parcel where it would adversely affect the parcel after construction.
31. That the construction area of all parcels will be cleared of debris after construction.
32. That the trench area of parcels not under agricultural use will be mounded to accommodate expected settlement after construction.
33. That no consideration is given to potential damage that may or may not arise from ultimate subsidence in the trench area.
34. That construction will be confined to the right-of-way as described in this report.
35. That the condemnor will pay for restoration of all items of permitted use that may be damaged by his entry to and/or over the easement area, regardless of when such items were installed unless such damage occurs from an entry necessary for the removal of items prohibited by the easement language.
36. That where the proposed pipeline crosses watercourses and/or storm water drainage ways, it shall be constructed at a sufficient depth and with sufficient erosion control so as not to interfere with natural water flow or to divert such water flow over adjacent lands.

FOR POSSIBLE UNLAWFUL CONDUCT

37. That the appraiser has become aware, through the media, that certain aspects of the subject property operations are being investigated by the Internal Revenue Service. The value opinion herein reported is based upon reliance on the legality of the subject property operation and resulting financial statements. However, the appraiser reserves the right to consider and evaluate data that become available as a result of the IRS investigation and to make any required adjustment to the value opinion.

FOR REVIEW WITHOUT INSPECTION

38. That the appraiser's sole role in this appraisal was that of review and approval and did not include personal inspection of the property appraised or the market data used.

Scope of Investigation

Some appraisers add a section in the introduction that details the scope of investigation undertaken. This may be presented in a generalized form or in detail. If included, it can be either a narrative or an outline. See Example 7.5.

EXAMPLE 7.5. Scope of Investigation

As part of this appraisal, the appraiser made a number of independent investigations and analyses. She relied on data retained in her office, which is updated regularly for use in all assignments. Listed below are the investigations undertaken and the major data sources.

AREA AND NEIGHBORHOOD ANALYSIS

Examined South Quincy Regional Planning Report for demographic data, land use policies and trends, growth forecasts, and employment data. Reviewed 1979 Planning Update and interviewed Ralph G. Calvin, assistant planning director, in 1980, to ascertain development patterns and trends for portion of Quincy lying west of Interstate 13. Interviewed the following industrial brokers active in the area: Margaret L. Raines of Industrial Realtors, Frank P. Major of Northlake Realtors, and Samuel P. Smith of Morris Industrial Brokers.

SITE DESCRIPTION AND ANALYSIS

Consulted Quincy Planning and Engineering Departments, Public Utility Company, and Suffex County Geologists Office. Reviewed American Title Report 40-31245 prepared January 5, 1980. Physically inspected site on October 1, 1980, walked perimeter of property, and photographed subject site, surrounding area, and street scenes.

IMPROVEMENT DESCRIPTION AND ANALYSIS

Reviewed plans and specifications prepared by Wilson and Wilson, AIA, and inspected similar building at 3150 Crosstown Lane by same architect and builder. Interviewed Judith G. Wilson on October 6, 1980.

MARKET DATA PROGRAM

Vacant and improved transfers were obtained by researching all transfers occurring between January 1, 1979, and October 15, 1980, which were industrially zoned and located west of Interstate 13 and within the Quincy Metropolitan Area. Copies of deeds and financing instruments were obtained from the courthouse and an attempt was made to contact buyers, sellers, or both to verify transaction data and ensure that the sales were at arms length. Details of the verified sales are included in the addenda as Exhibit E.

RENTAL DATA PROGRAM

The brokers listed in "Area and Neighborhood Analysis" above were questioned on the most recent industrial leases consummated in the subject's vicinity. They also provided data on expenses from three similar properties. The appraiser used recent lease data on other properties on file. Morris Industrial Realtors has maintained an industrial property inventory for the past four years, which was consulted for vacancy information.

EXHIBIT 3

GUIDE NOTE 1
To the Standards of Professional Practice

VALUATION OF REAL ESTATE INTERESTS INTENDED FOR SYNDICATION
AND
VALUATION OF REAL ESTATE PARTNERSHIP INTERESTS

GUIDE NOTE 1
To The Standards of Professional Practice

VALUATION OF REAL ESTATE INTERESTS INTENDED FOR SYNDICATION AND VALUATION OF REAL ESTATE PARTNERSHIP INTERESTS

Effective May 3, 1985

Introduction

The syndication of real estate has become an important element in the current real estate market. The process of syndication often begins when an individual or group (the syndicator) purchases interests in real estate for the purpose of transferring it to a limited partnership and then selling limited partnership interests to investors. Problems arise for an appraiser when he or she is asked to value the real estate interests at the time of their purchase by the syndicator because the syndicator frequently is buying more than real estate. Problems also arise when the syndicator sells limited partnership interests to investors because of the inherent difficulty involved in separating the value of the interests in real estate from the aggregate value of the limited partnership interests.

In the syndication industry the price of the interests in real estate at the time of acquisition by the syndicator is sometimes referred to as wholesale value; and the aggregate price of the individual partnership interests to be sold by the syndicator is sometimes referred to as aggregate market value, retail value, or syndication value. If these terms are used by an appraiser, however, they must be defined clearly and precisely so that the users of the report and the public will not be confused or misled.

Valuation problems often relate to non-real estate items or conditions involved in the sale and purchase transaction such as special financing and guarantees of occupancy or income. These items are difficult to isolate and evaluate even when all facts are known. In the context of syndication purchases, the problem of analyzing comparable sales is more difficult than usual because it is extremely difficult to obtain all relevant data.

When a syndicator sells the real estate partnership interests to investor purchasers, the sale price of a limited partnership interest includes a variety of items such as tax benefits, management services, and other benefits in addition to the interests in real estate.

The syndication of real estate involves the marketing of highly specialized interests, both real and personal, to a specifically defined group of purchasers with varying motivations. Unless extreme care is taken to distinguish the exact nature of the interests being appraised, valuation conclusions can be greatly distorted or misleading, and an appraiser may become liable to third parties under security and tax regulations that have often been described as punitive.

Basis for Proper Valuation

1. Acquisition by the Syndicator

All appropriate approaches should be used to estimate value. When analyzing comparable sales in the sales comparison approach, all transactions should be specifically analyzed to determine whether non-real estate items were included in the price. If non-real estate items were included, they should be separately identified and their effect on the sale price should be carefully considered.

A limited assignment should be accepted only in unusual circumstances.

2. Sale of Partnership Interests by the Syndicator

Syndicators frequently assert that the aggregate price they are paid by investors who purchase partnership interests establishes the market value of the interests in real estate that are the subject of the syndication. The market value of the interests in real estate is an important item in a syndication because the value of the improvements is used to establish the basis for depreciation which in turn creates substantial tax benefits. The appraiser, however, must carefully analyze the aggregate sale price of the partnership interests sold to investors and separate the value of the interests in real estate from the contributory value of the non-real estate interests sold. Rarely would the retail price of the individual partnership interests sold to investors equal the market value of the interests in real estate. It is essential that the appraiser understand that the partnership interests sold by the syndicator include many non-realty items such as tax shelter, potential capital appreciation, ability to invest in a major property that an investor might be incapable of investing in alone, and management services for the investment.

When valuing fractional interests in a real estate partnership, an appraiser must be certain that all market data is comparable and be acutely aware of what was included in each investment package utilized in the valuation process. In this connection an appraiser can appraise the partnership interest involved either by breaking it down into separate components or by considering it as a whole with all the components properly identified.

Unacceptable Practices

1. Failing to determine whether non-realty items were included in the price of comparable sales.

2. Using the retail price of the aggregate fractional interests in the partnership or the aggregate market value of the partnership as the market value of the real estate interests being appraised.

3. Combining the value of non-real estate items with the value of the real estate interests being appraised without proper identification and analysis.

4. Failing to describe and measure the effects of submarket or atypical financing on the value of the real estate interests being appraised.

EXHIBIT 4

APPRAISAL POLICIES AND PRACTICES OF INSURED INSTITUTIONS AND SERVICE CORPORATIONS (R 41c)

FEDERAL HOME LOAN BANK BOARD
OFFICE OF EXAMINATIONS AND SUPERVISION
MEMORANDUM R-41c

TO: Professional Staff—
Examinations and Supervision

September 11, 1986

FROM: Francis M. Passarelli

Appraisal Policies and Practices of Insured Institutions and Service Corporations

SYNOPSIS: THIS MEMORANDUM REVISES AND REPLACES R-41b. IT DOES NOT REPRESENT ANY SHIFT IN BOARD POLICY BUT IT DOES ENCOMPASS SIGNIFICANTLY GREATER DETAIL, SPECIFICALLY WITH REGARD TO "APPRAISAL MANAGEMENT," ADDING GUIDELINES WHICH ARE APPROPRIATE TO ENSURE ACCEPTABLE APPRAISAL PROCEDURES IN THE CURRENT MARKET. THE GUIDELINES LISTED ARE GENERALLY STANDARDS OF PRACTICE UTILIZED BY THE LEADING NATIONAL PROFESSIONAL APPRAISAL ORGANIZATIONS. THE MEMORANDUM ALSO CONTAINS THE NEW DEFINITION OF MARKET VALUE, AS RECENTLY ADOPTED BY BOTH THE FEDERAL HOME LOAN MORTGAGE CORPORATION (FREDDIE MAC) AND THE FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNIE MAE). R-41b IS HEREBY RENDERED OBSOLETE AND IS RESCINDED.

Introduction

The soundness of an association's or service corporation's mortgage loans and real estate investments depends to a great extent upon the adequacy of appraisals utilized to support such transactions. This memorandum sets forth the standards and reporting requirements utilized by the Federal Home Loan Bank Board in determining compliance with the appraisal requirements of Insurance Regulation §563.17-1(c)(1)(iii).

Management Policies

Loan and investment policies established by an institution's board of directors should reflect both the overall operational policies of the institution as well as the regulatory limitations under which it must conduct its business. Such policies should be clearly defined and set forth in a manner that provides effective supervision of the institution's operations by the directors.

Prudent loan policy should identify the types of credit arrangements the institution offers as well as the procedures to be followed in the underwriting of each of these arrangements. In secured credit transactions, such policies should definitely address the need to establish the value of collateral offered by borrowers in order to ensure that the institution is appropriately protected throughout the life of the credit arrangement. To a great extent, the complexity and diversity of the credit arrangements offered will determine the types of appraisal services the institution's underwriting staff will require. It is the board of directors' and senior officers' responsibility to ensure that the appraisal services provided, whether by fee or staff appraisers, properly reflect the collateral lending posture of the institution, as well as its lending policies.

Similarly, the board of directors is responsible for establishing appropriate guidelines and procedures relative to other investments of an institution. Appraisal services utilized by the institution in evaluating such transactions should reflect the institution's regulatory obligation to operate in a safe and sound manner. Failure to ensure that appraisal services match the needs of the institution will be considered an abdication of this responsibility and is representative of an unsafe and unsound operating policy.

In formulating its loan and investment policies, the board of directors should recognize that appropriate appraisal services are most often produced by fee or staff appraisers, who are both competent and knowledgeable and have properly equipped facilities within which to prepare adequate appraisals. Each association or service corporation should be able to demonstrate that the appraisers approved by the board of directors possess the requisite experience, education and facilities to perform in an acceptable fashion.

Appraisal skills and technology are not static and attendance at courses and participation in the activities of professional appraisal organizations are factors to be considered by the board of directors in selecting both fee and staff appraisers. Memberships in professional appraisal organizations as well as continuous professional development should be encouraged to ensure that the appraisers whose services are being utilized are actively increasing their knowledge and skills over time. Management should periodically review the performance of all approved appraisers for compliance with the standards and reporting requirements of the Federal Home Loan Bank Board and take whatever steps are necessary to eliminate poor quality or inappropriate work products.

Appraisal Management

Appraisals serve as an important basis in the decision process involved in the underwriting of secured credit transactions as well as investment decisions involving interests in real property. Management must ensure that appraisals utilized in these decisions:

1. Are prepared in accordance with the standards and reporting requirements of the Federal Home Loan Bank Board and conform with the institution's written appraisal guidelines. Management should provide appraisers approved by the institution with a copy of both the board's requirements, as promulgated herein, and the institution's written guidelines. Management should also assist appraisers in obtaining the information needed to comply with these requirements. Such information includes leases, purchase agreements, profit and loss statements from the security property, etc.
2. Are sufficiently current to reduce the likelihood of material changes in actual market conditions from those upon which the loan or investment decision were predicated. (Though not exclusively definitive, "sufficiently current" may be deemed to be an appraisal made six months prior to the approval of the loan or investment.)
3. Reflect the market value of the rights in realty offered as security or involved with the transaction. All other values or interests appraised must be clearly labeled and segregated, i.e., value of chattels, value of financing terms, business value, furniture, furnishings and equipment value, etc.
4. Contain sufficient information to assist management and/or the board of directors in establishing the loan amount as well as other significant terms involved in the credit arrangement.
5. Support the classification of the asset as a real estate loan or other type of credit arrangement.
6. Are prepared by appraisers, independent from the borrower or the seller of the real estate, and approved by the institution's

(Continued on page 4)

(From page 3)
board of directors. It is suggested the board review the prior work and references of newly engaged appraisers. Final board of directors' approval should be recorded in the board's minutes.

7. Contain adequate information relative to both current and projected market conditions and their resulting impact upon the estimated value of the property to enable an institution to determine whether its financial position will be properly protected over the life of the credit arrangement or term of investment. The scope of such information will depend upon the property type, the structure of the credit or investment arrangement and the financial realities of the contemplated transaction.

8. Are presented in a narrative style format, unless *both* of the following conditions are met:
   a. A form report is utilized which is appropriate for the specific appraisal assignment, i.e., the form is designed for both the property type and the interests being appraised.
   b. A form report is utilized, including all attachments, that results in a totally self-contained appraisal, as defined elsewhere in this memorandum.

9. Are based upon the following definition of market value:
   The most probable price which 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, 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:
   a. buyer and seller are typically motivated;
   b. both parties are well informed or well advised, and each acting in what he considers his own best interest;
   c. a reasonable time is allowed for exposure in the open market;
   d. payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
   e. 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.

10. Correctly employ all recognized appraisal methods and techniques that are necessary to produce a credible analysis, opinion, or conclusion. Exclusion or omission of any recognized method for cause must be fully justified.

11. Consider, analyze and disclose in reasonable detail:
   a. Any current agreement of sale, option, or listing of the property being appraised.
   b. Any prior sales of the property being appraised that occurred within the following time periods:
      (1) one year preceding the date when the appraisal was prepared for one to four family residential property, and
      (2) three years preceding the date when the appraisal was prepared for all other property types.
   c. A sales history of comparables, if the subject property is located in a speculative market, which has experienced dramatic price fluctuations relative to regional norms, covering the speculative time period involving the comparable sales.

12. Contain the following information where an analysis, opinion or conclusion of a proposed project, improvement or change in use is involved: (i) plans, specifications, or other documentation in sufficient detail to identify the scope and character of the proposed improvements; (ii) evidence indicating the probable time of completion of the proposed improvements; (iii) clear and appropriate evidence supporting development costs, anticipated rent levels or per unit sales levels, occupancy projections, and the anticipated competition at the time of completion; and (iv) all value changes projected to occur from the conception of a project to its completion and/or stabilized occupancy should be set forth in sufficient detail so that the continuum of present v[illegible] estimates over the life of the credit arrangement or investment can be reconciled with the values reported in the appraisal. Included as documentation should be an explanation of how discount and capitalization rates used in generating the present value estimates were deduced.

   In addition to the above requirements, whenever value is estimated as of completion and/or stabilized occupancy, the appraisal must contain the following information:
   a. The date or dates when the value estimate or estimates apply.
   b. Factual data supporting the reasonableness of all conditions and assumptions impacting each value conclusion cited in the appraisal. Such information must be presented in sufficient detail and directly linked to current market information so that the appraiser's logic, reasoning, judgment and analysis indicate to a third-party reader the reasonableness of the value or values reported.
   c. An explanation of the appraisal techniques selected and the data used to arrive at the final value estimate(s).
   d. A fully documented and supported highest and best use analysis and conclusion which coincides with the date(s) of the value estimate(s).
   e. A definitive statement as to whether the value estimate reflects the worth of the property at stabilized occupancy and whether the appraiser considered and included the effect of income and expenses during the projected absorption period in developing a value estimate as of the date of completion.

13. Accurately reflect the impact upon value of any changes in plans and specifications from those utilized in an appraiser's analysis of a proposed project, improvement or change in use.

   In all instances where an institution utilizes an appraisal bas[illegible] upon preliminary plans and specifications in a loan or inves[illegible]ment decision, it shall take appropriate steps, prior to the disbursement of any funds, to ensure the validity of the appraisal, relative to the decision, has not been negated. Further, whenever significant changes in plans and specifications occur after a loan or investment decision has been made, the institution's management shall take appropriate steps to ensure its financial position is appropriately protected. Typically, such steps will involve either having the original appraiser recertify his value estimate after examining the final plans and specifications for the project or a new appraisal will be obtained based on the final plans and specifications.

   For the purposes of this paragraph, significant changes in plans and specifications are defined as those which directly affect the value of the property, e.g., changes in the scope, character or timing of the proposed improvements.

14. Contain a properly documented and supported estimate of the highest and best use of the property appraised, which is consistent with the definition of market value cited in this memorandum. Such estimate must consider the effect on use and value of the following factors: existing land use regulations, reasonably probable modifications of such land use regulations, economic demand, the physical adaptability of the property, neighborhood trends, and the optimal usage of the property. In addition, the appraisal must consider the effect on the property being appraised of anticipated improvements as of the appraisal date.

   In all appraisals, incuding those involving proposed construction, development or changes in use, the appraiser must specifically address and consider in his analysis the anticipated economic feasibility, as well as cite all significant market data utilized in de[illegible]veloping his/her conclusions. Such analyses must be presented i[illegible] sufficient detail to support the appraiser's forecast of the probable success and the conclusion of highest and best use of the project.

   In all instances where the appraiser relies on feasibility/marketability studies prepared by a third party to support his esti-

mate of highest and best use, he must:

a. Attest that such study has been thoroughly examined and that he fully concurs with its findings and conclusions, and;
b. Specifically identify both the study examined as well as set forth within the body of the appraisal, a summary of the significant data, analyses and conclusions presented in the study. Such summary must be presented in sufficient detail, so that further reference to the study is unnecessary by a third-party reader of the appraisal, and;
c. Have available for future examination by users of the appraisal, a complete copy of the feasibility/marketability study prepared by the third party.

15. Report the market value to a single purchaser as of the date of completion for all properties, wherein a portion of the overall real property rights or physical asset would typically be sold to its ultimate users over some future time period. Valuations involving such properties must fully reflect all appropriate deductions and discounts as well as the anticipated cash flows to be derived from the disposition of the asset over time. Appropriate deductions and discounts are considered to be those which reflect all expenses associated with the disposition of the realty, as of the date of completion, as well as the cost of capital and entrepreneurial profit.

16. For properties under construction, conversion or proposed, report the market value of the subject property as of the date of completion, excepting those properties described in paragraph 15 immediately above, where anticipated market conditions indicate stabilized occupancy is not likely as of the date of completion. Such valuations shall fully reflect the impact upon the "as if completed value" of all pertinent operating expenses as well as the anticipated pattern of income during the absorption period. In addition, the value estimate must reflect the impact of rental and other concessions, including the costs associated with preparing the improvement for occupancy by tenants.

17. Contain a summary of actual income and expenses experienced by the subject property where it is an existing income or revenue producing property. In addition, all such appraisals must contain a complete reconciliation of all deviations projected by the appraiser in his forecast of future financial performance from those historically realized by the property.

18. Report the "as is" value of the subject property as of the date when either the appraisal was prepared or when the property was last inspected. The date of the "as is" value estimate should be sufficiently current to reduce the likelihood of material changes in the actual market conditions from those upon which the loan or investment decision were predicated. In addition to any other value estimates contained in an appraisal, the "as is" value must be reported.

19. Consider and report the effect on value, if any, of the terms and conditions of any agreement establishing a fractional interest or estate, where the objective of the report is to estimate the value of such fractional interest or estate. All such appraisals must clearly demonstrate that the value of any fractional part or estate has been evaluated by an analysis of appropriate market data. Such analyses must recognize that it is generally considered inappropriate to arrive at either the value of the whole or its parts by simply summing the fractional interests or subdividing the value of the whole into proportional parts.

    All analyses involving fractional interests or estates, where the combined value of all interests or estates is not reported, must definitely establish with market evidence whether the terms and conditions of the agreement creating the estates or fractional interests reflects market rates and terms.

    In addition to the above requirements, all analyses involving fractional interests or estates must disclose whether the final value estimate of such fractional interests or estates included non-realty components, i.e., tenant or borrower's credit quality, other non-realty contractual arrangements, etc. Further, whenever such value estimate includes non-realty components, the value assignable to them must be specifically disclosed in the appraisal.

    All appraisals, where there is a clear indication that the subject property is encumbered by a lease instrument or legal limitations upon its operation [e.g., when inspection reveals occupancy of the property by tenants or the property is subject to rent control statutes], must consider and report the impact of the terms of the lease or such legal limitations upon the value of the estate being appraised.

Appraisal Content

Prior to the approval of a loan or investment transaction, each appraisal accepted by an institution must be prepared in writing and contain sufficient information to enable the persons who receive or rely on the report to understand it properly. Appraisals which fail to set forth, in a clear and accurate manner, the analytical process followed by the appraiser, in a fashion that will not be misleading to the persons who receive or rely on the report, will be considered unacceptable.

The content of each appraisal accepted by an institution shall follow generally accepted and established appraisal practices, as reflected in the standards of nationally recognized professional appraisal organizations and as noted in the body of this memorandum.

Specifically, each appraisal must:

1. Be totally self-contained so that when read by any third party, the appraiser's logic, reasoning, judgment and analysis in arriving at a final conclusion indicate to the reader the reasonableness of the market value reported.
2. Identify via a legal description the real estate being appraised.
3. Identify the property rights be appraised.
4. Describe all salient features of the property being appraised.
5. State that the purpose of the appraisal is to estimate market value as defined in this memorandum.
6. Set forth the effective date of the value conclusion(s) and the date of the report.
7. Set forth all relevant data and the analytical process followed by the appraiser in arriving at the highest and best use conclusion.
8. Set forth the appraisal procedures followed, the data considered, and the reasoning that supports the analyses, opinions, and conclusions arrived at by the appraiser. The analytical process followed by the appraiser must be presented so that:
   (a) It includes a complete explanation of all comparable data adjustments utilized in the analysis together with appropriate market support for each adjustment, and;
   (b) It contains descriptive information for all comparable data presented with sufficient detail to demonstrate the transactions were conducted under the terms and conditions of the definition of value being estimated or have been adjusted to meet such conditions; have a highest and best use equivalent to the best use of the subject property, and; are physically and economically comparable to the subject property.
9. Set forth all assumptions and limiting conditions that affect the analyses, opinions, and conclusions in the report; however, such assumptions and limiting conditions must not result in either a non-market value estimate or one so limited in scope that the final product will not represent a complete appraisal. A summary of all such assumptions and limiting conditions must be presented in one physical location within the appraisal.
10. Include a manually signed certification by the appraiser that is similar in content to the following form:
    - the statements of fact contained in this report are true and correct.

(Continued on page 6)

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(From page 5)

- the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest or bias with respect to the parties involved.
- my compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report.
- my analyses, opinions, and conclusions were developed, and this report has been prepared, in accordance with the standards and reporting requirements of the Federal Home Loan Bank Board.
- I have made a personal inspection of the property that is the subject of this report. [If more than one person signs the report, this certification must clearly specify which individuals did and which individuals did not make a personal inspection of the appraised property.]
- no one provided significant professional assistance to the person signing this report. [If there are exceptions, the name of each individual providing significant professional assistance must be stated.]

Related Considerations

Appraisal reports prepared for the purpose of influencing in any way the action of a Federal Home Loan Bank, the Federal Home Loan Bank Board, a Federal Savings and Loan Association, any institution the accounts of which are insured by the FSLIC, any member of the Federal Home Loan Bank System, or the Federal Savings and Loan Insurance Corporation are subject to the provisions of Title 18, United States Code. It is encumbent upon all appraisers to diligently adhere to generally accepted professional appraisal standards of practice and the provisions and requirements of the Federal Home Loan Bank Board's standards and reporting requirements relating to the preparation of appraisal reports prepared for these entities.

Francis M. Passarelli
Director [FHLBB]

Kinnard Writing R-41c Seminar

With the Federal Home Loan Bank Board's release of Memorandum R-41c, the Society is preparing an accompanying seminar.

Dr. William N. Kinnard, Jr., SREA, the author of "R-41b and the Appraiser," will also be the author of the Society's new R-41c offering.

The seminar should be available for chapter presentation by late 1986.

Pilot Presentation of R-41c and the Appraiser, Tucson, Arizona, Arizona Inn, November 7; Dr. William N. Kinnard, Jr., SREA, instructor. Contact: Thomas A. Baker, 2500 N. Tucson Blvd., Suite 100, Tucson, AZ 85716; (602) 881-1700; sponsored by Tucson #116; 7 hours recertification credit.

Pilot Presentation of R-41c and the Appraiser, San Diego, California, Inter-Continental Hotel, November 20; Dr. William N. Kinnard, Jr., SREA, instructor. Contact: Don Knox/Janan Fussell, 4452 Park Blvd., #302, San Diego, CA 92116; (619) 295-1670; sponsored by San Deigo #33; 7 hours recertification credit.

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"Highest and Best Use," one of the four magazine advertisements which have been placed throughout the year to promote Society members, will appear during the latter part of 1986 in the following publications: *Corporate Real Estate, National Law Journal, Trial,* and *Mortgage Banking.*

During the last quarter of 1986, those who request copies of the Directory of Designated Members will receive the 1987 issue, which will be mailed in January. For those who need immediate information, copies of local listings from the current directory are available.

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EXHIBIT 6

RICS Guidance Notes on the Valuation of Assets - 2nd Edition

Guidance Note No. GN 22

LAND AND BUILDINGS
DEFINITIONS OF 'OPEN MARKET VALUE' AND 'FORCED SALE VALUE'

Guidance Note No. GN 22

LAND AND BUILDINGS
DEFINITIONS OF 'OPEN MARKET VALUE' AND 'FORCED SALE VALUE'

1. Open Market Value

1.1 'Open Market Value' is intended to mean the best price at which an interest in a property might reasonably be expected to be sold by Private Treaty at the date of valuation assuming:

(a) a willing seller;

(b) a reasonable period within which to negotiate the sale taking into account the nature of the property and the state of the market;

(c) values will remain static throughout the period;

(b) the property will be freely exposed to the market;

(e) no account is to be taken of an additional bid by a special purchaser.

1.2 The Institution stresses that if a valuer considers it appropriate to apply any qualifying words to 'Open Market Value', the meaning of those words should be discussed and agreed with the client before instructions are finally accepted. The Valuer should incorporate in his report the agreed meaning of the qualifying words.

1.3 It is emphasised that this definition can in no way override any statutory definition of market value which may have to be adopted for the purpose of valuations for Capital Gains Tax, compensation cases, etc.

2. Forced Sale Value

2.1 'Forced Sale Value' is the Open Market Value as defined above with the proviso that the vendor has imposed a time limit for completion which cannot be regarded as a 'reasonable period' as referred to in Para. 1.1.

2.2 If the term 'Forced Sale Value' is used members are advised that the time limit should be discussed and agreed with the client.

Guidance Note No. GN 23

THE VALUATION OF PLANT AND MACHINERY ASSETS

1. General

1.1 The Companies Act 1967 requires that assets shall be classified in the balance sheet under headings appropriate to the company's business and further that fixed assets, current assets and assets that are neither fixed nor current be separately identified but the Act contains no definitions of these classes of assets, although it refers to investments, goodwill, patents and trademarks in terms which recognise the possibility that such assets may be so classified. It should be noted that the very word 'fixed' is somewhat of a misnomer; ships, motor vehicles, railway engines and heavy movable equipment including cranes will be included although some may be classified as 'neither fixed nor current'. Smaller items of plant and machinery, particularly where they are movable, are often classified, for accounting purposes, as neither fixed nor current.

1.2 As a matter of practicality, many companies use a minimum expenditure level to account for capital expenditure; thus any item costing less than a specified amount is written off to revenue in the year of purchase whereas strictly speaking such expenditure could be charged to a fixed asset account.

1.3 Current assets (which will include stocks and work in progress) are in general those assets which are expected to be consumed or realised in the ordinary course of business in the short term.

1.4 The precise nature of the asset is not the only criterion as regards classification. Assets considered to be 'fixed' in one business would not necessarily be so in another.

1.5 When Valuers are asked to make a valuation whether it be of land and buildings or plant and machinery for inclusion in a company's accounts (whether by incorporating the valuation in the accounts or by a reference in a note or in the directors' report) it is essential that there should be a clear understanding by all concerned of what is being valued and the date of the valuation. Valuation Reports and Certificates should clearly define inclusions and exclusions. It is also essential that there should be a clear understanding of the basis of valuation and the proposed treatment of that valuation in the accounts, etc., in order to ensure that there is a proper comparison between the valuation and the book amount of the same assets. Unless this understanding exists between the directors, the accountants and the valuers concerned, there is always the risk that misleading comparisons will be drawn.

2. Basis of Valuation

2.1 Basic accounting concepts postulate that accounts are on a going concern basis, that is to say that the enterprise will continue in operational existence for the foreseeable future. The normal basis of valuation of plant and machinery where the valuation is to be incorporated or referred to in the accounts, etc., of a company should therefore be its open market value on the assumption that the plant and machinery will continue in its present existing use in the business of the company. Normally this existing use basis of valuation will be depreciated replacement cost, i.e., the estimated cost as new at the date of the valuation including the cost of installation less an allowance for depreciation (i.e., wear and tear, age and obsolescence). Account should be taken in the valuation, however, of special factors such as scarcity value or the possible limitation of value caused by limited natural resources or the building housing the plant having a limited life or being held on a limited tenure or with limited planning consent. Further it is necessary to consider both individual and overall values of the plant.

See GN 11

2.2 In some cases an existing use basis of valuation will not be appropriate. It would almost certainly be inappropriate to use an existing use basis of valuation of plant and

See GN 1 and BP

the effect on the value of plant and machinery. In these circumstances the following alternatives would be available:

(a) where the plant and machinery could be moved to and used by the company at another site, the valuation would be on a depreciated replacement cost basis, but making an allowance for the costs of removal and reinstallation;

(b) where plant and machinery is to be disposed of rather than used in the company's business it would then be valued on an open market value basis. If there is a time limit on the disposal, forced sale value may be the proper basis of valuation.

2.3 Where the land and buildings have not been valued, then the plant and machinery should be valued on the basis that would have been appropriate had the land and buildings been valued.

See GN 24

2.4 Definitions of open market value and forced sale value are given in GN. 24. These definitions are to be used for the purpose of valuations which are to be used in company accounts, etc., and they cannot override any statutory definitions of market value which may have to be adopted for the purpose of valuation for capital gains tax, compensation cases, etc.

2.5 In all instances, it is essential that, in advance of the valuation being carried out, there should be a clear understanding with the company and its accountants (and probably its auditors) of what is to be valued, the reasons for the valuation, the use to be made of the valuation and all the surrounding circumstances so that the appropriate basis can be determined.

3. Plant and Machinery forming part of a Building

3.1 Problems have arisen when valuing land and buildings where there are items of plant and machinery which are regarded by the valuer as forming part of the building but which the accountant may wish to segregate for accounting purposes. Valuers when valuing premises will normally include all items of plant and machinery on the premises which provide the services to the land and buildings and which the open market regards as an integral part of the premises for letting or sale or as security for a loan.

See GN 25

3.2 A list of such items is given in GN 25 but it is stressed that the list is not comprehensive and merely indicates, as a general guide to valuers, those items that would usually fall to be included in the value of the premises.

3.3 Normally process plant and machinery should not be included in the valuation of the premises.

3.4 It is possible that some or all of these types of plant and machinery normally included in the valuation of the premises may be needed to be separated for accounting purposes, for instance when it is expected that they have a shorter useful life than the rest of the premises and depreciation is being provided accordingly.

3.5 An apportionment of a valuation as between:

(i) land and buildings; and

(ii) the plant and machinery element;

may also be necessary in order to correspond with the headings adopted by the company in its accounts.

3.6 In such circumstances Valuers will have to indicate clearly that their valuation is of the whole and that any apportionment is an allocation of their overall valuation between the different components. This should also be stated in the notes to the Company Accounts if the apportioned figures are referred to therein.

4. Dies, Moulds, Patterns and Spare Parts

4.1 As a general rule, dies, moulds, patterns, jigs, drawings, designs and similar items should be excluded from a valuation.

4.2 In the normal course of events, spare parts would not be valued as part of the unit as it is often the practice for these to be carried in stock, and only auxiliary items necessary

4.3 In both cases, Valuers should consult with the directors and auditors in order to take the appropriate action.

5. Plant and Machinery Register

5.1 It is recommended that all companies be encouraged to maintain an up-to-date plant and machinery register showing as a minimum, the location of each item of plant and machinery, its date of acquisition, original cost and any further capital expenditure as this assists considerably in a valuation and its reconciliation with the company accounts.

6. General

6.1 Valuers are advised to discuss with the Company Accountants and Auditors the requirements of the valuation before carrying out the detailed valuation.

6.2 Reports and Certificates should incorporate suitable savings clauses covering the treatment in the valuation of such items as assets on hire purchase, government grants and goodwill.

7. Consent

7.1 The Valuer's Certificate should state that his written consent to any reference to his valuation in company accounts and/or directors' reports or any company statement or circular must be obtained before such documents are published. All Valuation Certificates should, therefore, incorporate a paragraph to the effect that:

> 'Neither the whole nor any part of this Valuation Certificate or any reference thereto may be included in any published document, circular or statement nor published in any way without the Valuer's written approval of the form and context in which it may appear.'

Guidance Note No. GN 24

PLANT AND MACHINERY DEFINITIONS OF 'OPEN MARKET VALUE' AND 'FORCED SALE VALUE'

1. Open Market Value

1.1 'Open Market Value' is defined as the best price at which an interest in the plant and machinery might reasonably be expected to be sold at the date of valuation by either Private Treaty, Public Auction or Tender, as may be appropriate assuming:

(a) a willing seller;

(b) a reasonable period within which to negotiate the sale, taking into account the nature of the plant and machinery and the state of the market;

(c) values will remain static throughout the period;

(d) the plant and machinery will be freely exposed to the market;

(e) no account is to be taken of an additional bid by a special purchaser;

(f) the plant and machinery may be valued, either

(i) as a whole in its working place, or

(ii) as individual items for removal.

2. Forced Sale Value

2.1 'Forced Sale Value' is defined as the open market value as defined above with the proviso that the vendor has imposed a time limit for completion which cannot be regarded as a reasonable period as referred to in above.

2.2 If the term 'Forced Sale Value' is used members are advised that the time limit should be discussed and agreed with the client.

Guidance Note No. GN 25

PLANT AND MACHINERY
ITEMS OF PLANT AND MACHINERY NORMALLY INCLUDED IN VALUATIONS OF LAND AND BUILDINGS

1. The following observations are intended to apply in the valuation of assets comprised in the majority of industrial and commercial types of property. Factory premises of a specialised nature will often require individual treatment and segregation to meet particular circumstances. In the case of sale, fire insurance, rating, etc., different criteria may apply. The list which follows, however, whilst not comprehensive, indicates those items usually valued on the basis that they form part of the 'building' service installations as opposed to those provided as part of the industrial or commercial processes carried on by the occupier. It follows that the valuation of land and buildings would normally exclude all items of plant, machinery and equipment which may have been installed wholly or primarily in connection with the occupiers' industrial or commercial processes, furniture and furnishings, tenants' fixtures and fittings, vehicles, stock, moulds and loose tools. The excluded items may need to be separately valued for balance sheet or other purposes.

2. **Electricity**

   Mains supply cables, transformer houses with transformers, sub-stations and their equipment, generating plant and associated equipment including standby plant, and all wiring and switchgear up to and including the main distribution board in each building, together with:-

   (a) *In non-industrial buildings:*

   Wiring for lighting and power from the distribution board to wall and ceiling points.

   (b) *In industrial buildings:*

   Wiring for lighting to wall and ceiling points.
   Note: (power circuits from the distribution board would normally be excluded on the grounds that these are related to the processes).

   (c) *Externally:*

   Wiring and associated structures for lighting to roads and yards, etc.

3. **Gas**

   Gas mains up to and including meter houses and piping from meter houses for non-process purposes. Where the property includes a gas producer plant this would normally be in connection with the occupier's industrial processes and would, therefore, be excluded.

4. **Water**

   Wells, boreholes, pumps, pump houses, service pipes including those connected to Water Board's mains, water treatment plants, storage tanks and reservoirs and all structures required to contain, support or house such items.

5. **Space Heating and Hot Water**

   5.1 Boilers and associated plant including fuel tanks, pipes and fittings (e.g., radiators and unit fan heaters) primarily supplying or using steam or hot water for space heating and other non-process purposes.

6. Air Conditioning and Ventilation

Air conditioning plant and trunking and fan extractors and ventilators except where forming part of a computer installation or primarily serving plant and machinery used in industrial or commercial processes.

7. Fire and Security

Hydrants, pumps and mains, sprinkler systems, smoke detectors and annexed fire and burglar alarm systems.

8. Drainage

8.1 Surface water and foul water drains and sewers.

8.2 Sewage disposal plants not primarily concerned with treating water and other liquids used in the processes of trade effluents.

9. Lifts and Gantries

9.1 Passenger and goods lifts, escalators and travelators designed to benefit the general occupation of a building.

9.2 Rails and supporting gantries for overhead travelling cranes where forming an integral part of the structure of a building.

Note:
Hoists, conveyors, elevators, overhead cranes, jib and derrick cranes would normally be excluded.

10. Structures

10.1 The decision upon which items should be included will, to some extent, depend upon general experience and the practice adopted by individual trades.

10.2 Among the criteria will be the degree of attachment, permanence and size. Structures which are necessary for the provision of the services or have been installed or erected other than for the industrial or commercial processes carried out on the property would normally be included in the valuation of land and buildings. Such items might include the following:

Boiler houses, Chimneys (brick and steel) and Economiser Chambers;
Pits;
Stagings;
Internal Buildings;
Permanent Partitions;
Railways;
Bridges and Housings for Conveyors;
Fences;
Roads, Yards and Hard Standings.

10.3 Structures which are ancillary to, or form a part of an item of Process Plant and Machinery, would normally be excluded.

Guidance Note No. GN 20

ASSET VALUATIONS IN ACCORDANCE WITH THE INSURANCE COMPANIES ACT 1974

1. When valuing assets of Insurance Companies it is necessary to comply with the terms of The Insurance Companies (Valuation of Assets) Regulations 1976 (SI 1976 No. 87) made under Sections 78 and 86 of The Insurance Companies Act 1974. (*See Footnote*)

   The Regulations are effective from 1st May, 1976, and revoke SI 1974 No. 2203.

   The Regulations apply to all general business assets, and all long-term business assets but unit linked property assets are excluded and subject to separate requirements. The Regulations apply to nine categories of assets: those likely to be of direct concern to members are 'Land' and 'Debts'. 'Land' includes land and buildings and any interest in land. An option to purchase is considered to be an interest in land and consequently must be valued.

   The Regulations apply to all insurance companies authorised to carry on any class of insurance business in the United Kingdom.

   Whilst Valuers will wish to read the Regulations as a whole, the following are probably of principal interest:

2. **Regulation 3**

   2.1 Para. (4) provides in effect that the most recent 'proper valuation' made under Regulation 7 is a maximum. If the Valuer makes a qualification to the valuation (e.g. the absence of HAC has not been verified or some other adverse factor) a lower value may have to be adopted by the insurance company. If there has been a change in circumstances since the last 'proper valuation' (e.g. a change in market conditions with rising yields) which make it likely that the valuation figure is not realisable, then the appropriate lesser amount is to be taken.

   2.2 This could mean in practice that an up-to-date revaluation may have to be made or further advice obtained and insurance companies can be expected to consult with their valuers.

   2.3 Similar considerations apply to certain other categories of assets including 'debts' valued under Regulation 6.

3. **Reulations 4 and 5**

   3.1 These Regulations concern the valuation of assets of dependents (as defined in Regulation 2(2)). If members are instructed to value assets of this category of companies they should consult with their clients as to the advice and valuations required to comply with the Regulations in the particular circumstances.

4. **Regulation 6**

   4.1 This prescribes the method of valuing 'debts' which include mortgages.

   4.2 If due within twelve months the value is the amount which can reasonably be expected to be recovered. This will include a debt which would become due within twelve months if the insurance company exercised any right to require payment.

   4.3 If due beyond twelve months the value is the amount which would reasonbly be paid for an assignment of the debt with the benefit of the security. Thus in 1979, for example, a standing mortgage of £100,000 for 20 years fixed at 7½% in 1965 would have fallen to be valued at a discount; consideration must also be given to the other conditions of the debt,

Note: These regulations should be read in conjunction with SI 1976 No. 2039 (which freed from the admissibility limits investments by insurance companies in Government and public authorities and increased the limit of admissibility set to certain debts from individuals) and SI 1980 No. 5 which enables insurers to elect, subject

the status of the mortgagor and the nature of the security and the strength of the cover provided by it for the debt. Where the security is land members may be asked to comment on its nature and/or the value of the land.

4.4 Members may be asked to advise on the value of a 'salvage right' where the insurance company have a right to possess or sell an asset.

5. Regulation 7

5.1 This deals with the valuation of 'land'. The value to the insurance company for the purposes of the Regulation will not be greater than the amount obtainable (after deducting reasonable sale expenses) if the land were sold at the most recent 'proper' valuation. This basis is governed by Regulation 3 (4) upon which comments are made above.

5.2 A 'proper valuation' is defined in Regulation 2 and is the amount realisable by an open market sale and must have been made not more than three years before the relevant date. This valuation must have been made by a 'qualified valuer' (see Regulation 2) viz. a person who is a Fellow or a Professional Associate of the Royal Institution of Chartered Surveyors (or a Fellow or an Associate of the ISVA or the RVA) who must have knowledge and experience in the valuation of land or by any other person approved by the Secretary of State for the Department of Trade.

5.3 As a 'person' can include any body of persons corporate or unincorporate it follows that a firm may or may not be a 'qualified valuer'. Where one or more of the partners is not a 'qualified valuer' the valuation must be made by, and the valuation report signed by, a partner who is a 'qualified valuer'.

5.4 It is recommended that the Valuer should produce the figure for the 'proper valuation' leaving the insurance company to assess the deduction for reasonable expenses of sale (according to the latter's judgement of the appropriate method of disposal). Members are advised to make it quite clear when submitting a valuation that it takes no account of the expenses of sale. Members should be prepared, if requested, to advise on the amount of sale expenses according to the circumstances.

5.5 The relevant date of valuation must be given to the Valuer by the insurance company.

5.6 It is to be noted that valuations do not have to be made by independent persons so that if they are 'qualified valuers' both directors and employees of the insurance company can undertake the valuation.

5.7 Land not so valued is excluded from being taken account of for the purposes of the Regulations (see Regulation 3(1)). This allows a company, if it so wishes, to exclude relatively small holdings.

5.8 Land occupied by the company is to be valued as if with the benefit of vacant possession; it would be wrong to value it on the basis of a sale as an investment with an assumed lease to the company at a rent.

5.9 Land is to be valued as free and clear of any mortgage or charge.

5.10 The Regulations cover land in the UK and overseas.

6. Regulation 8

6.1 This applies special valuation rules to equipment which includes 'plant and machinery'. Valuers in this field should note that the rules are severe and apply percentage deductions to a strict time scale on computer equipment and for all other equipment a minimum of 50% deduction on cost in the financial year of acquisition and a complete write-off thereafter. As the rules apply also to dependent companies it is important that Valuers consult with their instructing clients (see comments on Regulations 4 and 5).

6.2 In valuing an 'in hand' agricultural holding the basis of valuation of the land will assume vacant possession and it would appear that the operating capital (except for any item of plant and machinery acquired during the financial year) would have to be ignored.

6.4 Reference should be made to Guidance Note No. GN 25 as to those items of plant and machinery which are normally valued as an integral part of land and buildings and it follows that such items do not fall within the scope of this Regulation. See GN 25

7. Regulation 13

This Regulation provides for life interests to be valued as the amount which would reasonably be paid for an immediate transfer; it also expressly provides for leases and reversions to be valued on the basis prescribed in Regulation 7. It should be noted that reference in this Regulation to property includes all forms of property.

8. Schedule 2

This Schedule prescribes permitted limits for certain categories of assets in relation to the general business amount of the long term business amount (as defined in Regulation 15(2)). In this connection paragraph 1 should be noted by Valuers. This deals with the position where a valuation of a piece of land (other than land held as security for a debt) or a number of pieces of such land is greater than the aggregate of the valuations of each piece of land valued separately. This will cover the situation for example where the insurance company owns a number of interests (but not all) in a block of property or an island site, which is being assembled for development. Valuers can be expected, therefore, to be asked to advise on the 'lotting' of a portfolio to produce the highest proper valuation in order that the permitted limits can be tested.

9. The Signing of Valuation Certificates under the Insurance Companies Regulations

9.1 It is recommended that members should confirm in their Valuation Certificate that it is a 'proper valuation' made in accordance with the Regulations and the signatory is a 'qualified valuer' (see Regulation 7 above).

9.2 Care must be taken to ensure that the valuation is only signed by a qualified valuer.

9.3 The Institution is advised that where a partnership consists entirely of persons having the specified qualifications or corporate membership then the Valuation Certificate may be signed in the name of the partnership but this should also include a statement to the effect that all the partners have the specified qualifications.

9.4 If one or more of the partners is, therefore, not a corporate member of the Royal Institution of Chartered Surveyors, or the Incorporated Society of Valuers and Auctioneers or the Rating & Valuation Association the Valuation Certificate must be signed by the qualified valuer who has actually made the valuation and a statement included to the effect that the signatory is a qualified valuer within the meaning of the Regulations.

9.5 If the partnership consists entirely of corporate members of the Royal Institution of Chartered Surveyors or the Incorporated Society of Valuers and Auctioneers or the Rating & Valuation Association, the Valuation Certificate can still be signed in the firm's name, even though one or more of the partners may specialise in the valuation of categories of land other than that which is the subject of the valuation. In this event it must be understood that the actual valuation must have been made by a qualified valuer who has the appropriate knowledge and experience in valuing the subject land.

9.6 If the firm (and this may particularly apply in some overseas countries) is not a partnership but a corporate body then the signatory must be a qualified valuer, and a director or secretary, unless so qualified, may not sign the Valuation Certificate. In this case, it is also necessary for a statement to be made to the effect that the signatory is a qualified valuer within the meaning of the Regulations.

9.8 It follows, therefore, that there should normally be only four forms of signature in accordance with the following examples:

(a) Smith, Jones and Robinson

(Where in this case every partner is a qualified valuer within the meaning of Regulation 7).

or

(b) (i) A. Smith or

(ii) A. Smith
for Smith, Jones & Robinson, or

(iii) Smith, Jones & Robinson
A. Smith

In cases (b) (i), (ii) and (iii) A. Smith being a qualified valuer within the meaning of the Regulations and the person fully responsible for the Valuation.

In both cases (a) and (b) The Valuation Certificate must include the statements as to qualifications referred to earlier.

It must not be overlooked that a partnership can contain as a partner a body of persons corporate or unincorporate and in that case the requirements will only be met by the application of examples (b) (i), (ii) or (iii).

Guidance Note No. GN 21

REVIEWING OF VALUATIONS

1. Reviews of a Valuer's Previous Valuations

1.1 Valuers are often asked to carry out reviews of their previous valuations without undertaking a full reinspection of the properties. Valuers should be cautious in accepting such instructions and should have regard to the period of time that has elapsed since the last valuation. It would not normally be appropriate to accept such limited instructions where there has been a material alteration or change in the property portfolio, a material change in the property market, or a material change in the criteria previously adopted. Changes in rental income or other aspects of tenancies from investment properties would not normally be regarded as falling within the ambit of the foregoing circumstances.

1.2 Where such reviews are undertaken the Valuer is advised to obtain from the client a 'letter of comfort' stating that neither material alterations nor changes have taken place in the portfolio.

1.3 Where there have been material alterations or changes in the portfolio it will be necessary for the Valuer to undertake a valuation of those properties new to the portfolio or those where there have been alterations or changes.

1.4 When reporting the results of a review of a previous valuation the valuer is recommended not to refer to a 'desk study' or similar wording but to adopt the following, suitably amended to meet the particular circumstances:

> 'As instructed, we have reviewed our valuations of (date) without reinspecting (all) the properties and on the same criteria as previously used but under current market conditions we are of the opinion that the open market value as at (date) is of the order of £.....'

1.5 Where alterations and changes of a material or significant nature have occurred and a review has still been undertaken, these should be referred to in the review report.

2. Review of Valuations made by another party

2.1 A Valuer may be asked to review in whole or in part a valuation made by a director or internal valuer of the company which owns the property, or to undertake a review of a valuation by another external valuer.

2.2 A Valuer should not accept instructions to undertake a review of a valuation unless he made that valuation, in which case he should follow the recommendations above.

2.3 Unless the Valuer has already inspected the property concerned and is already familiar with the building and location or is afforded the opportunity of carrying out an inspection and has made all other relevant enquiries, or has been supplied with the information that would result from such enquiries, he is in no position to express an opinion as to value except on a restricted basis. See GN 2

2.4 It is recommended that the Valuer should report his own valuation with such qualifications as may be appropriate. There should be no reference to any valuation prepared by another party as otherwise there may be implied criticism which would be unfair and possibly damaging to the other Valuer's reputation if he is afforded no right of reply. See GN 17

2.5 Where a Valuer is instructed to carry out a valuation jointly with another Valuer, this would not be considered to be a review within the ambit of this Guidance Note, even though one of the Valuers may be an internal valuer. See GN 3

EXHIBIT 7

FIRST ASSET REALTY ADVISORS

APPRAISAL ENGAGEMENT LETTER

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First Asset Realty Advisors

First Bank Place
Minneapolis MN 55480

Appraisal Engagement Letter - Preliminary Draft

TO:

RE: Property Identification

Dear _____:

On behalf of First Asset Realty Advisors (FARA), we would like to engage your services for the appraisal of the above property to determine the fair market value of the legal interests owned by a Commingled Fund as of (date of appraisal). To that end and before accepting the assignment, the appraiser should consider the following requirements as to definition and procedure:

1. Fair market value shall be defined as the most probable price at which the property would sell to a knowledgeable buyer on a given date if placed on the market for a reasonable length of time by a well informed seller assuming:

   a. Cash to the seller or cash plus debt owed or assumed by the buyer, where appropriate.
   b. Fee title will be encumbered by leases in place and possible other covenants. Appraiser must indicate remaining market value of these other leasehold or non-possessory interests.
   c. The appropriate exposure on the market has occurred prior to the date of sale.
   d. Buyer motivation is profiled as an assumption by the appraiser.

2. Fee title may be encumbered by leases, mortgages as well as possible conditional use permits and private covenants. FARA is obligated to provide access to all of the appropriate documents at the office of _____ _____ located at _____ _____ during normal business hours. The appraiser is expected to read the leases, mortgage instruments and other encumbrances and relate to them appropriately. If existing debt is assumable by another buyer, then the appraiser can value the sale as cash to the seller with the buyer accepting the mortgage(s) already in place if that would be consistent with the most probable buyers self interest. Otherwise the trustees of the Commingled Fund management (FARA) are interested in a value which is the most probable cash price to the seller and with the buyer accepting the existing encumbrances in terms of leases and covenants, etc.

3. When using the market comparison approach the appraiser must document each comparable sale as to grantor, grantee, public record, plot plan and photograph as well as basic details of construction and existing encumbrances, terms of sale, and seller motivation. All calculations necessary to adjust engineered prices to cash equivalencies must be documented and explained as well as any and all adjustments to relate the comparable price to the subject property must be itemized and explained so that the reader can repeat the mathematical adjustments possible.

4. The income approach must use discounted cash flow from a ten year forecast (and your own forecast if different) in which all major leases are detailed individually and minor leases classified into groups if appropriate. The rationale for roll-over vacancies, absorptions, and expense projections must be itemized with a series of footnotes in the manner of a fully detailed accounting income and balance sheet statement. Normalized income methods including investment bond, Ellwood, or net income multipliers are not acceptable.

5. The appraiser must document his opinion as to the appropriate discount rate applied to each segment of the cash throw-off and after tax cash flow as appropriate, together with financing terms assumed.

6. A cost approach by a responsible service or professional should be supplied with the initial appraisal. If it is not used in the final valuation, then a discussion on why it is not used is required. The appraiser is expected to carefully inspect the property and report his own independent views on the quality of maintenance, deferred maintenance, and tenant housekeeping.

7. The appraiser is regarded as the eyes and property inspector of FARA. To put the property in context the appraiser must supply and evaluate a list of projects which are competitive alternatives in the market areas of the appraiser and indicate rent structures, vacancy rates, turnover rates, and in the case of the new building, coming on stream or about to be built, some indication as to their rentup success and the source of their tenants. Wherever possible the appraiser is to indicate the ownership and character of investment position in these competitive properties and the property management or leasing term involved with each.

Following the initial appraisal at the time of acquisition, the appraiser will be asked to submit a letter of review 180 days after the date of the original appraisal indicating if he would modify any of his critical assumptions at that time, and if so, indicating how this might affect his original value estimate as a specific dollar adjustment, up or down.

At the end of 360 days the appraiser would be expected to perform a thorough review of his original appraisal, specifically focusing on the market approach (Item 3), adjustments indicated for the income approach (Item 4 & 5), and additions and amendments to

First Asset
Realty
Advisors

First Bank Place
Minneapolis MN 55480

Appraisal Engagement Letter - Preliminary Draft

TO:

RE: Property Identification

Dear _____:

On behalf of First Asset Realty Advisors (FARA), we would like to engage your services for the appraisal of the above property to determine the fair market value of the legal interests owned by a Commingled Fund as of (date of appraisal). To that end and before accepting the assignment, the appraiser should consider the following requirements as to definition and procedure:

1. Fair market value shall be defined as the most probable price at which the property would sell to a knowledgeable buyer on a given date if placed on the market for a reasonable length of time by a well informed seller assuming:

   a. Cash to the seller or cash plus debt owed or assumed by the buyer, where appropriate.
   b. Fee title will be encumbered by leases in place and possible other covenants. Appraiser must indicate remaining market value of these other leasehold or non-possessory interests.
   c. The appropriate exposure on the market has occurred prior to the date of sale.
   d. Buyer motivation is profiled as an assumption by the appraiser.

2. Fee title may be encumbered by leases, mortgages as well as possible conditional use permits and private covenants. FARA is obligated to provide access to all of the appropriate documents at the office of _____ _____ located at _____ _____ during normal business hours. The appraiser is expected to read the leases, mortgage instruments and other encumbrances and relate to them appropriately. If existing debt is assumable by another buyer, then the appraiser can value the sale as cash to the seller with the buyer accepting the mortgage(s) already in place if that would be consistent with the most probable buyers self interest. Otherwise the trustees of the Commingled Fund management (FARA) are interested in a value which is the most probable cash price to the seller and with the buyer accepting the existing encumbrances in terms of leases and covenants, etc.

EXHIBIT 8

ALTERNATIVE

LETTER OF ENGAGEMENT

FOR PENSION FUND MANAGER

1. All the requirements of the General Information (revised 10-4-85) form apply to the Update. Data obviously repetitive may be omitted by incorporating the original appraisal by reference, but the need to refer to the original, or to earlier updates, should be minimum. Emphasize the changes.

2. Reinspect the property.

3. Include at least:

   a. A summary description of The Property.

   b. The site plan sketch.

   c. A current photograph.

   d. An updated HABU section. Restate the HABU of the land as if vacant, and of The Property.

   e. Description of national and local economy and market, neighborhood changes (such as evidence of growth and development, or of deterioration), and competition.

   f. Description of property condition, and estimate of cost to correct major curable deficiencies.

   g. Fresh land comps, property comps, and rent comps, including a recap of all leases in The Property over the last 12 months.

   h. Support for growth rates, inflation rate, rates of return, market rental rates and sales projections.

   i. For shopping centers, an updated review of department store (individually) and mall stores (total) sales, gross and per square foot, over the past three years.

Standard

The appraisal report is to be made in conformity with, and is subject to, the requirements of Regulation 10, Code of Professional Ethics of the American Institute of Real Estate Appraisers.

Material HAC will provide:

- A copy of the Investment Analysis And Property Valuation used for the acquisition.
- Current year Operating Statement forecast.
- Cash Operating Statements for previous years our client has owned the property, up to three years.
- Current Rent Roll.
- Current year Budget summary.
- 3rd party mortgage terms, debt service and balance.
- Title Report.
- Survey.
- Site Plan and Rent Plan for regional and community shopping centers.
- Base year operating expenses.
- Selling price and date of properties sold from industrial packages.
- Tenant-by-tenant sales volume reports for retail properties.

Leases and lease extracts may be reviewed at the respective management offices.

Table of Contents

We require a detailed Table of Contents so we may quickly locate specific sections, particularly in the Income Approach. This is especially important on large multi-use properties.

Value Fair Market.

Type Full narrative.

Interest

1. Always appraise the interest of a party that owns the entire property, both land and building, subject to the building leases.

2. When the building is (entirely or partially) on leased land, appraise also the interest of a party that owns the building, subject to the land lease and to the building leases.

3. On some properties our client has a partial interest. Where this is the case, calculate also the proceeds to our client at a sale of the entire p operty at the appraised value.

Financing

Appraise subject to existing mortgage debt.

Content Include:

1. Except for regional and community shopping centers, a site plan sketch showing lot lines, building lines, site square feet (or acres), building square feet, a few dimensions, and atypical easements. Do not use a copy of the survey.

   For industrial buildings, show on the sketch (1) the approximate outline of finished space (office, lab, showroom, high-tech), (2) the square footage of that space, (3) demising walls in multi-occupant buildings, (4) dock doors, and (5) drive-in doors.

2. The effect easements have on property value, if the value of the easements is substantial and the easements are atypical.

3. A discussion of the national and local economies, both in general and in respect to the property type. Cover historic absorption, current vacancy, additional space coming on line, projected future absorption, etc. in support of your forecast of the supply/demand relationship over the next 5 to 6 years. Support your selection of growth rates, inflation rate, and rates of return. Discuss neighborhood and market area status and trends.

4. Zoning:

A zoning map (entire or extract) showing the subject and the subject's zoning, with the subject's location identified.

Your synopsis (we do not want copies of, or excerpts from, zoning ordinances) of particularly pertinent parts of the zoning regulation (such as parking and prohibited uses), and your opinion as to whether the occupant is conforming. In industrial zones, include enough information (including restrictions and covenants running with the land) about set-back, signing, storage, and landscaping to define the quality of the neighborhood.

Where re-use is a consideration, as for example conversion of industrial to retail or office, we want to know the use, height, set-back, and parking restrictions.

5. Real estate tax:

A tax map with the subject outlined in red, and the tax number.

For states other than California, a comparison of the tax with the tax on similar properties, and comment on likely tax changes on The Property.

Base the real estate tax on what it is likely to become as the result of a sale at the appraised value.

6. A description of building condition, grounds condition, housekeeping, and the approximate cost to correct major curable deficiencies.

7. In the Highest And Best Use section, a conclusion on the HABU of the land as if vacant.

8. A Cost Approach. Include in it a Comparison Approach to land value, stating how each sale compares to The Property in respect to location. State the source (preferably published) for cost estimates, and explain the derivation of any soft cost breakouts such as financing, administration, rent-up expenses, leasing commissions, developer profit, and developer mark-up. For the basic depreciation (before the appraiser's adjustments), a published source is preferred over the appraiser's estimate of effective age/life.

9. A Comparison Approach. Include at least 5 sales within the past 12 months. Quality is preferred to quantity. Locate local sales on a map. State the age, and compare the location to The Property.

Shopping centers: Include at least 5 sales with a Gross Income Multiplier. (To obtain 5 GIM's on regional and community centers you may use sales other than the 5 sales which occurred during the past 12 months, and these sales may be as much as two years old.) Select a GIM for The Property, and include a GIM approach to value.

Regional shopping centers: Include total gross leasable area, GLA sold, and, for GLA sold, the total footage for department stores and the total footage for mall stores.

Industrial: Include clear height; lot coverage; and percent of office, high-tech, or showroom space. Specify single or multi-occupant; if multi, the number of units. Include photographs of the sale and rent comparables, preferably front and rear. These pictures may be photoprints.

10. An Income Approach. Include a discounted cash flow, typically for at least 10 years. Include in the last years cash flow the proceeds from a sale at the end of the last year based on the next year operation.

Use the DCF by applying a yield (IRR or discount) rate to the cash flows to obtain the value indication. (As opposed to using it to obtain an IRR as a check against other value indicators.)

Bottom line cash flows for the 11 years, with the IRR('s) and resulting value(s), should all appear on one page (either alone or with other data).

Show the proceeds of sale calculation, including the calculation of the commission, if any.

In support of the income used in the DCF, on percentage rent spaces show, for each space, the previous year sales, in total and per square foot and support your estimate of sales for the projection period. On a space-by-space basis, for all property types, show income for every year of the DCF, broken down into base rent, percentage rent, reimbursements, CPI, etc. On a summary sheet list all the spaces, with totals for each year.

On all operating statements for office and industrial, we prefer this sequence after income:

Expense
Expense
(etc.)
Total before-tax expenses
Tax
- Total expense
NOI
- Non-recurring
- Tenant improvements
- Leasing commissions
NI

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LANDAUER

JOHN R. WHITE

Honorary Chairman & Director
Landauer Associates, Inc.

For seventeen years over the past quarter century, John R. White under various titles led Landauer Associates, the New York based international real estate consulting company with offices throughout the United States, Europe and Australia. He is now enjoying working on key accounts for Landauer's clientele as Honorary Chairman, Director and principal management shareholder.

During this period he has been a forecaster of real estate markets; a valuation specialist in the largest scale properties; and a consulting intermediary in the purchase, sale and financing of such properties as the Pan Am and General Motors Buildings in New York; L'Enfant Plaza in Washington, D.C.; Bank of the Southwest Building in Houston; and the ground lease extension negotiations and lease re-casting at Rockefeller Center. He also served as consultant to General Motors in the site selection and location of Saturn Corp. in Spring Hill, Nashville area, Tennessee, and to NBC in its current corporate relocation studies.

He has served or is now serving on many different Boards of financial institutions and investment companies as a trustee or director. He is Chairman of Turner Equity Investors, a publicly owned realty trust. He has been both national president of the American Society of Real Estate Counselors and Chairman of the Appraisal Journal, the quarterly publication of the American Institute of Real Estate Appraisers. His awards include:

- The Ellwood Award for Appraisal Excellence, 1975 - New York State Appraisal Society
- The Armstrong Award (twice) for best article in the Appraisal Journal - American Institute of Real Estate Appraisers
- The Realtor of the Year Award, 1981 - The Realty Foundation of New York
- Urban Leadership Award, 1985 - Real Estate Institute of New York University
- Best Article Award, 1985 - Federation Internationale Des Professions Immobilieres (FIABCI)
- Y. T. Lum Award, 1986 - American Institute of Real Estate Appraisers

Mr. White also served as an Adjunct Associate Professor of Real Estate at New York University from 1948 to 1960 and is now Executive in Residence, Columbia Graduate School of Business. He has published 75 articles on real estate economics, finance and valuation. His recent writings include "Real Estate Valuing, Counseling, Forecasting," published by the American Institute of Real Estate Appraisers in 1984 and "The Real Estate Appraiser - The Elusive Goal of Professionalism," published by the American Institute of Real Estate Appraisers in 1987 in the Appraisal Journal.

Mr. White has a AB from Harvard College and an MBA from New York University.

The Real Estate Appraiser–The Elusive Goal of Professionalism

by John R. White, MAI

PREFACE

The purpose of the study presented in this article was to report on the relative progress that real estate appraisers have made towards professional recognition. Part of the study included a survey that focused entirely on members of the American Institute of Real Estate Appraisers. Members and candidates of the Appraisal Institute represent about 17,200 individuals of a total estimated 200,000 or more who practice as appraisers, or occasionally represent themselves as such. An objective analysis led to the inescapable conclusion that the preeminent appraisal body is the Appraisal Institute, because it possesses the highest educational, ethical, and testing standards for appraisers of income property. The Society of Real Estate Appraisers, which started as a single-family dwelling appraisal group, still represents the vast majority of qualified single-family dwelling appraisers.

John R. White, MAI, is managing director of Landauer Associates, Inc., Real Estate Counselors, in New York City. He has written numerous articles on appraisal, economics, and finance, as well as contributing to *Selected Readings in Real Estate Appraising.* He is the author of *Real Estate Valuing, Counseling, and Forecasting.*

The study presented in this article was carried out under the auspices of the Sylvan Lawrence Research and Data Center of the Real Estate Institute of New York University. Funding was provided by the National Council of Real Estate Investment Fiduciaries.

The second part of this article, "Profile of the Modern Appraiser," will appear in the October 1987 issue of *The Appraisal Journal.*

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The survey also concentrated on Appraisal Institute members who are recognized as appraisers of income properties, that is, those providing net operating income (NOI) from tenancies or readily estimable on owner-occupied properties. Although the survey of membership and client opinions and attitudes did not so intend, the responses indicate that the answers came mainly from successful, investment-oriented urban appraisers, and hence may indicate a bias..

Extreme care was taken in the introduction to the survey questionnaire to elicit the need for opinions on the relative status of appraisers, rather than an explanation of how respondents had fared in their personal development and work experience. An effort also was made to evoke opinions directly from clients of appraisers on how appraisers compare to those in other professional pursuits, with special reference to occupations with which appraisers compete. This effort was not entirely successful because the appraisers' thoughts tended to be influenced by their own relative progress. The clients of appraisers were no more specific in their views.

I would like to acknowledge the intelligent and conscientious effort of Edward M. Zevin of the Sylvan Lawrence Research and Data Center, who accomplished most of the research and wrote a portion of the report. To Dean Norman Weinberg of the Real Estate Institute of New York University goes my special thanks for his unwavering confidence in the outcome of the study and in his highly accomplished editing. Last, Suzanne van de Velde and Mary H. Smith must be singled out for the efficiency of their proofreading and production of the finished report.

I would also like to express my thanks to the Appraisal Institute and its officers and members for their whole-hearted cooperation, and for the splendid assistance provided by its staff.

HISTORICAL SETTING

From 1950 through 1965, the United States was in the midst of a 15-year period of economic euphoria and tranquility. This period was marked by very low inflation, correspondingly low interest rates, mild recessionary episodes, and a steady but moderate increase in Gross National Product (GNP), employment, and disposable personal income. Investment real estate was generally in supply-demand balance and patches of significant oversupply were rare. In 1960, for example, internal rates of return (IRR) were around 8%, while mortgage money for 75% to 80% of the value of real estate was available at 5% to 6% interest. In 1965, the Pan Am Building was financed at 5% interest on a 30-year self-liquidating mortgage loan.[1] Property was positively leveraged through conventional financing. A reasonable amount of amortization was paid out of cash flow while leaving sufficient

1. John Robert White, *Real Estate Valuing, Counseling, and Forecasting, Selected Writings of John Robert White* (Chicago: American Inst. of Real Estate Appraisers, 1984), 189.

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income for the developer or investor. Balance sheets had real meaning and did not require what some investment analysts regard as the added prop of appraised values as a substitute for the book value of the improvements.

POLITICAL-ECONOMIC EVENTS AND APPRAISAL METHODOLOGY

In this setting, there were no significant external incentives for changing appraisal methodology. The earlier writings of Frederick M. Babcock, H.E. Hoskold, and Irving Fisher ruled, along with the 4th edition of *The Appraisal of Real Estate.*[2] Babcock's book was a classic in its time.[3] The various residual capitalization techniques used William Inwood's or Hoskold's sinking fund depreciation. The need to forecast future income annually on the assumption of major changes in future lease rentals was never felt. The future was today. Flat rental projections were in vogue. The cost approach to value was still given weight early in the period, on the grounds that there was insufficient market evidence of value in the income capitalization and sales comparison approaches. The tedium of estimating an elusive reproduction cost, reduced by various equally elusive calculations of physical, functional, or economic depreciation, still prevailed.

The emphasis in rental property, however, was shifting slowly to increased reliance on income capitalization. Although not yet articulated, this method really evolved from a broadly considered overall sales comparison approach. The approach takes into account the comparability of rent, vacancies, operating expenses, real estate taxes, and rates of return. The pure sales comparison approach was somehow confined primarily to land sales and was never really in the forefront of appraisal methodology, except for its relatively rare application in income capitalization. Few appraisers, then or now, agree that there is only one way to derive market value–by comparison–and that the three legs of the valuation stool are the mechanisms by which to estimate market value comparatively. Nevertheless, at the time, income capitalization was considered to be most important. The thesis that every technique is basically comparative was dismissed as theoretical by most appraisers.

THE FEDERAL HIGHWAY PROGRAM

In the mid-1950s, the federally funded interstate highway program was conceived and initiated. The effect on appraisers and the appraisal function was profound. Routes were devised over almost endless tracts of vacant land, usually around the outskirts of the main cities, frequently in a circumferential fashion and sufficiently far removed from the central business district (CBD) to permit the land to be acquired less expensively. Because unimproved land

2. American Inst. of Real Estate Appraisers. *The Appraisal of Real Estate.* 4th ed. (Chicago: American Inst. of Real Estate Appraisers, 1964).
3. Frederick M. Babcock. *The Valuation of Real Estate* (New York: McGraw-Hill, 1932).

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or farms were the major types of real estate, followed by homes and smaller commercial or industrial properties, the sales comparison approach was extensively utilized. Most major properties, those normally appraised by the appraisal elite in larger cities, escaped condemnation; appraisal action was primarily in the suburbs and the rural expanses of America.

This was not a business venture to attract people to the practice of real estate appraising. Nor was it a provocation to test the ingenuity of the valuation methodology at the time. Comparative land sales techniques improved simply because appraisers realized the importance of having accurate facts about each sale and because the court system demanded accurate data from appraisers in condemnation and tax reduction proceedings. These small advances tended to be offset, however, by the injudicious and sometimes unethical use of land residual capitalization in condemnation cases involving land with no foreseeable chance of subdivision and development. Between 1950 and 1965, appraisal was characterized by relative stagnate technique, but intensive volume of condemnation business.

URBAN RENEWAL AND ITS EFFECT

The 1950s and 1960s also saw the advent of widescale urban renewal. Under the prevailing federal statutes, the government, in effect, funded a community's effort to restore itself; sometimes in housing for the poor and disadvantaged, and frequently in complete renewal of portions of, or the whole of a CBD. Two of the best illustrations of highly successful renewal processes are in Boston, Massachusetts, and Stamford, Connecticut. In the former, the waterfront area adjacent to the CBD was effectively salvaged, while Stamford's plan successfully provided for a comprehensive reconstruction of the CBD.

Appraisers benefited greatly from urban renewal. First, there were the required condemnation appraisals of the areas designated for renewal. Second, a new land use plan had to be adopted, backed by a market study. Third; the selling price of the land, subject to the land use plan restrictions, had to be estimated. Although there were literally thousands of appraisal assignments throughout the country, this had relatively little effect on the development of appraisal methodology. A few appraisers, including the late William S. Ballard, MAI, Charles F. Seymour, MAI, and I, made a limited contribution by recognizing and articulating the impact of the specific land use standards and controls on market value. These factors tended to be more limiting than existing zoning restrictions and generally had a negative effect on market value. Participation in the formulation of the land use plan, and the need for a market analysis of the proposed quantities of uses out of the total market, broadened appraisers' horizons about the forces that lead to development motivations. Unfortunately for the appraisal profession, many

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of the market study assignments went to planners and economists because of appraisers' general reluctance to assume responsibilities outside the narrow field of real estate valuation.

THE REAL ESTATE INVESTMENT TRUST (REIT) DEBACLE

The REIT debacle of the 1970s did much to deprive appraisers of any luster they may have possessed. Under the misguided notion that money could always be effectively reinvested at a higher rate than its borrowing cost, mortgage, equity, and mixed REITs proliferated in the mid-1960s and thereafter. Reasonable lending criteria were compromised because of the pressure to invest. REIT staffs were generally young, inexperienced people who were not adequately supervised. Both internal staff and independent fee appraisers were caught up in this frenzy. It took only the hard money, high interest, depression-ridden days of the mid-1970s to expose the REITs' investments for their weaknesses, which led to foreclosures and bankruptcies on an unparalled scale. The calamity was caused by the inability of the REITs to pay the interest charges on borrowed capital because of insufficient revenues (interest) from investments in defaulted mortgage loans.

Appraisers' status was diminished significantly by these events. In retrospect, however, the primary problem lay with Wall Street's pressure on fund managers to accept more money for investment, regardless of the problems of managing growth effectively. Others explain this era in terms of the Federal Reserve Bank's policy, even before Chairman Paul C. Volcker, of being too restrictive with the money supply. It does seem that neither the appraiser nor the REIT entrepreneurs could have foreseen the severity of the interest rate rise which, with oversupply, bankrupted the REIT industry. How prescient could appraisers' employers expect them to be?

INTRODUCTION OF NEW TECHNIQUES

Two developments in the mid-1960s, one methodological and the other economic, provided the shock that was needed to stimulate the appraisal business. First was the introduction of the innovative theories of Leon W. Ellwood, MAI. Ellwood's mortgage equity capitalization method was the first real advance in appraisal methodology in 50 years.[4] Second was the onset in April 1966, of the country's first postwar credit crunch. This was triggered by the costs of the Vietnam war being financed by federal borrowing rather than by additional taxation. The economic tranquility of the previous 15 years ended and a 20-year period of increasing financial volatility began, culminating in a prime rate that rose from 9% in 1979, to 21% in 1980, and fell back to 10% in 1981. This financial volatility was predictably followed by a period of rapidly advancing inflation that reached a peak of 14% in 1979.

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4. L. W. Ellwood. *Ellwood Tables for Real Estate Appraising and Publishing* (Cambridge, Mass.: Ballinger Publishing Company, 1977).

Appraisers were not, of course, immediately aware, nor prepared for the consequences to real estate of budget deficits, surging interest rates, rampant inflation, and negative leveraging. The consensual outlook was for the economy to climb cyclically to successively higher inflationary peaks. Financial markets were beset with increasing volatility through 1981, and particularly from 1976 to 1981.

THE ELLWOOD ERA—A MAJOR ADVANCE IN PROFESSIONALISM

The creativity of Leon W. Ellwood, MAI, the originator of the Ellwood theory of mortgage equity capitalization, became apparent through his writings and teaching. Elwood's influence was particularly supplemented by his devoted friend and fervent supporter, James E. Gibbons, MAI, who was able to enunciate the Ellwood system of mortgage equity capitalization with greater clarity and meaning for appraisers.[5] Ellwood was the first appraiser to develop mathemetical approaches to revenue changes over a period of time, perhaps even annually, and to assert that stability, or flat rental, was not necessarily what the future held for real estate. He believed strongly in equity capitalization, recognizing that virtually every parcel of real estate is financed with a mortgage or is capable of being mortgaged. He also recognized that amortization payments—all other things being equal—constitute an increase in equity because a debt is being reduced out of cash flow.

Because Elwood originally intended that his system be taught as an algebraic exercise, there was significant confusion among appraisers. That situation was alleviated by Gibbons's teaching and mathematical skills, and the article "Ellwood Without Algebra," by Charles B. Akerson, MAI.[6]

INCREASING FINANCIAL VOLATILITY

In reviewing the economic and financial history of the period from 1950 to 1960 it is very evident that the increasingly higher long-term inflation rate that followed the April 1966 credit crunch was the single most important event to appraisers. Inflation ebbed and flowed following 1966. In brief periods, it produced a false sense of security about the severity of its effects because of stabilization at lower levels. In 1979, a more intense, much more volatile type of inflation took hold. The very severe 1974 to 1976 real estate and economic recession temporarily blunted the effects of inflation. The extreme prosperity of the late 1970s triggered a wild inflation accompanied by extreme swings in interest rate patterns that usually led to successively higher levels of prices and values. Some of the financial instability arose from the policies of the Federal Reserve System under Paul Volcker's leadership. The Fed chose to concentrate on containment of the money supply as the

5. James E. Gibbons, *Appraising in a Changing Economy: Collected Writings of James E. Gibbons* (Chicago: American Inst. of Real Estate Appraisers, 1980).
6. Charles B. Akerson, "Ellwood Without Algebra," *The Appraisal Journal* (July 1970): 325-335.

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dominant factor in restraining inflation, rather than on a more multifaceted program that would have given greater weight to movement in interest rates, credit, and a host of other economic factors.

THE COMPUTER REVOLUTION— A SIGNIFICANT DEVELOPMENT IN APPRAISAL HISTORY

In the early to mid-1970s real estate appraisal work utilizing computers was performed on large mainframe systems through time sharing. Initially, the applications were limited to entering income and expense components, projecting these forward at assumed inflation rates, and combining resultant cash flows with loan and depreciation factors to generate pretax, after-tax, and yield analyses.

Software became more sophisticated around 1976, with the advent of multilease analysis. This enhancement involved entering information on each lease in a property. Fifty to 100 items per lease could be entered, encompassing both current and future occupants of the space in question, to generate a rigorous projection of income.

The introduction of the personal computer in the early 1980s provided the mechanism to bring computerized appraisal techniques to firms that did not have a mainframe system or could not afford timesharing costs. In the early 1980s appraisal software for personal computers was in its infancy. The few programs were slow, hard to use, and sometimes produced incorrect results.

Since then, the number of appraisal software programs on the market has increased. Some of them are of a quite high quality, and provide the user with friendly screen interface, fast calculations, and a variety of reports. The market for programs is, in fact, oversaturated. There is no "industry standard" nor is there any benchmark or comparison of the capabilities of one program versus the other. Appraisers seeking to purchase a program for the first time must do a lot of research into the available software before making an appropriate decision.

Even though personal computers have brought increased appraisal capability to more firms than ever before, a word of caution is in order. Most noncomputer professionals look at the computer as a tool, with which they expect to push a button and get an answer. Even with the best software on the market, the quality of the appraisal will be only as accurate as the data entered and the care given to checking the numbers that emerge. The computer makes the repetitive tasks of changing one or two numbers and rerunning extremely easy, but some users tend to lose sight of the need for quality control because abuse of the system is so easy. In the hands of an irresponsible person, the computer becomes an artifact manipulated to achieve a misleading appraisal result.

SYNDICATION—A BIG BUSINESS

Before the passage of the Economic Recovery Tax Act (ERTA) of 1981, syndication was rather limited and confined primarily to the purchase of subsidized or nonsubsidized apartments for tax shelter purposes by affluent investors seeking to minimize their income tax liability. In the five years following the passage of the act, syndication blossomed as a powerful force that survived the Tax Reform Act of 1984 and will survive the Tax Reform Act of 1986. Some of the imprudent transactions in this period will be exposed for their weaknesses over the ensuing years, and in many cases, appraisers will have to defend their actions.

Many instances of mortgage foreclosures on syndicated property, principally apartment houses have already surfaced. To the extent a recession occurs, the incidence of failure will invariably increase. Among other reasons, many of these properties will be unable to pay the accumulated deferred interest in purchase-money secondary debt financing granted by sellers at below-market interest rate terms, which was possible under the provisions of the 1981 act. Appraisers have had some problems in trying to resolve whether at the same time, under the so-called bundle of rights theory, they can estimate different values for the same property, as dictated by the appraisal instructions, conditions, and assumptions furnished by the client.

THE APPRAISED VALUE BALANCE SHEET

In 1976, The Rouse Company, a major developer of regional shopping centers, decided to include in the company's annual report an appraised value balance sheet in addition to the standard book value balance sheet. As a development company, Rouse had long felt that its stock was fundamentally underpriced because its earnings-price relationship did not reflect the investment health of the company. The relative success and profitability of a development company are difficult to divine for the average shareholder. This results from the tendency of intense development activity to obscure the appreciation sustained by the completed centers, and by the probable success anticipated from the properties under development.

Rouse engaged a national real estate consulting firm, with which they formulated a basis for a review of internal appraisals made in a consultant-approved format and methodology by Rouse financial officers. This led to the adoption of similar activity by many other companies. In the case of one of Rouse's major competitors, Corporate Property Investors, the annual appraisals were not made by the investment company, but by the appraiser-consultant firm. Generally, the method had a very salutary effect on the stock market performance of the shares.

Recently, appraisers are being questioned about their capabilities in relation to appraised value balance sheets. Many critics have concluded that the valuations are optimistic. In the case of open-end real estate funds, they

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claim that the inconsistency of the results has inhibited some analysts from recommending their pension funds to invest in open-end funds. Similarly, due diligence appraisals are now a concern of appraisers because more attention is focused on results as a basis for a public issue of real estate stock or mortgage bonds. Overall, the increased size of urban complexes puts a greater responsibility on the appraiser to recognize every facet that affects value, especially where mixed uses are involved. Renewed attention on marketability and market analyses, as well as market value has positioned appraisers in an evergrowing web of responsibility for their actions.

CLIENTS' INSTRUCTIONS AND APPRAISERS' ETHICS

When clients dictate appraisal assumptions considered to be unrealistic, appraisers must refuse the assignment or disassociate themselves from the valuation result and indicate their reasons in the report. One of the most obvious examples of such assumptions is a market value of a development project assuming a 95% occupancy on completion. Ethical appraisers may operate on this assumption, but they must also make clear what the realistic absorption rate will be, the time required to achieve normal occupancy in that market, the supporting market reasons for their judgments, and the effect on value. Essentially, then, two appraisal results must be presented when appraisers are at odds with the client's instructions. There have been countless occasions when appraisers have refused to proceed further when their research reveals the misleading nature of the appraisal assumptions, and when the client has been unwilling to modify them to comform to the reality of the market.

In a recent interview, Glen M. Sanders, Vice President of Examinations, Federal Home Loan Bank, San Francisco, listed certain assumptions that appraisers make that are not necessarily correct or realistic in terms of the market:

1. A building is finished and rented.
2. The land has been rezoned according to the builder's prediction.
3. The soil is stable.
4. All the utilities are at the site and connected.
5. All fixtures and appliances manufactured off-site are installed.[7]

LIABILITY INSURANCE

The cost of liability insurance for financial services companies has skyrocketed in the past few years. Officers' and directors' liability, and so-called errors and omissions (E&O) policies are now virtually unobtainable except at prohibitive expense. The wave of suits and extremely high awards in liability matters have made appraisers acutely aware of their responsibilities and personal exposure to loss. The difficulty of obtaining insurance for

7. Glen M. Sanders. "Real Estate Loan Review Practices." *Bankers Research* (May 12, 1986):3.

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coverage that was always assumed and in the past did not represent an important part of the appraisers' operating expenses, has made appraisers very cautious and highly sensitive to the possible implications of their assignments.

The usual solutions of offshore coverage, self-insurance, and other means are currently under study. In the interim, appraisers must be conscious of the significance of every statement they make and of the need to have supporting documentation leading to a rational answer, or they may face a legal suit with the possible risk of loss of their net worth.

Areas of particular concern to members of the American Institute of Real Estate Appraisers include the startling increase in the cost of E&O coverage, which bears no relationship to actual losses experienced by carriers. "For some members, the cost has increased over 600% in the past two years despite the fact that no claims were filed," according to Richard B. Gaskins, Executive Vice President of the Appraisal Institute. Gaskins has said that the growing crisis in procuring E&O coverage is not due to unfavorable losses relating to appraiser claims, but rather the result of losses from claims against other professionals such as doctors, attorneys, and accountants.

Obviously, appraisers are taking a very careful look at self-insurance as a logical alternative. The outcome is not known, but it should cause the quality and accuracy of appraisal results to improve dramatically. This very beneficial result for the general public will have as significant an effect on appraisers as the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice. Obviously, appraisal fees will increase as well.

APPRAISERS' PUBLIC RELATIONS PROBLEMS

Historically, the appraiser has never been thought of as a controversial figure in the financial and investment world. An appraisal was rightfully considered an opinion of value in an imprecise science in which judgment prevailed. A series of limiting conditions and assumptions crafted by appraisers through their professional trade organizations provided further insulation from liability actions by clients, or by those claiming a grievance as the result of an appraised value.

Yet periodically throughout the post-World War II era, appraisers have been accused of incompetence, misjudgment, or unethical conduct. Because of the size of the project, administrators of the federal highway program were forced to engage many persons with backgrounds as brokers, managers, and property owners, but with insufficient training and skills in appraising. The extensive condemnation of hundreds of thousands of acres throughout the country led to a volume of appraisal that occasionally revealed the advocate or the incompetent. Judged in the context of the size of the program, the majority of persons did reasonably well in estimating market value.

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Urban renewal caused rumbles as well in the 1960s and 1970s. The problems, however, were primarily attributable to a misunderstanding of the appraisal requirements, or from rather obscure governmental instructions designed to clarify the "write-down" nature of land value, depending on the intensity of the land reuse, in which cleared land was frequently surrounded by only slightly better housing than that of the slums. Recently there has been considerable criticism by the Federal Savings and Loan Insurance Corporation (FSLIC) and the Federal Home Loan Bank Board (FHLBB) about the shoddy quality of appraisals of properties serving as mortgage collateral on loans made by the savings and loan industry. This has provoked governmental bulletins describing in painfully basic fashion the essentials of an appraisal report.

Events of the 1980s have tried the capabilities of the most skilled and knowledgeable Realtors and appraisers. The economic base roller coasted from an extreme peak of prosperity in 1980 and the first six months of 1981, to a relatively severe recession in late 1981 to 1982, followed by four years of unsurpassed prosperity. Interest rate volatility; real estate oversupply; high inflation followed by distinctly lower inflation and interest rates in the 1983 to 1986 period; a historical peak in stock market averages; and through it all, strong investment demand from pension funds, syndicators, insurance companies, and investment groups—all paraded by the appraiser in a confusing melange of events. Surely the difficulties caused by the extraordinary volatility of the times could not be laid at the appraisers' feet.

EDUCATIONAL STANDARDS IN APPRAISING

IS APPRAISING A PROFESSION?

On the founding of the Appraisal Institute in 1932, its president, Philip W. Kniskern, announced that as one of its primary goals "the Institute will foster the development of the science of real estate appraising and will elevate it to the level of a profession as it deserves."[8] Over half a century later, there are still serious doubts as to whether real estate appraisal has achieved these goals. Beginning in the 1960s, when professional institutions in general came under attack, articles appeared in *The Appraisal Journal* questioning the professional status of real estate appraisers. In the majority of cases those who analyzed the issue concluded that appraisal had not yet become a true profession. The criticisms continued, but in the 1970s, appraisers began to speak loosely of the "appraisal profession" as if it were already an accomplished fact. Then in 1979, H. Bob Stellmacher, MAI, announced the arrival of real estate appraisal as "the world's newest profession."[9] Stellmacher

8. Philip Kniskern, "A Message from the President of the Institute," *The Appraisal Journal* (October 1932):2.
9. Bob H. Stellmacher, "Real Estate Appraisal: The World's Newest Profession," *The Appraisal Journal* (January 1979):99.

admitted that it would be difficult to prove exactly when real estate appraisal had become a profession, but he pointed to public recognition as the key criterion for professional status. A few recent court decisions have also referred to the increasing professional status of the appraiser.

> Until recent years there were only a limited few people trained in the science of real estate appraising, but it has now reached a professional status that should be recognized by the courts. The American Institute of Real Estate Appraisers has developed real estate appraising to almost an exact science.[10]

Clearly, however, not only is the general public far from unanimous in its recognition of appraisal as a profession, but many appraisers themselves continue to deny the professional status of their field. A recent article in *The Appraisal Journal,* based on a study partially funded by the Appraisal Institute, examines what it calls "the failure of the real estate appraisal field to become a profession."[11] In order to examine this difference of opinion, it seems appropriate to begin with the dictionary definition of the word *profession.*

Webster's New International Dictionary provides the following definition of *profession*:

> 4a. A calling requiring specialized knowledge and often long and intensive preparation including instruction in skills and methods as well as in the scientific, historical, or scholarly principles underlying such skills and methods, maintaining by force of organization or concerted opinion high standards of achievement and conduct, and committing its members to continued study and to a kind of work which has for its prime purpose the rendering of a public service.

According to this definiton, the following characteristics are to be found in any profession:

1. Specialized knowledge
2. Practical and theoretical training
3. Continued study
4. High standards of competence and conduct
5. Rendering of a public service as a prime purpose

Further simplified, we may separate the requirements for professional status into two categories:

1. Education and training. The professional must receive and continue specialized training in a chosen field, both theoretical and practical, such as would qualify one as an expert.
2. Ethics and standards. The professional must be committed to the maintenance of high standards, both in the performance of duties and in relations with the public.

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10. *Newport Housing Authority, Inc. v. Hartsell,* Court of Appeals of Tennessee, Eastern Section, 533 S.W.2d 317 (cert. denied by Supreme Court) (1076).
11. James H. Boykin, "Review and Prospects for Real Estate Appraisal Education," *The Appraisal Journal* (July 1985):347.

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Although not an absolute requirement, the members of a profession often form professional societies for the purpose of expressing their professional viewpoint, undertaking various efforts on the group's behalf, and in general maintaining the high standards of the profession as a whole. Appraisers do not have a single all-encompassing professional organization, but the Appraisal Institute is the oldest, largest, and most prestigious. Since its formation in 1932, the Appraisal Institute has remained in the forefront of attempts to achieve professional status for appraisers.

An examination of the real estate appraiser's progress toward professionalism, first from the point of view of education and training, and second from the point of view of ethics and standards follows. Particular emphasis is placed on the efforts of the Appraisal Institute in these areas.

DEVELOPMENT OF THE APPRAISAL INSTITUTE CURRICULUM

One of the primary objectives of the Appraisal Institute at its founding was the advancement of the science of appraising through the establishment of educational standards for the profession of real estate appraising. These would encompass the general fields of knowledge with which an appraiser of real property should be acquainted to understand and perform the function of evaluating interests in real property.[12] The original idea was to accomplish this by using the Appraisal Institute as a forum for discussion and self-education among the leading appraisers from various parts of the country. In this way, appraisers would be able to achieve a "greater unanimity of thought and procedure than now exists."[13]

Continuing education seminars in which appraisers can meet and discuss important issues are still an important component of the Appraisal Institute's education program. However, a serious attempt at establishing a uniform body of knowledge for appraisers was shelved for nearly half a century in favor of providing facilities for basic training in appraisal technique. The success of its first "Case Study Course," held in 1935 on the University of Chicago campus, convinced members of the demand, as well as profitability, of such instruction. Since then, the Appraisal Institute has expanded its efforts in this area. Courses are offered on the campuses of various colleges and universities across the country. (Many appraisers list in their professional qualifications the university's name in describing the courses they have taken. Because the university has no control over the course content and assumes no responsibility for the program or its instructors, this is misleading and unethical.)

The number of courses offered by the Appraisal Institute has also expanded. With the implementation of examination requirements for the

12. Harry Grant Atkinson, "Recollections of the Founding of AIREA," *The Appraisal Journal* (October 1972):291.
13. Kniskern, p.2.

Member, Appraisal Institute (MAI) and Residental Member (RM) designations, enrollment in certain Appraisal Institute courses became practically mandatory for candidates. By the early 1960s, a basic curriculum of required and elective courses in real estate appraisal had been developed. Further changes have generally been forthcoming in response to new developments and problems faced by the appraiser. For example, initiation of a course on "Condemnation Appraising and Court Testimony" was an obvious reaction to the increased volume of condemnation activity and subsequent litigation in connection with the federal highway and urban renewal programs of the 1950s and 1960s. A more recent emphasis on capitalization theory and quantitative methods reflects the importance of these new developments in appraisal technique in the 1970s and 1980s. The recent expansion of the Appraisal Institute's curriculum is also an indicator of the widening of the scope of activities considered appropriate for a real estate appraiser, as reflected by new courses in valuation, investment, and market analyses. Indicative of a current emphasis on uniform standards in the appraisal field are new courses on report writing and standards of professional practice. The curriculum is continually updated. The Appraisal Institute now offers a "hands-on" computer course in connection with investment analysis.

OTHER CURRICULUM DEVELOPMENTS

In 1979, the appraisal program of seminars offered by the national organization and its regions and chapters began to expand. The Appraisal Institute has sponsored seminars and conferences since its early days in an effort to provide an "open forum" for qualified appraisers. The current list covers a wide range of subjects, such as Applied Sales Comparison Approach, Appraising Conservation or Preservation Easements, Electronic Spreadsheet in the Appraisal Office, and Hotel/Motel Valuation.

In another major restructuring of its educational curriculum, begun in 1980, the Appraisal Institute expanded its introductory courses, added new courses, and updated established courses. Annual updates ensure that the curriculum is abreast of changes in real estate economics. In addition, course designations have been coordinated with the Appraisal Institute's examination requirements.

PROBLEMS IN APPRAISAL EDUCATION

Given the Appraisal Institute's efforts in the area of education, it is somewhat surprising that the major criticism leveled at appraisers in their attempt to gain professional recognition is deficiency in educational standards. In the late 1950s, real estate education in general was criticized as being too heavily oriented toward licensing and examination requirements.[14] Along with a new emphasis on professionalism in the business world, writers of the 1960s

called for an expansion of the appraiser's role, which in turn necessitated an expansion of the appraiser's educational background. Although it was generally accepted that appraisers were "specialists" in their field, in 1960 Robert K. Brown pointed out that "the specialist's understanding of particular concepts and techniques must depend, in the first instance, on a thorough grounding in the general principles which condition and to a large degree determine the more specialized variables.[15] Although Brown turned to the Appraisal Institute to initiate such "generalist" educational requirements for its candidates, it rapidly became clear that the Appraisal Institute could do little more than offer its own specialized courses in basic appraisal techniques. Dr. William N. Kinnard, Jr., MAI, stated in 1968 that "most 'educational' opportunities represent training for specific applications rather than basic education," while Dr. Richard U. Ratcliff pointed out that "absorbed in procedure the appraiser has neglected the systematic development and study of the basic science—the economics of real estate production and the real estate market."[16] In the late 1960s, Dr. Paul Wendt criticized the Appraisal Institute's curriculum as being too rigid, resulting in the institutionalization of various techniques and practices and the stifling of innovations.

As early as 1954, Ernest M. Fisher pointed out that real estate is an economic and social resource deserving to be in the collegiate curricula.[17] Ten years later, Boyd T. Barnard, MAI, was still complaining about the lack of response from the academic community. "Appraisal groups should not be relied upon as the source of education for this specialty in the real estate field. Colleges and universities must recognize that it is their responsibility for basic education in any profession. [18] The problem is that real estate appraisal has, as yet, failed to achieve general recognition as a professional discipline. This is somewhat of a "Catch 22" situation. While academic institutions may refuse to offer courses for the real estate appraiser until he has achieved professional status, Dr. Ratcliff pointed out that "no group has attained this blessed state without complementary facilities for education and research in our institutions of higher learning."[19] As a result, universities offering the kind of real estate curriculum designed to give the appraiser the desired generalist background are few and far between. Some notable examples are the undergraduate and graduate programs of the Department of Real Estate,

14. Jerome Dasso and Lynn Woodward, "Real Estate Education: Past, Present, and Future—The Search for a Discipline," *AREUEA Journal* (Winter 1980): 404–416.
15. Robert K. Brown, "The Need for Generalists in the Appraisal Profession," *The Appraisal Journal* (April 1960): 219–220.
16. William N. Kinnard, Jr., "The Approaching Crisis in Appraisal Education," *The Appraisal Journal* (April 1968): 167; Richard U. Ratcliff, "A Restatement of Appraisal Theory," *The Appraisal Journal* (January 1964): 53.
17. Ernest M. Fisher, "What Should Be Included in a Real Estate Curriculum?" *The Appraisal Journal* (July 1954): 359.
18. Boyd T. Barnard, "The Future of Appraising," *The Appraisal Journal* (April 1965): 187.
19. Ratcliff, p. 52.

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School of Business Administration at the University of Georgia, Athens, Georgia; the Department of Real Estate and Urban Economics, School of Buisness at the University of Wisconsin, Madison; and the Department of Real Estate at the University of Connecticut, Storrs.

THE APPRAISAL BODY OF KNOWLEDGE

In part, the difficulties encountered by real estate appraisal in relation to academic institutions stem from a general problem with the appraiser's public image as a professional. More particularly, appraisal has been denied the status of a professional discipline because of the lack of a generally accepted uniform body of knowledge. Two decades ago it was pointed out that "there are critical inadequacies and divergencies between theory and application in the present state of appraisal education," and that "there remains a considerable and long-term task of formalizing existing knowledge, expanding it and providing the facilities through which it may be transmitted to the practitioner."[20] Little has been accomplished in the meantime. A 1985 study of real estate appraiser education, cosponsored by the Appraisal Institute and the Homer Hoyt Institute, concluded that one of the major reasons why real estate appraisal has failed to become a profession within the past two decades is "the incoherent effort to articulate an educational curriculum either within universities or among the disjointed and feuding appraisal groups."[21]

In an effort to remedy this situation, in April 1985, the Appraisal Institute set up a Task Force on The Common Body of Knowledge. The stated purpose of the task force's proposed research project was twofold:

1. To identify and outline the component parts of the appraisal body of knowledge that define the current minimum requirements for the MAI and RM designations
2. To utilize the derived body of knowledge to initiate a process of developing continuity in the presentation of appraisal concepts, methods, and techniques

OTHER EDUCATIONAL ACTIVITIES

Since its inception 35 years ago, The Appraisal Institute's Research and Educational Trust Fund has awarded nearly half a million dollars in scholarships, research grants, and awards to individual appraisers whose work has helped to advance the profession of real estate appraising. The fund also promotes the advancement of appraisal education through the development of educational seminars and appraisal publications, such as *The Dictionary of Real Estate* published in 1984. The Appraisal Institute also is the foremost publisher of real estate appraisal literature in the United States.

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20. Kinnard, p. 166; Barnard, p. 184.
21. Boykin, n.11

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At its November 1985 meeting in New Orleans, the Appraisal Institute's Governing Council approved the establishment of a research department to provide direction and continuity for theoretical and applied research in real estate appraisal. The department's first two projects are a membership profile survey and an update of the Appraisal Institute's *Real Estate Appraisal Bibliography*.

GENERAL MEMBERSHIP REQUIREMENTS

Changes in the Appraisal Institute's curriculum, as well as criticisms of its shortcomings reflect a widening of the real estate appraiser's expected areas of competence. As a result, requirements for membership in the Appraisal Institute have expanded. Initially, membership was based on a review of no less than 10 appraisal reports and two recommendations from independent credit agencies. No written examination was required. Although the reports did not have to be perfect, the standards adopted were so high that less than 25% of those who applied were able to qualify. In an effort to expand membership, first the "junior" appraiser, then the "candidate" designations were established to distinguish these persons from full MAIs. Through the formulation of the candidate program, achieving the MAI title was made similar to the receipt of a college degree. Candidates are required to secure a sufficient number of credits through completion of a designated number of courses, the passing of specified examinations, and the preparation of a qualified demonstration report. In 1968, the RM designation was added for individuals who had demonstrated ability in the valuation of single-family dwellings and in two-, three-, and four-unit residential properties.

Although candidates are still required to provide recommendations as to their good moral character, integrity, and general fitness for the designation applied for, the requirement for 10 appraisal reports has been simplified to receiving a passing grade on a single, highly specialized demonstration appraisal report. The RM's report must relate to a one- to four-family residential property, while the MAI's must be on the valuation of an income-producing property. The report must satisfactorily demonstrate the candidate's ability to handle at least two forms of depreciation, and the proper analysis and development of net income.

Other requirements for the various Appraisal Institute designations have undergone some interesting changes in the last two decades. Age requirements—(21 for a candidate, 23 for the RM, and 28 for the MAI)—were dropped in the late 1970s. In the early 1970s, an attempt was made to expand the previous educational requirements for candidacy from a high school education to the equivalent of a four-year accredited college education. By 1975, this latter requirement had been restricted to those seeking MAI designation. However, as of January 1, 1987, individuals applying for either designation are required to have received an undergraduate

college degree from an educational institution approved by the National Admissions Committee. There are no provisions for equivalency.

EXAMINATION REQUIREMENTS

Before 1973, RM candidates were required to pass the Appraisal Institute's Examination No. 1 or IA, after Course I—basic principles, methods and techniques—was expanded into two sections. In 1973, this requirement was changed to passing the new Examination No. 8, taken in conjunction with the course on residential properties. In 1980, this examination was split into three parts: 8-1, Real Estate Appraisal Principles; 8-2, Residential Valuation; and 8-3, Standards of Professional Practice.

MAI candidates are also required to pass the Appraisal Institute's Examination No. 1. When this was expanded into two sections, both Examination 1A on the fundamentals of real estate appraisal and Examination 1B on the income capitalization approach were required, whereas the RM had only been held responsible for 1A. In addition, MAI candidates are required to pass Examination No. 2 on urban properties, one "special" or elective examination, and a Comprehensive Examination. As with Examination No. 8 on residential properties, the course exams required for MAI designation were split into several sections after 1979. Examination 1A became 1A-1, Real Estate Appraisal Principles; and 1A-2, Basic Valuation Procedures.

Between 1980 and 1983, Examination 1B was split into three parts; in 1984, this was simplified to Examinations 1B-A and 1B-B, Capitalization Theory and Techniques, parts A and B.

Examination No. 2 became 2-1, Case Studies in Real Estate Valuation; 2-2, Valuation Analysis and Report Writing; and 2-3, Standards of Professional Practice.

Once again, new concerns of the Appraisal Institute are indicated by the inclusion of examinations on report writing for MAI candidates, and on professional standards for both MAIs and RMs.

PROFESSIONAL EDUCATION/CERTIFICATION PROGRAM

In November 1979, the Appraisal Institute's Governing Council approved the development and operation of a Professional Education Program designed to enhance the professional competency of all MAIs and RMs through continuing education. Certification, lasting for three years, is part of the program and is acquired after completion of 60 hours of approved educational activities over a three-year period. Appraisal Institute seminars and courses are approved for certification credit. The program is solely for MAIs and RMs, not candidates or non-Appraisal Institute members. According to the education director of the Appraisal Institute, the program is highly successful. About 50% of the members participate in the program by taking

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courses or seminars offered by the Appraisal Institute; another 30% receive certification through other means. The remaining 20% is generally made up of retired members, or members presently holding nonappraisal jobs.

EXPERIENCE REQUIREMENTS

In addition to a basic training in appraisal methodology, candidates for professional designation are required to have a certain amount of previous experience in the real estate business. In recent years these requirements have been simplified to focus more on experience connected with the valuation of real estate. Although the required number of years of field appraisal experience has remained the same for both MAI and RM candidates, the total number of years of experience required, which would include general real estate business, was reduced in the early 1970s from five to three for RMs, and from seven to five for MAIs.[22]

At the same time, the scope of acceptable appraisal experience has been significantly widened for MAI candidates. Requirements for the RM designation have remained stable since the early 1970s with three years of real estate experience, including at least two years of residential appraisal experience. At present, the MAI is required to have five years of creditable appraisal experience, three of which must be specialized appraisal experience. In addition to experience as a field appraiser, such specialized experience can now include three years as a review appraiser, a real estate analyst-consultant, or teacher of appraisal. These developments not only demonstrate the growing importance of appraisal within the real estate business, but are also indications of the expansion of the appraiser's role in recent decades.

ANALYSIS OF EDUCATIONAL PROGRAMS

The Appraisal Institute has an impressive record of performance in diversifying and strengthening its educational courses and seminars over the years. It has also been responsive to the political and economic times in its ability to organize and offer courses of contemporary meaning and interest. I can offer only two constructive suggestions for course improvement. First, there is still a very obvious deficiency in report writing because of the natural tendency to concentrate on the so-called boilerplate, at the expense of sentence structure, vocabulary, and semantics. More must be accomplished in this respect. The Appraisal Institute has recently taken a step in the right direction through its experimentation with team teaching for its report writing course, in which instruction is shared by a practitioner in real estate appraisal and an expert in writing skills.

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22. Field appraisal experience is defined as personal investigation, estimation, and field appraising of real estate value, including the written reports, some of which must bear his or her signature as a professional appraiser.

Another suggestion for course improvement concerns the degree of emphasis on market analysis. These courses are few compared to the vast array of specialized appraisal courses. Perhaps some expansion would be appropriate here, especially in feasibility, which has its own unique meaning and is an extension of marketability and market analysis. Overall, however, the Appraisal Institute is to be commended for its educational programs. The Appraisal Institute's principal need is to recognize the distinction between college-oriented courses that should stress theory, market structure, and the role of real estate in relation to the economy and the GNP; and the more mechanically oriented "how to do it" courses that it must teach. The colleges are attempting to address both these needs, and usually at the expense of what Dr. Ratcliff referred to as the "basic science."

ETHICS AND STANDARDS OF PRACTICE IN APPRAISING

In 1982, the Appraisal Institute celebrated its 50th anniversary. In his "Message from the President," John D. Dorchester, Jr., MAI, stated that "it is fascinating to observe that the economic and professional conditions leading to the formation of the Appraisal Institute in 1932 bear a striking resemblance to those of recent time."[23] There is a striking difference as well, however, in that the years between 1932 and 1982 provided appraisers with a half century of experience in modern appraisal problems. Particularly through the efforts of the Appraisal Institute and with recent technological advances, appraisal methodology has been advanced and refined to a level of sophistication undreamed of during the depression years of the 1930s. As a result, there has been a shift of emphasis within the Appraisal Institute, and although there are many similarities between the current crisis in real estate and that of 50 years ago, the response of appraisers has shown marked differences.

REASONS FOR CREATION OF THE APPRAISAL INSTITUTE

During the real estate boom of the 1920s, appraisal work was carried on largely by persons who lacked any special competence in the field of valuation. By the end of the decade, the amount of overfinancing based on misleading or inaccurate appraisals had reached alarming proportions. The 1930s' economic recession brought about a collapse of values. Real estate owners defaulted on their mortgages, real estate bond issues stopped paying interest, and real estate corporations went into bankruptcy and receivership. In 1932, the Appraisal Institute was established to help remedy this situation. Stated simply, the primary purpose of the Appraisal Institute is threefold:

23. John D Dorchester, Jr., "A Message From the President of the Institute," *The Appraisal Journal* (October 1982): 492.

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1. The advancement of the "science" of appraising
2. The selection and identification of competent individuals for membership
3. The control of its members through disciplinary powers

In the 1930s, the emphasis was clearly on following the order of these objectives.

During the Depression, the standards of market value seemed to have disappeared. Sales were few, limiting the number of comparables from which an appraiser could choose, while erratic economic conditions meant that current prices were unreliable for comparison. Any prediction of the future was extremely risky. The public saw appraisers as close to, if not, charlatans. At best, appraisers were simply considered inefficient. Among appraisers themselves, there was no consensus on how their problems should be dealt with. As a result, one of the major tasks set before the Appraisal Institute in its early years was to rethink the basic concepts of valuation; and, in the words of the founding president, Philip W. Kniskern, "to develop an agreement, which does not now exist, as to sound, proper, and reasonably uniform procedures for each of the varied appraisal problems."[24]

The Appraisal Institute's emphasis on functioning as a forum for arriving at useful standards by which to measure value, implies that the major problem is faulty, rather than fraudulent appraisals. Abuses do exist, but until proper appraisal procedures are established there are obvious difficulties in classifying any appraisal as "improper." Even the Appraisal Institute's original set of Rules of Professional Ethics seemed as concerned with appraisers' methodology as with their honesty, and included much that would now be classified as Standards of Professional Practice.[25] Discussions of ethical problems in *The Appraisal Journal* have tended to revolve around relations between members of the Appraisal Institute and proper use of the MAI designation, rather than the abuse of the appraisal procedure.

As the decades passed, the Appraisal Institute proceeded with its work and the established body of knowledge for real estate appraising continued to grow. At the same time, however, economic conditions were changing, and with them the role of the appraiser. World War II stimulated the American economy and the real estate market. Appraisers were able to report higher valuations, and because these were borne out by the market, the image of appraisers improved. The main fear was that government regulation would interfere with the profits of the American businessman. Whatever its effect on the economy as a whole, government regulation in the postwar period resulted in a significant volume of business for appraisers without any regulatory shackles.

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24. Kniskern, "A Message From the President", p.2.
25. For the Institute's original "Rules of Professional Ethics," see *The Appraisal Journal* (July 1933): 368-370.

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LEGISLATIVE ENACTMENTS SPUR APPRAISING VOLUME

Two basic legislative enactments were primarily responsible for the high level of appraisal activity in the 1950s and 1960s. As discussed previously, both the federal highway program and urban renewal legislation stimulated a great demand for real estate appraisers in condemnation proceedings and reuse appraisals. Appraisers became the experts to whom the government, courts, and the public turned for accurate valuations of real property. As a result, there was general consternation when condemnation proceedings began to reveal wide divergencies between the valuations of individual appraisers. Despite the efforts of authors in the *The Appraisal Journal* to convince the public of the possibility of honest divergencies, the public was not easily convinced. The Appraisal Institute had accomplished one of its tasks all too well—the public assumed that appraisers were competent; therefore, divergencies were the result of fraud. *The Appraisal Journal* began to carry discussions concerning the ethical extent to which an appraiser can act as an "advocate" of the client. Helpful hints were given as to how an appraiser should act when called as an expert witness in court, in order to avoid personal liability.

The Appraisal Institute was determined to police its own ranks. At a meeting on May 6, 1961, its Governing Council adopted a new resolution designated as Regulation No. 12, to become effective July 1, 1961. The Appraisal Review Committee (ARC) was established, "empowered to review and take appropriate prescribed action in cases where two or more MAIs and/or candidates representing opposing litigants testify to value, damages, or benefits in a judicial proceeding or any other public hearing."[26] The volume of business that came before the committee was overwhelming. An early report on ARC's progress stated that between May 1961 and the end of 1965, the committee reviewed 2,123 files, 638 of which were still being processed; 1,424 had been closed; and 61 referred to the Ethics Committee, which can admonish, reprimand, suspend, or expel the appraiser. It was stated that "there are a great many cases where the deficiencies are not matters of ethical violations as such, but are shortcomings which ARC feels can be materially lessened by corrective action and continuing education."[27] In 1971, however, the Appraisal Institute's Committee for Special Research Project on Divergencies in Right-of-Way Valuations recognized the importance of ethical considerations as well:

> The AIREA Appraisal Review Committee has acted as a major deterrent to advocacy among its Members and Candidates, as indicated by its findings. This encouraging trend has resulted in the refusal of appraisal assignments from clients with pre-conceived ideas of market value and damages, and to some

26. Laurence Sando, "Appraisal Review Committee: Its Purpose and Function," *The Appraisal Journal* (April 1966): 229.
27. Ibid., 231.

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extent has impressed upon the legal profession that the professional services of a Member or Candidate are not for hire as an advocate.[28]

It was added that the success of ARC was indicated by the decreasing number of files to be reviewed.

This decrease in ARC's activities may also have been a reflection of the changing economic climate. The inflation of the 1970s offered lucrative opportunities to the appraiser outside of government condemnation proceedings, and once again, the business community became more respectful of those appraisers whose high valuations could be realized in the market. At the same time, the advent of computer technology added to the sophistication of the appraiser's product. More than an expert, the real estate appraiser was moving closer to the status of an advisor, if not a true professional.

In the late 1970s and early 1980s, the economic climate became much less certain, and appraisers were accused of reacting slowly to the new environment. On December 24, 1980, an article entitled, "Critics Contend Chaotic Economy Makes Appraisal Worthless" appeared in *The Wall Street Journal*, criticizing the current applicability of the traditional three approaches to real estate valuation. Appraisers had responded to a similar crisis in the 1930s, by admitting their technical deficiencies and forming the Appraisal Institute to arrive at common solutions to current problems. By the 1980s, appraisers could claim in response to their critics that appraisal methodology had indeed reached a level of sophistication that allowed it to contend with the problems confronting appraisers in an erratic economy. In a series of replies to *The Wall Street Journal* article, several appraisers affirmed that they indeed possessed the tools to make accurate appraisals in a changing market.[29] The major problem apparently, was a general misunderstanding on the part of the client as to the appraiser's proper role, the methodology to be used, and the definition of market value. As a result, in recent years the Appraisal Institute has placed a great deal of emphasis on insuring proper communication between the appraiser and the client, from the statement of the assignment to the writing of the final report.

The responses to *The Wall Street Journal* article also pointed out another, perhaps more serious problem. Although appraisal methodology has developed along with the economy, not all professional appraisers keep current; a poor appraisal can be the fault of the appraiser. The issue becomes that of insuring that appraisers use the most modern and effective methods in arriving at a valuation.

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28. "Divergencies in Right-of-Way Valuations," *The Appraisal Journal* (October 1971): 492.
29. "Can Appraisers Appraise Today?" *The Appraisal Journal* (April 1981): 271-278.

PROCEDURAL CHANGE IN ETHICS AND STANDARDS ENFORCEMENT

On January 1, 1982, The Appraisal Institute implemented a new procedural system for the enforcement of its Code of Professional Ethics and Standards of Professional Practice, as provided in Regulation No. 6. An important change from the old regulation was that the new system's enforcement procedure was to be based on eight regions rather than the organization's individual chapters. Not only had many inconsistencies been discovered from chapter to chapter, but it also had been difficult to find enough people at the local level who could be sufficiently detached and uninvolved with any individual member to be impartial.

More significant, however, was the separation of the Appraisal Institute's Standards of Professional Practice from its Code of Professional Ethics. First, the previous code, found in Regulation No. 10, was amended so that what was formerly simply referred to as "disciplinary rules" were now divided into "Ethical Rules" and "Standards Rules." On January 1, 1983, the Standards Rules were taken out of Regulation No. 10 and made into a separate document known as "Standards of Professional Practice," leaving Regulation No. 10 simply as a "Code of Professional Ethics."

In effect, the new enforcement system recognizes that ethical and standards violations are quite different matters and have to be treated differently. Thus, the first step taken when a complaint reaches the Director of Screening is to determine whether it involves a possible violation of the Standards of Professional Practice or of the Code of Professional Ethics. Standards violations are generally seen as being the result of ignorance rather than dishonesty, so such complaints are sent to a Review and Counseling Committee with disciplinary competence extending primarily to counseling of the offending member or candidate in writing.

FAULTY APPRAISAL TECHNIQUES

The Appraisal Institute's enforcement system reflects its belief that many faulty appraisals are the result of appraisers who fail to stay abreast of modern techniques, a problem that presumably can be corrected by counseling appraisers on proper procedure. For this to work, however, the Standards themselves must be updated as new techniques are introduced. Unfortunately, as the real estate industry becomes more complex, it also becomes more difficult to agree on uniform standards of professional practice. In the early 1980s, record high interest rates led to the widespread use of creative financing, that is, seller financing at below-market interest rates in sales to syndicators and others. This added to the prices of properties, although it was questionable whether the accrued interest and other costs could be recaptured over a reasonable period. As a result, there was considerable overextension of loan portfolios, particularly among the savings and loan associations that were taking advantage of the 1982 deregulation of

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the banking industry. The number of savings institutions forced to close in the final months of 1985 was the highest since the Depression. The problem of unique financing was also a concern to appraisers of syndicated property. Recently such properties have been in default because of inability to pay the heavy current or deferred interest charge. In May 1985, the Appraisal Institute adopted a new set of Standards of Professional Practice that require that the effect on market value of "atypical" financing be estimated and included in the appraisal report. At the same time, it was determined that a continuing series of Guide Notes for applying the Standards to hypothetical appraisal assignments was to be added to the Standards of Professional Practice to aid appraisers in dealing with specific problems.

As much as the Appraisal Institute might avow that faulty appraisals are usually the result of honest mistakes, it does recognize that this is not necessarily the case. In August 1984, the president of the Appraisal Institute, Reaves C. Lukens, Jr., MAI, met with members of the FHLBB to discuss the problems facing savings and loan institutions. According to Lukens, "The FHLBB has accumulated a substantial number of appraisal reports of such atrocious quality they would be an embarrassment to most of us. Some of the work reflects a lack of skill, but the majority of it seems to indicate advocacy on the part of the appraisers involved.[30] Such ethical violations are dealt with by the second branch of the new enforcement system, Ethics Administration. Recognizing that ethics violations can also result from ignorance, the disciplinary actions available range from 1) admonishment, 2) censure with publication, 3) suspension of member, and 4) explusion of member, to 5) termination of candidacy, with educational alternatives offered for 1 through 3.

It is difficult to judge the success of this new system. A look at the number of disciplinary actions taken suggests that the aim of uncovering guilty parties takes precedence over the task of lessening their number. The statistics, however, do show that the committees have not been lacking in business.

WHEN IS AN APPRAISAL SOMETHING ELSE?

When is an appraisal not an appraisal, but something else? The Appraisal Institute has experienced considerable confusion over this question. Its 1985 publication of the Code of Professional Ethics and Standards of Professional Practice tried to clarify the issue. Standards Rule 2-7 states that an appraiser is permitted to make an "appraisal report" that is "something less, or different from, the complete appraisal report that would otherwise be required... ."In the accompanying explanatory comment regarding Rule 2-7, the Appraisal Institute states that it would prohibit any report that would mislead or confuse the client, the user of the report, or the public. Incorpora-

30. Reaves C. Lukens, Jr., "Professionalism," *The Appraiser* (October 1984): 2.

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tion of revelant material by file references is suggested as one means of relieving the situation. The rule as stated accomplishes little, and lacks the definitions necessary to provide any insight into what is permitted in a nonappraisal report.

However, in the "Explanatory Comments Relating to the Code of Professional Ethics," a distinction is made between *an appraisal* and *an appraisal assignment.* The latter covers the formal, documented report rendered by the appraiser as a disinterested third party, and calls for "an unbiased report of the nature, quality, value, or utility of interest in or aspects of real property." Presumably, an appraisal or appraisal report, as the terms are variously employed, permits all other activity, such as marketability and feasibility studies, investment analyses, consultative work, and arbitration. Any report containing material relating to the foregoing is considered for ethical purposes as an appraisal report, regardless of other titles employed. When taken in conjunction with the newly recognized right to charge contingent fees, it is evident that the Appraisal Institute has yielded to its general membership in liberalizing the basis on which ethical conduct is to be judged. All of this is logical and practical. The confusion could be avoided by labeling all work for a client other than an appraisal assignment as an "evaluation," or "investment analysis."

The Appraisal Institute's insistence on having the MAIs under its total ethical control for all their business activities appears to have created the uncertainty over what constitutes an appraisal assignment as opposed to any other activity. This has been further complicated by the Appraisal Institute's leniency, as set forth in Comment E.R., 3-3, which allows an appraiser to accept what amounts to a preliminary and indirect contingent fee to investigate market value on an unbiased basis. If the client agrees with the valuation result, he or she presumably would then engage the appraiser to prepare a formal appraisal as part of an appraisal assignment. The obvious intent of this provision is to satisfy the needs of appraisers engaged in condemnation and tax abatement assignments. It apparently enables these specialists to be paid for their "unbiased" opinion of market value, while the client decides whether to engage them to perform the full, formal documented report.

This procedure makes good sense for all types of appraisal assignments, not only those in which condemnation and tax abatement are involved. Simply stated, clients pay to determine whether the appraiser agrees with them or not. However, this has placed many appraisers in an awkward position when a noncontingent appraisal assignment is requested by another client. The client must expend a full service fee without knowing whether the appraiser's opinion will be in agreement with his or her own views. All of this puts pressure on the appraiser to estimate a value that is at least sympathetic to a client's position, and exposes the appraiser to bias pressures when he or she is supposed to be acting as a disinterested third party. Why not adopt a

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more practical policy of conceding that within the bounds of propriety, all appraisers are advocates for their clients? This would eliminate the present double standard. Obviously, full disclosure of the appraiser's position and role is essential to observance of the ethical requirements.

ENFORCEMENT OF THE APPRAISAL INSTITUTE'S CODE OF PROFESSIONAL ETHICS AND STANDARDS

At present, nearly 100 alleged violations of the Code of Professional Ethics and Standards of Professional Practice are referred to the Director of Screening each month.

There is no denying that the new system has its problems. The primary one is the length of time involved between receipt of the complaint and final determination of the case. In part, this is an unforeseen result of the general recognition of the importance of the MAI designation in real estate appraisal. The courts have ruled that if membership in a professional association has a substantial effect on the "relevant market," the association must adopt admission and disciplinary procedures that conform with "due process" requirements. The essential elements of due process of the law are "proper notice" and that everyone has the "opportunity to be heard." The Appraisal Institute admits the difficulties encountered in implementing what is still a new procedural system, but claims that these are being corrected. While formal hearings for only nine cases were held in 1985, the Appraisal Institute expected to hold 40 more in the next 12 months.

CERTIFICATION AND UNIFORM STANDARDS

The Appraisal Institute alone cannot solve the problems facing the appraisal industry, primarily because it has no jurisdiction over the majority of appraisers practicing today. As of April 1, 1987, the Appraisal Institute included 5,205 MAIs, 1,313 RMs, and 10,716 candidates. This total of 17,234 is quite small when compared with the alleged 200,000 to 250,000 people calling themselves appraisers. This number would be even smaller if one were to exclude those who are merely candidates for professional designation, as well as dues-paying MAIs and RMs who do not practice real estate appraisal on a regular basis. A recent estimate indicates that the Appraisal Institute currently represents only about 3% of practicing appraisers in this country.

Even if all accredited appraisal organizations were included, it has been estimated that their members would represent a mere one-quarter of the people in the marketplace calling themselves appraisers. Attempts to merge the various appraisal groups into a single all-encompassing organization have repeatedly proven unsuccessful. Most recently, in May 1985, a proposed plan for consolidation of the Appraisal Institute with the Society of Real Estate Appraisers did not receive the required two-thirds majority vote of the

members of both organizations. Areas of concern expressed by members included the question of whether or not the new organization would be affiliated with the NATIONAL ASSOCIATION OF REALTORS,® (as is the Appraisal Institute), and the proposed altering of requirements for Appraisal Institute designations.

The failure of the Society to accept merger conditions in which it would fairly and reasonably have the opportunity to grant the MAI status over an agreed time period, and the provincialism of the Appraisal Institute in adopting an independent course of action have severely damaged the appraisal business and its members. The end product of the failure to merge has been the elimination of any current chance of either organization to claim professional status.

Given this situation, the Appraisal Institute and other appraisal organizations have advocated some form of state or national certification. At present there is no federal legislation concerning the licensing of appraisers. Only 12 states require licensing. All of these have widely varying requirements. In most of these states only a broker's license is required. Only Nebraska and Oregon have a separate licensing classification for appraisers. In November 1985, the Governing Council of the Appraisal Institute approved a resolution to permit the president or his designees to work with legislators and regulators to develop a national certification program for the appraisal profession, similar to the Certified Public Accountant Program for the accounting profession. Several states have already expressed an interest, and the Appraisal Institute has appointed a task force to draft model legislation for the certification of real estate appraisers.

The legislation is aimed at setting up a national Real Estate Appraisal Board that will consist of a combination of "public" members and real estate appraisers, all of the latter being members in good standing of a nationally recognized appraisal organization. This board will be responsible for establishing requirements and procedures for issuing certificates to state certified real estate appraisers. This will involve defining the levels of education and experience required of certified appraisers, and the requirements of periodic renewal of certification; reviewing the standards for the development and communication of real estate appraisals; and establishing disciplinary proceedings for those who fail to uphold such standards.

As a first step, in May 1986, an ad hoc group of representatives from the eight largest appraisal organizations in North America, including the Appraisal Institute and the Society, adopted a set of uniform professional standards for the entire real estate appraisal industry. These are the same as the revised Standards of Professional Practice adopted by the Appraisal

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Institute in May 1985. Organizations subscribing to these uniform standards are:

American Institute of Real Estate Appraisers (AIREA)
Society of Real Estate Appraisers (SREA)
American Society of Appraisers (ASA)
American Society of Farm Managers and Rural Appraisers (ASFMRA)
Appraisal Institute of Canada (AIC)
International Association of Assessing Officers (IAAO)
International Right of Way Association (IR/WA)
National Association of Independent Fee Appraisers (NAIFA)

While the effort to establish national certification through a board approved by the various states is both essential and commendable, it appears that appraisers have the cart before the horse. A critical precondition is the need for the Institute and the Society to merge and produce a plan for the ultimate merger or switch of individuals from the myriad other organizations. The full force of what the Appraisal Institute seeks will be lost until the two qualifying organizations present a unified front.

HOW SUCCESSFUL HAS ENFORCEMENT BEEN?

The Appraisal Institute has conscientiously exerted every effort to create and maintain high ethical and practice standards since its founding in 1932. The task has been made more difficult since the 1960s by a growing resort to the threat to use civil rights and due process as a basis for escaping any punishment for gross ineffectuality, deliberate violation of rules, or obvious advocacy. Increasing sensitivity to human rights, together with the nonhomogeneous nature of real estate, have enabled many appraisers to avoid admonishment, censure, or more.

There is no single arbitrary figure of value that can be relied on as "the truth," in appraisal. This makes it very difficult, if not occasionally impossible, for any committee of the Appraisal Institute to conclude with certainty the relative guilt of an appraiser, although in a nonlegal sense such guilt may be more apparent. Furthermore, the offending person may elect a court defense in which the issue may not be as clearly understood by a jury.

Nevertheless, the Appraisal Institute's very earnest enforcement of ethics and standards has had an extraordinarily salient effect. If nothing else, it has made members much more aware of their responsibilities to their clientele and to the general public. Conscientious adherence to high standards is, in the long run, a greater deterrent to the possible compromising of an answer to an appraisal problem. Occasional incidences of departure from Appraisal Institute standards will also diminish as better educated and more dedicated people are attracted to the field.

Vigilance in administrating the Code of Professional Ethics and Standards of Professional Practice is essential. Otherwise, a marginal few will

sense a letdown in enforcement, to the detriment of the Appraisal Institute and members who are willing to play by the rules. Thus, strong committee action on a continuing basis is critical to achieve success. The Appraisal Institute has been very impressive in its dedication to the maintenance of high professional standards. The administration of ethics and standards by staff and committee members has been efficient, conscientious, and analytical, while the rights and sensitivities of the members have been scrupulously protected. All in all, the Appraisal Institute can be proud of its achievements in a complex and difficult business environment.

PROGRESS IN APPRAISAL METHODOLOGY

In the period from 1960 to 1985, the cost and sales comparison approaches seemed to lag in terms of any significant improvements in methodology. The income capitalization approach, however, was the beneficiary of two extraordinarily substantive improvements that appear to have vaulted the appraiser from a rather pedestrian occupation into the possible ranks of a true professional, at least in a liberal interpretation of the definition. Events subsequently occurred, which, at the time were difficult to evaluate without a historical perspective, and the significance of which was not then fully appreciated. In the one instance, one man made a critical contribution to capitalization technology. In the other, the consequences of a raging inflation prompted several astute appraisers, computer software experts, and mathematicians to produce both separately and in combination the use and application of lease-by-lease analysis and discounted cash flow (DCF) on an annual basis.

THE NEW CAPITALIZATION ERA

The man who contributed to capitalization methodology was Leon W. Ellwood, MAI. At his retirement in 1973, Ellwood was senior vice president and chief appraiser of the New York Life Insurance Company. Ellwood had many disciples but his most faithful and infinitely patient one was James E. Gibbons. Gibbons, a scholarly man of deep intellectual capability and exceptional writing ability, in many instances sacrificed his own business time to teach the gospel of mortgage-equity capitalization by the Ellwood method.[31] The salient point of Leon Ellwood's method is the assumption that market value is specifically defined as "the present worth of all rights to future benefits arising from ownership."[32] The future, according to Ellwood's method is not "now," but truly ahead. He conceived the mathematics of his method and then published a book in 1959, in which he reflected on what future income expectations could reasonably be attained. Interestingly enough, Ellwood was perfecting his method in the early 1960s, a period of

31. Gibbons, Chap. 7, n.5.
32. Ellwood, p.1, n.4.

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economic tranquility, when most appraisers were not thinking beyond tomorrow in their property valuations. He pointed out that values could rise or fall, and that the property should be given credit, all other things being equal, for the equity appreciation resulting from reducing the actual or presumed mortgage debt on the property over a five- to ten-year projection period. He felt that appraisers had not recognized that the payment of amortization reduces liability on a property on an individual's balance sheet, and contributes to the increase in the property's net worth.

The original problem with Ellwood's method was the algebraic nature of the formulas. The typical practicing appraiser, especially the older ones without extensive educational backgrounds, did not fully understand, or reacted poorly to the need for solving algebraic equations. The resentment and confusion that followed was difficult to appease, despite the efforts of Gibbons and others. In 1969, a major step in the use of Ellwood's method was achieved with the publication in *The Appraisal Journal* of an article by Charles B. Akerson, MAI, entitled "Ellwood Without Algebra."[33] According to Akerson, the mortgage equity rate could be developed without special symbols and formulas. Familiar amortization schedules and compound interest tables could be used to develop the same capitalization rates as shown in the Ellwood Tables. While Akerson by no means simplified Ellwood's method to the level required by some older members, he did remove some of the mystique, fear, and misunderstanding held by many.

From 1960 to 1976, Ellwood's method gradually dominated capitalization. Its use surpassed the land and building residual techniques employing Hoskold or Inwood sinking fund factors. It made appraisers more conscious of the future and more aware of the effects of mortgage amortization on capital appreciation. Many lending institutions would not put an appraiser on its approval list for mortgage purposes without the appraiser having a demonstrated mastery of the Ellwood method. Teachers Insurance and Annuity Association was in the forefront in this respect.

Through the years the Ellwood method was able to withstand the criticism made by those who resisted change or feared the unknown. One criticism deserving response is the use of pretax rates of return and yields. In actuality, this is the way in which the real estate market operates, that is, on a pretax basis. How would one appraise otherwise, in light of the various entities in which property ownership is held? The sole proprietorship, the partnership, the typical corporation, the life insurance company, the thrift institution, the pension fund, and the individual, all may have different investment objectives and tax liabilities. Pretax overall rates of return were and still are the accepted way to quote a property's success. As Gibbons pointed out, a few simple, further steps could take the appraiser to an

33. Akerson, n.6.

after-tax equivalency basis, as custom-crafted for the legal entity in which the property was held.[34] In no sense does the basic pretax nature of the Ellwood method invalidate it as a capitalization method.

A SEVERE INFLATION PROVOKES NEW COMPUTER-BASED METHODOLOGY

Many authors had warned and in some instances complained in the late 1960s about the increasing volatility in financial markets, the topsy-turvy nature of interest rates, and the increasing inflation since the first credit squeeze in 1966. Ellwood and Gibbons saw the necessity for forecasting the future, no matter how risky that prediction might be. In the immediate recovery period in 1977, following the full three-year real estate recession of 1974 through 1976, a group of professionals saw the computer as a means to combine new techniques of income and expense forecasting with a more advanced and computerized method for finding "net present value" (NPV). This group included computer experts from Decisionex, Inc., a Connecticut based computer software company; some professionals from the staff of Landauer Associates, Inc., Real Estate Counselors, in New York; several mathematically minded trust company bankers; and several developers. Computers had been in widespread use previously, but a major breakthrough did not occur until 1977.

At that same time, these real estate professionals had been puzzling over the increasingly more complex task of recording on a spreadsheet basis, the future course of rental income, especially for office buildings and shopping centers, cases in which lease terms tend to be of long duration and complex. The lack of uniformity in the leases created difficulty as appraisers were asked to value the more substantial buildings for various purposes. Computerized lease-by-lease analyses had previously been available, but the software lacked depth, breadth, and flexibility.

THE LXL/DCF METHOD

The new computer-based forecasting and capitalization techniques evolved from 1976 to 1980. There was no one author or creator, but many contributors; nor was there a name for the techniques. Because it did not burst on the scene like Ellwood's book, but simply developed over a period of time, the significance of the new methodology was initially not comprehended. For want of a name, it is referred to here as the LXL/DCF capitalization method because it combines a detailed forecast of future rents (lease-by-lease analysis) and expenses with computerized discounting of the estimated NOI or DCF.

The real estate recovery surged, in a breathtaking way, after January 1977. Inflation came back strongly after the mid-decade pause and became

34. Gibbons, n.5.

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ingrained almost as a way of life. Thus, market pressure intensified the need for a computerized method for valuations, to increase the efficiency and accuracy of the process. Decisionex, Inc., with the assistance of several real estate professionals from different New York appraisal offices, was able to upgrade significantly the entries, depth, and flexibility of its so-called Quick system, which was able to accomplish what previously was considered unachievable on a printout. On a mainframe computer on a time-sharing basis, this innovative and pioneering software program could accept innumerable entries about property leases and operating expenses, and thus created a maximum degree of flexibility. Effective analyses for clients with complex buildings could now be offered with accurate printouts. This marked the end of manual calculations for spreadsheets, with all the glaring inaccuracies. The entries in the Quick system included, but were not necessarily limited to the following:

Rents per square foot and per floor
Lease commencement and termination
Lease options and renewals
Real estate tax escalation
Percentage lease provisions, if any
Expense escalation, including any "stops" or ceilings
Miscellaneous revenue
Vacancies and contingencies
Rent increase on termination
Assumed percentage of tenant move-outs on lease expiration
New tenant work letter cost per square foot
Existing tenant work letter cost per square foot
Automatic substitution of new rents
Automatic substitution of new expenses
New tax and operating escalations terms
Compounding of future rent increases
Compounding of future expense increases
Sublet provisions
Assignment provisions
Vacancy provisions during relocations
Spinout of old rent and escalation terms
Spinout of any irrelevant data
Mortgage amount
Terms of interest and amortization
Balance of mortgage at any time
Self-liquidation time
Prepayment provisions
Ground lease terms
Deferred interest circumstances
Discount rates and capitalization rates

The capacity to undertake a lease-by-lease analysis was a giant step forward for real estate appraisers. It made Ellwood's method almost completely obsolete for large scale buildings. Ellwood's system relies on a weighted mathematical average or, as the term was used, "stabilized equivalent level annuity," for forecasts. Later, the Ellwood method incorporated use of the "*J*-Factor," which adjusted for an equivalent increasing or decreasing annuity. Under the LXL/DCF method, the full effect of any and all individual lease changes on an annual basis are entered into the computer so that much more accurate data emerges about the property's leases, operating expenses, and forecast of NOI. The Ellwood method was and is capable of annual lease analysis and discounting of each year's NOI. It is still sufficient for smaller, simpler buildings with a smaller number of tenants. However, when the lease terms are varied and the number of tenants is large, it is essential to use a computer program.

The algebra required in the Ellwood system has been programmed into the LXL/DCF software, including application of a series of discount and capitalization rates, permitting a sensitivity analysis almost instantly. The basic Ellwood tenets of income capitalization have been retained, except that there is less stress on the components of value, namely debt and equity. The computer has been programmed to accept NOI on a pre- or after-debt basis, depending on the circumstances, or on a pre- or after-tax basis, or both.

Again, Ellwood's basic belief in a reversionary value has been largely faithfully observed. The general concept is to forecast NOI annually over a 10-year period and discount each year's income at the selected discount rate. Then, as in Ellwood's method, NOI is stabilized and then capitalized by using a capitalization rate as a divisor (I/R = V). Finally, the market value established 11 years hence is deferred by use of the same discount rate.

Being able to do an accurate lease-by-lease analysis in an almost unassailable way through the computer, while at the same time, converting the expected income into market value, had a very strong appeal to appraisers. The process of entering rent as predicted at a certain growth rate when tenants vacate, discarding prior escalation provisions, providing for the competitive capital cost of refurbishing the space at the owner's expense, creating a new basis for real estate tax and operating escalation, providing for a vacancy period until rerental, entering all the new assumed terms of the rerental—all of this was heady stuff to appraisers.

The new methodology caught on quickly, however, especially after all the publicity surrounding the sale of the Pan Am building for $4 million in late 1980. In that instance, Decisionex's Quick software was employed. The results were unbelievably revealing. The enhanced income prediction enabled Pan Am to realize more money than its appraiser advisor and itself thought possible. The Quick program was, of course, available to owners and brokers as well as appraisers. A number of very useful programs for

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lease-by-lease analysis, similar to Quick were thereafter devised. One such program is Office-2.[35] At the same time, generic spreadsheet programs like Lotus 1-2-3[36] and SuperCalc[37] could be used on personal computers, for those wanting to do the calculations themselves. Although the latter programs lack the flexibility and depth of Quick, they helped to popularize the so-called spreadsheet method of estimating market value.[38]

In late 1981, urban appraisers became alarmed at what they foresaw as possible abuses of the LXL/DCF methodology. For example, it was easy to overestimate rents and rent growth, while understating expenses and expense growth. It was simple to use a discount rate that was lower than the market consensus. All this added to professional concerns about the ever-present problem, in one form or another, of misrepresentations of property values. An article was published warning appraisers and others of the potential for abuse in the manipulation of revenue and expense estimates and discount rates.[39] The precise effect of this article on the investment public is unknown. What is apparent now, however, is that relatively few professional appraisers were accused of manipulating figures for their own purposes. A new maturity that surpassed any other part of their history had seemingly enveloped appraisers.

The LXL/DCF method received the same criticisms as the Ellwood method. The principal criticism is that it is not a means of income capitalization, primarily because it dares to peer into the future, and therefore is only a means of "investment analysis." Those rendering this criticism seem to reject the method because it is not based on the present. On examination, it does appear difficult to select an overall rate of return, free of mortgage debt, without a detailed consideration of what the future holds for the property. Another criticism states that the method is workable only in an inflationary era. This could hardly be the case. What would happen if we had a severe deflation and an accompanying depression? The equation (I/R = V) would become much more of a guess about the future than the estimate of the appraiser equipped with a considered perspective about the downward course of future rents.

THE FUROR OVER R 41b AND R 41c[40]

The recent abnormal number of thrift institution failures accompanied by deficient appraisals prompted the FHLBB to issue Memorandum R 41b on

35. Office-2. New York, N.Y.: H.B. Pascal.
36. Lotus 1-2-3. Cambridge, Mass.: Lotus Development Corporation.
37. SuperCalc. Garden City, N.Y.: Computer Associates.
38. By the early 1980s, Decisionex introduced the Q-2 software program, which was made available on a license basis and less cumbersome, but with all the flexibility of the Quick program.
39. Robert A. Steele and John R. White, "Beware the Abusers of Internal Rate of Return Methodology." *The Appraisal Journal* (April 1982):204-211.
40. See David C. Lennhoff, "Why All the Ruckus Over R 41b?" *The Appraisal Journal* (July 1984):443; and "Letters to the Editor," *The Appraisal Journal* (July 1985):472.

March 12, 1982. This was followed by Memorandum R 41c on September 11, 1986. No methodological significance can be found in these memos, except for a warning to discount future receivable revenue, after all appropriate expenses, and provide adequate documentation on all aspects of the market. The 1986 memorandum also provided a new, improved definition of market value and is more detailed. It includes interesting material on the topic of "appraisal management." For some reason, the memos have created an unusual stir in the appraisal business, although there is nothing in them to suggest a governmental directive to utilize methods not already fully and customarily employed.

The litany of common errors in either R 41b or R 41c includes failures to obtain relevant data and instructions from the client, follow the agreed definition of market value, and document market support for the property, as if vacant and improved.

There is considerable reference in both memoranda to the lack of proficiency in market and economic feasibility analysis. This is at the very least embarrassing to the Appraisal Institute, suggesting that its members have not uniformly been able to develop this facility. The creation of a regulatory memorandum illustrates the periodic difficulty that appraisers have encountered in meeting and coping with changing economic and financial times. It also indirectly reflects the narrow body of market data and methodology that appraisers appear willing to deal with. In short, although appraisers' futures compel them to widen their professional capabilities, in many cases they appear unwilling to accept the challenge.

VARIATIONS ON THE COST APPROACH

Some appraisers have been using a revised cost approach that assumes that the valuation result is a definite ceiling of market value based on an overall consideration of market value through reconciliation of the three approaches. This group holds that the cost approach has not been properly calculated in previous years. It also holds that appraisers have minimized or ignored the significance of those periods in the market when, for example, the income capitalization approach will yield a much higher value. When this occurs, it may signal one or more of many circumstances. It may indicate an undersupplied market. It most certainly may be indicative of an overheated and perhaps inflationary market in which compounding of rent increases provokes higher market values by income capitalization. It certainly would imply that the market has achieved a peak at which caution must be exercised about future conditions.

Most appraisers are not qualified quantity survey cost estimators. In estimating market value, they almost universally use unit cost figures pre-

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pared by such firms as Marshall Stevens and the Dow Calculator. These basic unit costs are then adjusted by a local cost modifier that reflects local building and labor costs. One problem has been the appraiser's failure to add a sufficient amount to the basic cost for architectural, engineering, general and overhead costs, property taxes, marketing, and mortgage loan interest. These so-called soft costs add from 15% to 35% to the basic field (labor and material) cost. Traditionally, the market value of the land, presumably as if vacant, is added to this.

The above considerations on soft costs do not represent a new technique. What is represented is a modification of the cost approach based on the need to add the full range of soft costs to the hard field costs, depending on the type of building, the extent of the marketing effort, the period of time for construction, and construction interest charges at the time. Some appraisers believe that the developer, as an entrepreneur, is also entitled to a fee as much as 5% of basic costs for supervision and management of the construction process. There is also some merit in considering adding a presumed developer's profit, say in the 10% to 15% range, after all other basic building soft costs have been totaled.

A second modification of the traditional cost approach involves deciding whether or not the historic record of sales provides the correct estimate of land value. All other things being equal, the value of land under construction may be worth more or less, depending on the relative demand-supply balance, the price paid, or the apparent market value by past or current sales. The new way of thinking holds that the land may be entitled to some appreciation, if for no other reason than that it is actually being developed at the time of the appraisal, subject again to market circumstances.

> The analysis of the difference in value between the new, optimal property and the property being appraised leads to an understanding of the economics of real estate not obtainable from the other approaches.... Properly done, the cost approach tells significant things about the property: the value of the land, the reproduction cost in case of casualty loss, and why the (subject) property is not worth as much as similar new property or the optimal property.[41]

The net effect of this modification of the cost approach is to provide a more realistic market value without the embarrassment of an improperly calculated estimate that in a balanced market may only be 75% of the value obtained through income capitalization. When the value estimate derived from each of the three approaches varies significantly, the appraiser can now provide an explanation for the disparity.

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41. Max J. Derbes, Jr., "Is the Cost Approach Obsolete?" *The Appraisal Journal* (October 1982) :589-90.

DYNAMIC CAPITALIZATION[42]

Early in 1984, C. Gordon Blackadar, a senior appraiser with the Metropolitan Life Insurance Company, published a paper on dynamic capitalization. Blackadar is an outstanding mathematician whose grandfather and father had preceded him as actuaries with Metropolitan Life. While not an actuary himself, Blackadar applied his knowledge of math and actuarial principles in the formulation of his methodology. Blackadar's theory had its genesis in the extraordinary inflation that engulfed the country from 1977 through 1981, the effect of which was to erode the value of money equal to the inflation rate. Dynamic capitalization applies the actuarial theory of interest to the problem of capitalizing net income from real estate investments, as a means of precisely calculating the present value (PV) of an income stream in an inflationary environment. The method appeared as the nation was rapidly cooling off from a hyperinflationary period. Consequently, its acceptance and recognition has been slow because, at the time, appraisers were preoccupied with mundane matters such as analyzing the meaning of the current serious oversupply in many types of real estate, and of evaluating the significance of a possible long-term period of low inflation and interest rates, as was characteristic of the 1950 to 1965 era.

One of the major contributions of the dynamic capitalization formula is its quantification of the forces acting on real estate investments. For example, dynamic capitalization differentiates between cash flows fixed in nominal dollars, those fixed in nominal dollars but with periodic lease stipulated recoveries, and those determined by free market forces on a continual basis. In addition, the dynamic capitalization equation allows present value to be used to its best advantage because the actual timing of cash flows can be taken into account—that is, continuous increases in expenses, monthly rent collections, quarterly debt service payments, annual Consumer Price Index (CPI) adjustments, etc.

One benefit of applying the dynamic capitalization formula is that the appraiser can determine the real, rather than the nominal rate of return on a real estate investment. The real rate of return, the amount actually earned on invested capital after allowing for the erosion of purchasing power, is sometimes overlooked in the wake of double-digit internal rates of return (IRRs) pumped up by inflation. Blackadar's formula enables appraisers to break an IRR into its components—real yield and inflationary expectations. In doing so, it is often discovered that an income stream marketable under one set of inflation assumptions becomes unmarketable under another.

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42. We are indebted to C. Gordon Blackadar and to Charles E. Snoddy, Jr., Vice President of Metropolitan Life and member of the Real Estate Investment Committee, for their summarization of an extremely complex mathematical formula and explanation of the methodology. See Mr. Blackadar's article, "Dynamic Capitalization: An Income Approach in Real Dollars at Real Interest," *The Appraisal Journal* (October 1984):565-94.

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The dynamic capitalization formula can be relatively easily applied manually in appraising new and proposed properties. In situations where there are large numbers of existing leases, however, the formula requires too many individual calculations. To accommodate such cases, Blackadar has written a real estate investment computer software program employing the dynamic capitalization methodology. This program enables the user to complete calculations that would have taken hours or days, in minutes. It is particularly valuable for testing a variety of assumptions relating to yield requirements, inflation, depreciation, market rents, and other parameters without having to recalculate numerous spreadsheets. The program is especially useful when the appraisal involves proposed development.

It is too early to assess the degree to which appraisers will ultimately accept dynamic capitalization. Surely it is to be commended for its capability to increase accuracy in distinguishing between a real and an inflationary yield. However, real yields can readily be computed now with existing methodology. This is done by comparing projections and values without assumed inflation, with projections currently employing compound growth rates for revenue and expenses, together with higher discount and capitalization rates presumably in economic consonance with inflationary or noninflationary expectations. Many sophisticated developers will project NOI on a nongrowth basis, but employ an IRR more consistent with nongrowth to establish the downside potential of the real estate. Another question raised by the dynamic capitalization method is whether real estate lends itself, or requires the degree of accuracy and precision implied, when the answer tends to preclude a strictly mathematical solution.

QUESTIONNAIRE SURVEY RESULTS

Whatever the specific criteria required to qualify as a profession, an important precondition is that no field is accepted as a profession without some reasonable degree of public recognition. It is true that the general public has little idea of what appraisers are, and therefore is in no position to judge their professional status. Appraisers, however, have a public of their own—private and public clients and fellow appraisers, groups that could have very different perspectives on the matter. Therefore, it was important for this study to provide both an introspective and a public view of the professional status of appraisers, and objectively assess the progress appraisers have made in this regard in recent decades.

QUESTIONNAIRE RATIONALE

A special questionnaire with 20 questions was designed to elicit from a carefully selected sample of MAIs, their reaction to and opinion of the progress of the appraisal business since each one had begun practicing under his or her own signature on reports. Because of the subjectivity of the matters

being discussed, the questions were designed to give the appraisers a wide latitude in their responses. In addition, the respondents were encouraged to talk with others to gain additional insights from business acquaintances. As a result, the survey revealed a wide range of opinions, often expressed at great length and with such nuances as to make quantification of responses practically impossible. An attempt to tabulate statistically the results of the survey was discarded. Instead it was decided that a narrative description of the responses, along with some rudimentary estimates of their relative weight, would give the reader a feel for the various opinions expressed. For this reason, rather than aiming at a statistically accurate cross section of practicing appraisers, the bulk of the respondents were chosen from among the top practitioners of commercial real estate appraisal. Random selections were made as well. As a result, even opinions expressed by a single individual have been given due consideration. It should also be kept in mind that a single question might receive several different answers that are not necessarily mutually exclusive. Finally, more weight was given to survey responses that were detailed, thoughtful, and obviously well prepared. All responses will be kept on file for use as requested by the National Council of Real Estate Investment Fiduciaries.

A detailed presentation of instructions and explanations accompanied the questionnaire. A careful geographic dispersion was arranged. Some RMs were included, but the vast majority of questionnaires went to MAIs. Replies were received from MAIs all over the United States, representing excellent cooperation. Virtually all responses were forthright and very carefully reasoned, indicating that considerable time and effort were spent in answering the questions. The quality of the replies was very impressive. A similar, but not identical questionnaire was also sent to 100 users of appraisal services. The response for these was only 15%, indicating less interest or perhaps preoccupation with other matters.

APPRAISERS' VIEWS ON APPRAISAL

Basic Appraisal Methodology

The appraisers were asked to discuss recent improvements in the income capitalization, sales comparison, and cost approaches to commercial real estate valuation. Certain areas of change were mentioned with respect to all three approaches: 1) better collection and availability of data, 2)increased use of computers, and 3) recognition of outside factors (unusual financing, tax shelter, indirect costs, etc.) affecting value.

Many appraisers were quick to point out, however, that improvements in methodology can be undermined by individual appraisers who either fail to understand, ignore, or deliberately misuse such improvements. For example, three of the respondents stated that many appraisers have no idea how to analyze the vast amount of data that they now accumulate.

The majority of respondents felt that the use of computers in real estate appraisal is now taken for granted, but opinion on the extent of the benefits of such use varied widely. Two respondents acknowledged that computers make work easier for the appraiser, but denied that their use is necessary. Many others felt that the use of computers is limited, with seven respondents stating that they are only as good as the information entered. Many went even further and pointed out the dangers involved in improper use, particularly in cases in which they are used to improve the appearance of the appraisal report as a cover-up for shoddy work. As one appraiser put it. "The computer is making the good guys better and unfortunately making some of the bad guys look like good guys." Some respondents felt that computers can be positively harmful and pointed out that the computer may make reports faster, more detailed, and longer, "but the end result will most likely be the dehumanization of the appraiser."

> The computer is a fabulous tool, but its use involves some dangers. Programs introduce an element of mechanization which may take away from application of reasoning to individual items in the appraisal process. In mass appraisal, it is, of course, an absolute necessity.
>
> James E. Gibbons, MAI

> It has accomplished no special recognition for the appraiser, and it has generated no enhancement for appraisers over other professions. It is needed when considering alternatives and variables within a project, but the key element is still the appraiser's judgment.
>
> Peter D. Bowes, MAI

Opinions varied widely on the relative standing of the three basic approaches in contemporary appraisal technique. In general, it was felt that the income capitalization approach has progressed the most. Ten respondents mentioned the development of the Ellwood method of mortgage equity capitalization as a major improvement in recent decades. Several respondents felt that appraisal technique has already progressed beyond Ellwood, but only one went so far as to say that "the Ellwood method, useful at one time, now seems laughable to sophisticated critics." Nearly half of the respondents pointed to DCF analysis as the most important step taken forward in the income capitalization approach. Yet even DCF had its critics who emphasized the dangers involved when the technique is misused or abused. One appraiser pointed out that the technique is "too subject to input variations to be useful in valuation."

A minority of the respondents felt that proper use of the income capitalization approach has deteriorated in recent years, with three stating that the margin of error has increased as the technique has become more sophisticated. One respondent stated that DCF is not an appraisal tool at all: "The new income capitalization technology has addressed counseling more than appraising, but has been used as an 'easy' appraisal tool." One has to

question whether this type of response belies a lack of understanding of the LXL/DCF methodology.

The sales comparison approach appears to be the least controversial and aroused few comments. Only one appraiser felt enthusiastic enough to say that this approach has shown more improvement than any other area of real estate valuation. Another felt that it has actually lost ground, having been ignored in favor of income capitalization. One more appraiser simply stated that the approach is "vastly overrated."

There seems to be general agreement that the cost approach is presently the least important of the three. Opinion was fairly equally divided over whether or not this approach has progressed in recent decades, and no one felt that the progress has been substantial. Six stated that the approach has been neglected and its proper use has actually deteriorated, but they did not say that this is necessarily a bad trend. Five others stated that the cost approach is usually not relevant to the valuation task at hand. Only one appraiser felt that the approach deserves more consideration than it has been receiving.

Although there was no direct question to the following effect, it was interesting to observe that not one appraiser felt it necessary to support the thesis that there is only one overall approach to market value, the comparison approach, the three traditional approaches being comparative components.

One general comment on the subject of developments in appraisal methodology was made by several appraisers: "Changes" are not necessarily improvements. Rather, these developments should be looked on simply as adaptions to the way the market evaluates income property.

Dealing with Specific Problems

The responses to questions on appraisal methodology seem to reflect a general feeling that problems are not due to lack of progress in this area, but are the result of misuse, abuse, and lack of use of new methods by individual appraisers. This became particularly clear when the appraisers were asked about specific problems in modern appraisal technique. On the whole, they seemed to have a relatively low opinion of their fellows' success in responding to such problems and felt that there is a general lack of agreement on solutions.

Forecasting—Nearly half, 20, of the respondents stated that appraisers are inadequate when it comes to forecasting future value, as opposed to three who implied that despite their limitations, appraisers' abilities in this area are sufficient. Of the latter, one respondent stated that the problem lies with clients who ask too much, while the other two felt that it is possible to make accurate appraisals on the basis of predictions that later turn out to be faulty.

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Eight respondents felt that appraisers should avoid the problem of forecasting entirely by contenting themselves with looking at the past. Because all data are historical, accurate forecasting is impossible in any case. Twice this number, 19 respondents stated that appraisers should train themselves to become adequate forecasters as well as historians, but five of these also pointed out that the appropriate techniques have yet to be developed. Despite a generally low opinion of their abilities as forecasters, many respondents pointed out that appraisers are no worse than economists or any others who profess an ability to predict future economic events. It was somewhat discouraging to find that some appraisers generally do not appear to comprehend fully that forecasting, with all its obvious frailties, has not seriously been challenged; and that the present discounted worth of the future remains our most reliable value indicator.

> Unfortunately the generalization concerning most appraisers functioning in a historical reference is partly accurate. There is greater emphasis on detail rather than being a "generalist" trying to grasp a sense or feeling as to the direction of the market governed by the traditional forces of supply and demand. Appraisers are by temperment somewhat disinclined to predict future trends due to their generally conservative outlook. It is in the nature of our work to look back at what happened (sales data) rather than to look ahead at what most likely will happen. The truly professional appraisers will compensate for this by making a special effort to keep up-to-date by obtaining data not only on past transactions but current escrows, offers, listings, etc. Predictions concerning future values are fraught with pitfalls as evidenced by assumptions concerning future inflation rates and rental growth made just a few years ago in our cash flow assumptions. Nevertheless, it is in the nature of our business to make future projections. Quoting Justice Oliver Wendell Holmes, "All values are anticipations of the future."
>
> Ronald L. Buss, MAI

> My years in evaluation have caused me to develop certain strong convictions:
>
> 1. All investments in real estate are money.
> 2. The usual investment is a combination of debt and venture capital, what we appraisers call the mortgage-equity combination.
> 3. Any change in the value of money, in the absence of offsetting factors, will change the worth of its assets, whose values are expressed in terms of money. This is the big inflation problem.
> 4. Notwithstanding changes in the mechanics of appraisal, its essence is that the real estate interest to be valued must be clearly identified and described. A forecast must be made of future benefits, usually cash flows that will flow to the interest. An appropriate discount rate must be selected, reflecting the investment's risk qualities and maturity structure. And finally, valuation is accomplished through the arithmetic of compound interest discount.
>
> There is no doubt in my mind that there are many instances where there is a lack of mutual understanding between appraiser and client about the nature of the interest being appraised. Beyond that, there are the many problems that are

being highlighted in today's debate about proper definitions of value. Obviously, the great need is for education of clients and appraisers and ample communication between them. An appraisal is the answer to a question about some real estate interest, and the question need not always be what is fair market value of the fee simple title.

James E. Gibbons, MAI

Market feasibility studies—This appears to be one of the more controversial areas of modern real estate appraisal, with five respondents stating that this is the greatest weakness in appraising today. While a sizable majority of the respondents felt that no progress whatsoever has been made in the market feasibility analyses, only four voiced a need for improvement. Five appraisers criticized the whole idea of such studies, saying that they lead to overbuilding. The most negative view was expressed by one appraiser who felt that they merely serve as a smoke screen to disguise inadequate appraisals: "'Feasibility Analyses' and 'Market Demand Studies' are the biggest joke in our business. There is a real reluctance to take a stand and render an opinion, rather than manipulating statistics." Only five respondents felt that any progress at all has been made in this area. Opinion on the value of courses offered by the Appraisal Institute was evenly divided between those who felt that such courses are deficient and those who believed that younger MAIs are learning how to deal with this kind of market analysis.

Overbuilding in many facets of the construction industry has resulted in numerous entrepreneurs going down the proverbial drain. In my opinion these occurences are largely attributable to the inability of appraisers to interpret market absorption. A case in point—35,000 motel rooms constructed in Orlando oriented to Disney World in the early 1970s. Developers and lenders were shocked when for several years occupancy hovered in the area of 50% to 55%. Subsequent improvements in the economy and inflation resurrected many projects destined for failure.

Richard M. Hamilton, MAI

Determining Cash Equivalency—Responses were relatively divided on this, with somewhat less than half of the respondents admitting that they have problems with this technique. In general, there seems to be the conviction that urban appraisers who deal with this problem regularly are able to overcome any difficulties. Two respondents stated that they felt that the Appraisal Institute's new Standards of Professional Practice will help, but another pointed out that the 8th edition of *The Appraisal of Real Estate* ignores the problem entirely.

Relations with Clients

A recurring complaint of appraisers is the attitude of the client, who generally is characterized as failing to understand, or sometimes even care about, the processes involved in the valuation of a particular piece of property. With respect to forecasting, respondents stated that clients expect too much from

Report Writing

A great deal of attention has been focused on the appraisal report as the most important element in appraiser-client communications. Once again, appraisers' assessment of progress in this area is mixed. Although the majority of respondents felt that they have seen some improvement over the last few decades, most stated that this progress has been inadequate. Two respondents felt that appraisal reports are the most serious problem in appraisal today. While there is general agreement that the average appraiser's use of the English language is poor, there seems to be a difference of opinion as to the exact problem with current report writing. Five respondents stated that reports need expanded explanations for the benefit of the client, and expressed disapproval over a current trend toward shortened reports. On the other hand, 18 respondents felt that appraisal reports already have too much detail—referred to as "boilerplate," "Chamber of Commerce Data," or simply "selling by the pound"—four of these noting with satisfaction the trend toward shorter reports.

> Unfortunately, we overreacted to the old inadequate reports that stated, in effect, that the property was worth so much "because I say so." We became so preoccupied with documentation and attempts to "prove" value that we began selling our reports by the pound. The inclusion of unnecessary, and even irrelevant, information became commonplace. I hope that the pendulum is swinging back but none of us would want it to swing back too far.
>
> Charles B. Akerson, MAI

As a cure for poor report writing, five respondents recommended that new courses and Standards of Professional Practice be offered by the Appraisal Institute. A few appraisers expressed disapproval over such regimentation of report writing. One felt that the Appraisal Institute encourages appraisers to include more material than is really necessary in their reports, while another went so far as to state that the suggested Appraisal Institute format for an appraisal report "borders on being ridiculous."

With the advent of computer graphics, appraisers have become more concerned with the appearance of their reports, though many point out that sometimes this has been to the detriment of content. Nevertheless, very few appraisers denied the importance of good graphics in today's appraisal reports.

A final element in report writing with regard to the client is the appraiser's liability for his or her actions. One-half of the respondents stated that this growing problem has resulted in taking greater caution in the preparation of reports. Although the other half denied that they have ever made any changes in their reports, a few of these pointed out that doing so implies that proper care has not been taken in the past. A few expressed the fear that higher insurance rates would lead to increased appraisal fees. One appraiser proudly announced that he is still uninsured.

the appraiser; with respect to cash equivalency, that while appraisers understand the concept, clients do not.

An understanding with clients is crucial if appraisers are to perform their tasks adequately. The one question on which the appraisers showed most agreement was whether it is possible for a property to have more than one value. The vast majority, 43, said yes, as opposed to one "no" and one "maybe." This being the case, it is not surprising to find that several of the respondents went on to emphasize the importance of a clear definition of the particular kind of value being obtained for the client. Although there seems to be general agreement that there is a communication problem between appraisers and their clients, there is a great difference of opinion as to the source of the problem and the individual appraiser's success in handling it.

Opinion was fairly evenly divided on the question of whether communications between appraisers and their clients have improved in recent decades. Fourteen respondents felt that there has been no progress whatsoever. Of the 16 who disagreed, nine stated that they have seen "some signs" of progress, while seven respondents felt that there has been great improvement.

There seems to be general acceptance of the appraiser's responsibility in ensuring proper communication. When seeking a cause for misunderstandings, eight respondents put the blame on appraisers for not properly educating their clients. The client did not escape censure entirely, however. Four others accused clients of not going beyond "I need an appraisal" when giving out an assignment. Only one respondent stated that the appraiser was at fault for failing to understand an assignment, while two more felt that appraisers step outside the bounds of their knowledge when they try to act as consultants, as well as appraisers. Thus, appraisers get it from both ends—either they are communicating too little or too much to their clients.

> Financing techniques have tended to blend a variety of capital forms with a variety of property interests. These complexities of the last 10 years have tended to make the appraisal purpose more difficult to define. I believe in a good number of cases that the appraiser is not sufficiently educated to the precise nature of the assignment.
>
> Glenn J. Rufrano, MAI

> There has been no progress made in defining the appraisal purpose. In fact, I would say that there has been a regression in this area. The narrowing of the scope of the definition of market value by the FHLBB's so-called R 41b appraisals is a good example of this perceived regression. More attention needs to be addressed to the definition of the appraisal purpose. The enlightened appraiser interviews the client prior to undertaking the assignment in order to define more fully the purpose of the appraisal. The purpose of the appraisal should be as perceived by the client. The appraiser must be aware that sometimes even the client does not know what he wants; it is the appraiser's responsibility in these instances to counsel the client to the problem definition.
>
> Joseph Farber, MAI

It is my opinion that the more sophisticated the clients, the more likely they are to be capable of making quality distinctions, and the less likely they are to be fee conscious; they become aware of the fallacy of the statement that "an appraiser is an appraiser." Too many appraisers (perhaps due to "competition") do not charge enough for quality work.

Joseph Farber, MAI

I feel that the private client in this area is in a transition from looking at an appraiser as a house specialist. Many of them are still shocked at the amount of information, time, and work that goes into an income property analysis. Most of these clients are impressed by the AIREA educational requirements when they are informed. As to the professional standards, private clients generally accept them and understand our position. The same can be said of governmental agencies. However, many governmental agencies are trying to buy brains by the pound and are trying to obtain appraisals at the lowest possible cost. Unless there is a very large and difficult problem, most of them go with the lowest priced quote regardless of the quality of the work. There are still a large number of financial institutions that say all we want is a letter in our files to justify the loan we want to make. They appear to be looking for a scapegoat to point a finger at if the loan goes bad. They are attempting to reduce the amount of the fee and their loan cost. The recent financial crunch has made some institutions more sensitive to the quality of their reports. It has been my observation that many people apply their own ethical standards to the expectations that they have of others. In other words, a person who is extremely suspicious of being cheated is one who, given the opportunity, will cheat you.

Wilbert L. White, MAI

A slight majority of the respondents felt that appraisers have made some progress relative to other professions such as law, accounting, architecture, engineering, with 16 stating that they have made "major strides." Seven stated that appraisers' status has remained relatively unchanged. Only one respondent felt that appraisers have actually lost ground as a result of the field being demeaned by some of its members. Opposed to this view, however, one appraiser stated that recent troubles in the business have had the beneficial result of showing the importance of good appraisals.

Having started in the real estate business in Boston in 1925, I was in an era in which real estate salesmen and brokers were not rated very highly... .I was constantly irritated at the lack of esteem held for the professionals. The constant upgrading of the profession by the National Association of Real Estate Brokers (NAREB) and later by the Appraisal Institute have certainly improved the opinion of the public regarding the status of appraisers in recent years. It is my opinion that at this time, financial institutions and government agencies have considerable respect for our profession. I feel that the general public is still not well acquainted with our industry.

Theodore W. Slack, MAI

Only a quarter of the respondents felt that appraisers are now on a level with the other professions, and a nearly equal number stated that the general public does not agree. Only three appraisers stated that the general public places appraisers on a level with other professionals, as opposed to six

Professionalism

> Given various definitions of a profession and given the current educational standards of the AIREA, strictly or technically speaking, MAIs may be deemed "professionals" practicing a "profession." However, as stated in Black's Law Dictionary, a vocation must "receive the name" profession; which raises the question of from whom or what does one "receive the name"? It is my opinion that it is the layperson, "John or Mary Q. Public," who grants the name profession to a particular vocation. Furthermore, the layperson has yet to make said grant to the vocation of real estate appraising, not even to the top group of the vocation, namely the MAIs. The late Dr. Robert O. Harvey made this point in a paper addressed to the NATIONAL ASSOCIATION OF REALTORS® by saying "simply wishing will not make it so." In other words, MAI appraising meets the literal definition of a profession but not the common perception of a profession. It is the latter that really counts. With nearly 50 professional designations in real estate, 21 of which are in real estate appraisal, the public is confused to the point that, for many, the designations remain as merit badges to show accomplishment to others in their own field.
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> Joseph Farber, MAI

The respondents were asked several questions concerning the professional standing of appraisers, beginning with whether or not, according to the dictionary definition, real estate appraisal qualifies as a profession. To this question approximately one-half, 26, appraisers answered in the affirmative, as opposed to seven negative responses. An additional 17, however, qualified their responses in such a way as to imply a lack of professional recognition for appraisers as a group. For example, four respondents felt that appraisers are professionals in a general sense, but not according to the strict dictionary definition. Perhaps even more negative, one said that while appraisers qualify as professionals according to the strict dictionary definition, it is unlikely that they can be considered professionals in the general sense. Five respondents felt that the level of professionalism depends on the individual appraiser, and four more stated that there is too much unprofessional activity even among MAIs. One appraiser felt that younger appraisers have lost the sense of professionalism found among their elders, and one more simply stated that appraisers would *like* to be considered professionals. Even among the 26 who stated that they felt appraisers are professionals, five admitted that the general public feels differently.

> The public perception of the AIREA educational and ethical requirements and standards is currently nebulous at best. This is primarily a dual function between the recent negative press on "appraisers" and the confusion surrounding MAI designation and the average non-MAI practitioner. The many other appraisal organizations and designations tend to cloud the distinction between standards and requirements of the Appraisal Institute. The Institute needs to continue its advertising and create a clearer awareness by the public of the quality and ethics behind the MAI designation.
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> Donald M. Blake, Jr., MAI

their thoughts more towards what is happening in the world around them. From this information may come additional vital information relating to the future of the properties they are now appraising and a better understanding of the factors that are currently and may, in the future, influence real estate values.

John R. Garvin, MAI

I believe the public perceives the requirements as being difficult (to become an MAI, not just to be an appraiser). In my opinion, my education only *started* when I became designated. Course work was too oriented to number-crunching; not enough to understanding economic forces, real estate markets, how to research, using good judgement, ethics, etc.

Kathleen W. Price, MAI

There was much more agreement over the Appraisal Institute's ethical standards, although ultimately the response was anything but positive. Over half of the respondents felt that the ethical standards set down in the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice are good. Once again, however, there were about 10 others who had various reservations such as "too strict," "too loose," "too verbose and complex," and "too much emphasis on due process." The weight of these opinions was nearly reversed in regard to the enforcement of these standards. Thirty-one respondents stated that the Appraisal Institute's ethical standards have been poorly observed and administered, although a few of these noted that ethical matters are difficult to enforce in any case. Only nine expressed satisfaction with curent enforcement of ethical and professional standards.

Concerning administration of the Code of Professional Ethics and Standards of Professional Practice, I have two major complaints. First, not nearly enough people report violations to the Director of Screening; and second, the morass of data that has created a log jam. I feel as though complaints must be processed most expeditiously in order to create incentive for other violations to be reported. I know this is repetitious, but many, many appraisers I have talked to, who have taken the time and trouble to issue a complaint, are most discouraged because they have never heard or seen any results of those complaints, and state quite candidly they'll never do it again. This is a very bad situation in my opinion, and must be corrected if we are to achieve the status of a profession.

Warren Hunnicutt, Jr., MAI

These are admirable standards, generally endorsed by all MAIs but interpreted differently by individual MAIs when the pressure is on to satisfy the needs of a client. *Most* appraisers probably adhere to *most* of these standards *most* of the time. However, we deviate often enough to question our commitment to our "professional" integrity. It is also impossible to administer the necessary "police action" to keep the standards pure, because it is done by volunteers at the local level who find it difficult to sit in judgment of a fellow appraiser accused of something that they may also be guilty of—at least to some degree.

W. Reynolds Couch, MAI

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appraisers who agreed with the negative assessment of their own standing. In terms of educational requirements, the general feeling is that appraisers are lagging behind other professionals. Nearly half of the respondents felt that the educational standards of appraisers are less demanding than those of related professions like architecture or engineering, although six of these stated that the standards are more rigorous than those required of planners. Opposed to these, seven respondents felt that appraisers' standards are on a level with those of the related professions.

A key question in discussing the professional status of appraisers seems to be whether one is looking at appraisers as individuals or as a group. With regard to professionalism in general, only three appraisers specifically stated that they are gaining as a group. Ten appraisers stated that they are personally respected as professionals, but that others are not. In all, 17 respondents made the point that respect for the appraiser as a professional depends entirely on the individual appraiser. In addition to differences in the natural talents individuals possess, we have already seen that while most of the appraisers seemed generally satisfied with progress in appraisal technique, many pointed out that not all appraisers take advantage of new developments.

One possible means of distinguishing the professional from the nonprofessional appraiser is designation by a reputable appraisal organization, the most prestigious of which is the MAI designation offered by the Appraisal Institute. From the responses to the survey, it is difficult to judge the relative standing of MAIs among appraisers. Only six respondents stated that one must be an MAI in order to be respected as a professional appraiser. This seems to have resulted partly from the fact that many seem to have taken it for granted that when one says "appraiser," what is meant is "MAI."

Leaving aside the question of undesignated appraisers, however, it is clear that many respondents felt that even the MAI designation does not necessarily guarantee professionalism. To begin with, there was a certain amount of dissatisfaction with the Appraisal Institute's educational requirements. A slight majority of the respondents felt that the Appraisal Institute's educational programs are good, and respected by the general public. Ten, however, had doubts about the standards, with assessments ranging from "mediocre" to "bad."

> Current educational requirements for the valuation business are not as demanding as the requirements for the other professions. The requirement for just a college education does not specifically address general areas of knowledge related to the valuation field where some knowledge and background should exist. Examples of these are economics; general planning; economic geography; finance accounting; marketing; and other factors that influence regional, area, and community development patterns. There are many forces that drive and impact upon the real estate community and property ownership beyond just the neighborhood in which it is located. I believe our members should be directing

Once again, as with appraisal methodology, the problem with ethics and professionalism is not that the appraiser lacks the proper tools to be successful. New developments in appraisal technique, along with the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice would seem to provide adequate guidelines for any appraiser desiring to be respected as a professional. In the opinion of the appraisers themselves, however, there are simply too many appraisers who fail to take advantage of the opportunities that exist for advancing themselves as individuals or as a group.

CLIENTS' VIEWS ON APPRAISAL

Basic Appraisal Methodology

With respect to the three basic approaches to valuation, clients tended to focus on income capitalization as most accurately reflecting the thinking of buyers, lenders, and sellers. Not only do techniques such as DCF analysis help clients understand the approach, but the use of long-range projections, as opposed to values at a single point in time, actually reflect what the investing public demands. Clients appear to understand more clearly than appraisers that value must reflect future expectations for the property.

Except for the better accumulation of data through the use of computers, clients had little to say about the sales comparison or cost approaches to valuation. The appraisers themselves stated that they have little use for the cost approach. Although one client seemed to imply that this is really not the case ("Appraisers act *as if* clients no longer consider the cost approach useful"), others confirmed that the approach holds no interest for clients, and that the diminishing emphasis on costs is appropriate.

Most clients recognized the benefits that the computer can offer and noted that its absence would reflect poorly on the appraiser. None, however, felt that its use results in any enhancement of the appraisal field as a whole. "The computer is only a better pencil, calculator, typewriter, not a better appraiser!" I tend to disagree sharply with this consensus. The use of the LXL/DCF method has had far reaching beneficial consequences for appraisers that both they and their clients appear unwilling to appreciate. Granted that the appraisers' judgement is paramount, the computer has enabled more precise and accurate appraisals to be made and has significantly increased the utility of appraisal services. In the process, appraisers' status has been materially enhanced, despite their unawareness.

Dealing with Specific Problems

Forecasting—Practically all of the clients felt that appraisers are inadequate as forecasters, although one stated that this is not necessarily a bad thing. Eight respondents felt that it is important for appraisers to improve their skills in this direction, with two pointing out that new developments

such as DCF analysis have made forecasting necessary. One client added that appraisers already have the necessary tools to become reliable forecasters. A new slant on the problem was offered by one client who stated that appraisers do not always have access to current data, and blames brokers and owners who are "very reluctant to share the specific nature of 'the deal'; I don't blame them, considering many of the deals are zero cash flow!"

Market Feasibility Studies—Opinion was somewhat more divided on appraisers' skills in market analysis, but was still weighted on the negative side. Only three clients felt that there has been sufficient progress in this area. Ten disagreed, with one stating that this is the biggest deficiency in appraisal today. One client stated that there has been some progress in manipulating data, but there is a continued weakness in interpretation. Another felt that even the data are inadequate. One client complained that appraisers do not know the difference between "absorption" and "activity."

Determining Cash Equivalency—Responses were much more varied on this, perhaps reflecting some confusion over exactly what "cash equivalency" means. One client apparently did not even understand the question. Four clients stated that they did not think that appraisers have trouble with cash equivalency, although two of these did not sound very positive. Five stated that appraisers definitely have difficulties in this area. Three clients stated that it depends on the individual appraiser. One appraiser stated that his clients feel that "the person who has not had difficulty is extraordinary."

Relations With the Client

Report Writing—Opinions on progress in this area varied widely, from "notable improvement" and "getting better every year," to complaints that too many reports are "wordy, unclear and poorly organized," or "bare bones, standardized, and boilerplate." One client stated that "I am still painfully aware that New York City is on the eastern coast of North America in the United States of America, on the planet Earth." On the whole, all clients seemed to agree that there is still room for improvement in this area.

Defining the Appraisal Purpose—Once again, there was a wide range of opinion. Two clients stated that they have noted some progress in this area, while two others stated that it has never been a problem, one of these pointed to their "clear engagement letter" as the reason. Two clients blamed the appraiser for failing to understand or ascertain the purpose of assignments, but four others blamed the clients themselves. Two of the latter claimed that it is clients' misconceptions, rather than appraisers', that are at fault. The other two stated that the problem is often the result of the client not clearly articulating in writing what the appraisal assignment entails.

One respondent had some very strong words concerning the appraiser-client relationship: "Appraiser's greatest problem. At mercy of client's needs. Leads to complete compromise. Source of 90% of industry's problem."

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Professionalism

Only two clients denied that appraisers qualify for professional status. The remainder seemed to feel that, while the term "professional" can be applied to appraisers in general, there are many who act in an unprofessional manner. Three clients pointed specifically to MAIs, although one of these felt that MAIs are "specialists/consultants" rather than true professionals.

Most of the clients had little idea of the educational requirements for the MAI designation, but on the whole seemed to feel that they are highly respected. Nevertheless, not a single client felt that the educational requirements for the valuation business are as professionally demanding as those for architects or engineers. One client, however, stated that this is an apples and oranges comparison. In appraisal education, "the subject matter is not as scientific, and involves a more subjective application of the basic principles. The field is still more of an art than a science."

Although there seemed to be some feeling that the Appraisal Institute's ethical standards are of high caliber, the clients were practically unanimous in stating that these standards have not been well observed by individual appraisers. Two clients felt that in their experience the standards have been fairly well observed. One pointed out that this was the result of careful selection of appraisers for individual assignments. Two clients repeated the by now stale joke that "MAI = Made As Instructed."

On the whole, clients do not seem to rate appraisers on a level with other professionals. Some pointed out that there are appraisers who rise above the general level of professionalism of their fellows, while another stated that appraisers have reached the level of professionals, but that their current public image belies the definition.

Profile of the Modern Real Estate Appraiser

by John R. White, MAI

Unquestionably appraisers' status, especially those accredited by the American Institute of Real Estate Appraisers, has grown perceptibly over the past seven to 10 years. As I pointed out previously, however, in the public's eyes, appraisers made relatively little progress in the era from 1950 to approximately 1970.[1] There were few, if any, improvements in income methodology until the theories of Leon W. Ellwood. Prior to 1970, the use of direct capitalization in the income approach was widespread; the various residual techniques were used when a report needed "dressing up." The use of William Inwood's tables as a basis for depreciation or return of capital was reserved for instances in which the outlook for the property was favorable. Generally, H.E. Hoskold's tables were used to obtain more conservative answers when the outlook was fair. The use of a straight-line depreciation allowance in the

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Part one of this article, "The Real Estate Appraiser—The Elusive Goal of Professionalism," appeared in the July 1987 issue of *The Appraisal Journal*.

1. John R. White, "The Real Estate Appraiser—The Elusive Goal of Professionalism," *The Appraisal Journal* (July 1987):325–377.

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residual techniques produced the lowest possible value. Little or no thought was given to predicting future income.

Similarly, the 1950 to 1970 period did not witness any real advance in market comparison techniques, but significant progress was made in improving the accuracy of market data. More effort was exerted to "get in back of the sales price" by interviewing the buyer or seller, or both, to obtain the details of the transaction. The use of computerized central data banks did not occur until 1982 or later. The accuracy of data slowly became better appreciated as data became more critical, but the simplest comparative techniques —principally time, location, zoning, and property size adjustments—were basically unchanged. Regression analysis was rarely used in the sales comparison approach. The cost approach had sunk into disuse, while income capitalization and sales comparison dominated. Recently, but on a very limited basis, and presumably provoked by four years of moderate inflation and a nonoverheated economy, some re-examining of the cost approach as having real meaning as a ceiling of value has occurred.

A series of apparent failures beset the appraisal business from 1950 to 1970. They were the result of a lack of experience and competence on the part of some appraisers, and unethical conduct on the part of others. All these failures were expressed in diminished credibility in the public's eyes. Problems arose as highway condemnation, urban renewal, and Real Estate Investment Trusts (REITs) created new demands on appraisers' imagination and ingenuity in meeting entirely new situations. The earnest growth in ethics, standards, and education tended to be obscured by the times.

PROGESS SINCE THE LATE 1970s

The period from approximately 1977 through 1985 produced a dizzying series of events that contributed significantly to an elevation of appraisers' status and brought enhanced respect. These events included:

- The development of excellent software to permit extensive and detailed analyses and valuations of income properties
- The perfecting of lease-by-lease analysis in the major software programs so that the most complex changes in revenue and expense escalations could be made
- The emergence of the need for forecasting of revenue and expenses at a compound growth rate because of hyperinflation
- The utilization of discounting techniques in converting the anticipated net operating income (NOI) into value
- The steady decline in price and further development of microcomputers, making them affordable for most appraisers

Along with these refinements came the increasing use of appraisers as investment advisors. They were engaged because of their recognized skills and advanced knowledge for a wide variety of client needs, but primarily for their valuation skills. The combination was exhilarating.

SHOULD APPRAISAL OFFICES REMAIN SMALL?

A surprising revelation of the questionnaire survey on which this article is based is the persistence of the cottage industry concept. Many appraisers still work out of their homes. Others occupy very small office suites, frequently as small as 500 square feet. Appraisers tend to believe that they must stay small to be recognized, as well as to keep overhead down. Many outstanding appraisers choose to remain small. When they require additional staff they are usually able to obtain competent temporary help. This same type of appraiser is also generally able to keep up with the changing technology because of his or her innate intelligence. The freedom of action and independence of others dominate their business philosophy. However, there is a tendency to grow in company size and have specialists in property types. The obvious drawback to the self-sufficient, single-proprietor concept, however, is the difficutly of keeping up with the market. This presupposes that the sole proprietor is constantly alert to and current with evolving methodology, that is, the use of word processors, advanced calculators, and microcomputers. Lack of peers to discuss problems with is also a disadvantage. Another drawback is the inability of the proprietor of a small appraisal office to leverage his or her time effectively by employing younger associates to do the research work. And finally, the larger the company, the greater the tendency to have specialists in a wide range of fields on the staff, thus providing a basis for the enlargement of the practice and the enhancement of the appraiser's status.

The questionnaire returns disclosed that 60% of the appraisal companies had no more than 10 professional associates. One company, a distinct exception, reported having 60 market-value appraisers on its staff. Otherwise, 20 professionals or more was a very large aggregation, with only six companies in this category. What has recently emerged is the growth of the larger, say 10 professionals or more, urban appraisal operation as an independent entity or part of a real estate agency or consulting company in which group action permits acquisition of the most advanced word processing and computer equipment. These appraisal operations have become completely "state-of-the art" and offer a variety of services that the small shop or sole proprietor finds difficult to match. Such operations are likely to be found in the heart of the 50 largest metropolitan areas. However, as Robert E. Hickman, MAI, has sagely observed on the subject, "In analyzing appraisal services, one must distinguish between the small office and the small mind. It's the person that counts."[2]

HOW EXTENSIVE SHOULD AN APPRAISAL PRACTICE BE?

There are few practicing appraisers who can successfully accomplish an

2. Robert E. Hickman, letter to the author, 1986.

economic base analysis. The most common basic factors included in a mastery of demographics—disposable household income, employment and its distribution, transportation and its effect, climatic conditions, and more—are not necessarily part of an appraiser's arsenal. Nor does an appraiser always have the insights required to relate the meaning of the economic base factors to the market value of a particular property. A few appraisers even lack a sufficient comprehensive knowledge of physical geography, including factors of climate—soil and subsoil, terrain, vegetation, temperature changes, prevailing winds, and so forth—the essential backdrop for many real estate conditions. An applied form of economic geography is required to make corporate industrial and office relocation studies. This is a potentially very profitable field for appraisers that has been pre-empted by economists and city planners. Some appraisers have successfully entered this field as in the recent study of industrial location sites for the proposed Saturn automobile plant. Over a quarter century ago, Robert K. Brown voiced the need for "generalists" in the appraisal business stating:

> Professionalization of appraising will require a broadening of the appraiser's body of knowledge in two vital areas. One area is that of urban land economics, embracing site utilization and the planning and zoning of land uses. The second area is that of market analysis, or the understanding of basic economic forces which contribute to an area's economic vitality and which find expression in the local, regional, and national real estate markets.[3]

More appraisers should represent themselves outright as advisors to their clientele rather than merely as appraisers. The use of the sophisticated techniques of investment analysis in assisting a client in the financial structuring of a deal or in making a basic decision to hold, sell, or finance, are ways appraisers can very effectively serve their clients in a long-term relationship. To impress clients with their professionalism, appraisers must, where the opportunity presents itself, abandon their traditional passive image in favor of an activist role in which they may not only be advisors, but also effectuators on behalf of their clients.

SHOULD FEE APPRAISERS BE OBJECTIVE AND DETACHED?

A continuing inclination at distinct cross-purposes with the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice is the disposition of appraisers to reflect to some extent their client's viewpoint; rather than to insist on an independent, objective, and detached view. The vast majority of appraisers are honest and would not intentionally falsify a value. However, the notion persists that formal appraisals "made as instructed" can still be purchased, if not from the top rung of appraisers, at least close to it. In practice, it is the appraiser's natural or sometimes subconscious

3. Robert K. Brown, "The Need for Generalists in the Appraisal Profession," *The Appraisal Journal* (April 1960):222.

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disposition to see the market through his or her client's eyes. The resultant appraisal may then be described as being in either the upper or lower range of value, depending on the client's circumstances. Chances are that any client using the appraisal will not be hurt by relying on the value estimate because the deviations from the considered norm are not at all significant, and, in fact, are difficult, if not impossible, to detect with any certainty. In more instances than not, the appraiser will go no further than perhaps reflecting a slightly more optimistic view of things, or the reverse, as the case may be.

A minority of appraisers has forcefully argued that within reasonable bounds, it is not an incorrect or unethical procedure to find a formal market value that is supportive of a client's position. A few believe that it is unrealistic to expect their peers to be any less an advocate for his or her client than an attorney or accountant. Why should the burden of steadfast independence, professional detachment, and objectivity fall on appraisers to a greater extent than other professionals? There appears to be a certain "holier than thou" attitude in the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice that is generally not found in other professional disciplines. The Appraisal Institute has begged the question by advising its members that they may act as advocates in instances in which a formal documented appraisal is not required, presumably such as an investment analysis or in described advocacy services. My comments are confined to the Standards surrounding the formal appraisal assignment. The Appraisal Institute's position is that the appraiser is never released from its ethical constraints and Standards in accomplishing either an appraisal assignment or an evaluation study of any type. More broadly based individuals may question the wisdom of becoming an MAI because the Appraisal Institute has placed a Standards blanket over them that may prove chafing and inhibiting at the least. A logical case may be made for the Appraisal Institute's having jurisdiction only when an "appraisal assignment" is being carried out. A merger with the American Society of Real Estate Counselors (ASREC) (which permits advocacy) may be one way to solve a perplexing dilemma.

This ambivalence as to appraiser's actual position in regard to advocacy seemingly causes confusion and has tended to detract from their professional status. The assumption that appraisers owe nothing more essential to their clients than objectivity may some day be challenged by top-flight appraisers. The stock response that opponents of this radical veiwpoint of advocacy cite is the prospect of mass confusion and loss of credibility in the event that every appraisal has a bias of one type or another. However, the appraisal public, that is, those who either engage appraisers or rely on appraisal results, can readily distinguish incredible reports from those that make sense. Why not consider elimination of the very thin veneer of objectivity and professional detachment in favor of recognizing appraisers as advocates for their client's cause? It appears that as a matter of practice, this is happening every day.

Surely this is occurring in appraisals for ground lease renewals. It happens to a sometimes ridiculous extent in tax abatement and condemnation appraisals. The extremists would soon be spotlighted under a reasonable advocacy standard and the market would expose them for incredibility. On the other hand, the best appraisers would operate in this new environment within a very narrow band of market value because of the credible nature of their opinions. Appraisers need to engage in a full-scale open debate over this issue.

Nowhere in the codes of ethics or standards of professional practice of attorneys, accountants, architects, planners, and some of the other professionals is there a prohibition against advocacy under some or all circumstances when acting on behalf of a client. Surely the most comparable organization to the Appraisal Institute, ASREC, has no such requirement. In practice there is scarcely any appraiser who would not privately agree that he or she has at a minimum been sympathetic to a client's position at least within the bounds of what every appraiser presumably decides represents decent business propriety. These appraisers do not provoke any problems nor is their work product apt to be misleading or inadequate. Conscience rules as to the limits the appraiser believes he or she may stretch in representing clients.

Appraisers who demean the Appraisal Institute's Standards and ignore the most elementary rules of business conduct tend to be extreme advocates for their clients or are simply incompetent or careless. The issue is whether removing the restrictions against advocacy would fundamentally sully appraisers' efforts at professionalism. The majority of thoughtful decent appraisers would not be affected by this radical change in the concept of ethical conduct. Their innate sense of propriety probably existed long before their first reading of the Code of Professional Ethics or Standards of Professional Practice. The outright extremists would continue to practice their deceit as before. Markets, like voters, are more discerning and more capable of grading individuals than can be imagined. Over a period of time, the "made as instructed" appraisers and the incompetent and habitually careless would be readily sorted out. The quality of their clientele would also decline from mediocre to poor because such appraisers lack credibility and hence, respectability. On the other hand, those appraisers acting within reasonable bounds of advocacy (normally defined as the upper or lower range of value as the case may be) will be recognized and respected for their professional judgment.

Through their trade organizations, appraisers must confront the assets and liabilities of a major departure from an established policy that has been part of their efforts since the Appraisal Institute's founding in 1932. Unfortunately in many cases, the maintenance of a postion of independence and complete impartiality may prove to be a deceit rather than a frank and open

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attitude. I take no stand on the issue. I believe it must come "out of the closet" and be aired before an open forum. As stated by Boyd T. Barnard, MAI:

> Are our pesent rules and rigidities (which seem to be increasing) inspiring or encouraging to our most experienced and able practitioners? I think of some of the "greats" of the past, and even now, as being men who used a freedom of thought, actions and writing which now is difficult or impossible without violating some rules of procedure or ethics as prescribed by the Institute or by some departments of government.[4]

INVESTMENT ANALYSIS ENHANCES APPRAISERS' STATUS

Investment analysis has been adopted by many outstanding appraisers as the occasional replacement for a formal estimate of market value. Appraisers recognize the formal appraisal as an estimate of market value being fully supported and documented at all levels of the market; setting forth all valuation rationale; and containing all the facts about a region, city, and neighborhood that have a bearing on the market value of a specific property. The problem in many instances is the arbitrary quality of the appraised value itself. Once made, the appraiser and his or her client are "stuck" with it. Another problem is the vast documentation and lengthy report the client frequently demands. An investment analysis is much more flexible; provides a range of possible market values, usually set forth in a grid or matrix; and demonstrates the sensitivity of the market value to different discount and capitalization rates and sometimes to other operating assumptions. Investment analysis does not normally require heavy market or city documentation, nor does it purport to represent any process other than an investment approach. The appraiser is prequalified and does not have to prove him- or herself by documentation. The client retains discretionary authority as to what figure he or she might employ from the valuation matrix and is not circumscribed by a formal valuation number.

Investment analysis is increasingly prevalent in instances of anticipated purchase or sale, or for the purpose of establishing a basis for action such as alteration, modernization, addition, or financing. In cases involving expected purchase or sale, it enables the appraiser to be involved in the ensuing implementation without the spectre of ethical considerations or standards violations that accompanies a formal appraisal and can be construed as self-serving.

In any event, appraisers' status as advisors and confidants to their clients has been significantly enhanced since 1977 by this new use of investment analysis. In formulating investment analyses, appraisers work closely and continuously with their clients and consequently, may be retained when any action is taken on the basis of their studies. In some instances, MAIs have

4. Boyd T. Barnard, "Artist or Mechanic?" *The Appraisal Journal* (October 1970):587.

recently been able to obtain investment analysis business in the face of competition from investment banking companies and real estate agencies. They were also able to obtain the ensuing assignments that led to the sale, for example, of the Pan Am Building and the financing of the General Motors Building in New York.

In the top 50 metropolitan areas of the United States, appraisers are increasingly being used as confidential advisors and not in the conventional view as some hide-bound numbers cruncher intent on his or her "slipstick" ways. The advisory role now being played in increasing numbers by appraisers to such clients as banks, savings and loan associations, insurance and investment companies, development companies, and pension funds is the most significant personal and professional advancement since the foundation of the Appraisal Institute in 1932. The role of advisor removes the appraiser from a passive and somewhat clerical position to one whose importance to the development process, financing, purchase, and sale is widely recognized. As Charles F. Seymour has stated:

> The sooner we come to a realization that value is always incidental to the solution of some other problem, and train ourselves in the solution of these larger problems, the more service we can give to our clients.[5]

PROFICIENCY LAGS IN MARKET ANALYSIS AND FEASIBILITY

Appraisers have also been slow in accomplishing more expert market analysis and feasibility studies that, among other requirements, compel them to decide by an inferential reasoning process what share of a defined market area can reasonably be allocated to the specific site or tract, the absorption per month or year, the size and general character of the buildings, and the rent or sale levels the public is willing to pay.

Feasibility studies have been even more taxing to appraisers because in addition to the basic ingredients for a marketability study, there are added requirements to estimate precise development costs, operating and overhead costs, and the ultimate return on a presumed or derived equity investment. The questionnaire survey did not satisfactorily explain why this type of business has been shunned by appraisers and instead has been awarded by default to planners, architects, and economists. Apparently, for those attracted to the appraisal profession, there is something inherently elusive about the economic base as it relates to the total competitive market and real estate development. Appraisers instead, appear more comfortable dealing with easily ascertainable known facts. They tend to shy away from the admittedly difficult vagaries of a tract's absorption capabilities. In this

5. Charles F. Seymour, "More and More of My Reports are Valueless," *The Appraisal Journal* (October 1967): 65.

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regard, appraisers' progress has not been uniform. Well over a decade ago, Dr. James A. Graaskamp pointed out that:

> An appraisal is a very narrow-minded form of a feasibility study because market value presently requires a fictional client and limiting conditions which exist only in the deductive logic of appraisal theory. Appraisal methodology must be revised to reflect current competition and be in accord with behavior of the economic enterprise or actor. Only then will the theory of appraisal be compatible with the reality of feasibility analysis.[6]

CONSISTENCY OF APPRAISERS' RESULTS

Some lingering doubt and cynicism about the consistency of appraisers' results remain. Much of this can be traced to the imprecise nature of valuation as an art that employs certain disciplines to achieve the best judgmental result, rather than to deliberate alterations or misjudgments in market value. Among the doubters are members of the New York Society of Securities Analysts and its real estate arm who in private conversations have expressed reservations about the consistency of appraisals made for open-end realty funds or current value balance sheet purposes. Other doubters are the large-scale real estate investment and development companies that have elected to ignore appraised value balance sheets in their annual reports, despite the possible loss of share value by so doing.

Difficulties with consistency are unique to real estate as a product. When the properties included in a portfolio are scattered all over the country and the assignment is carried out by a selected group of local appraisers, consistency becomes a problem despite efforts by fund managers to adopt a detailed common format and uniform capitalization techniques; subject, of course, to local conditions. The problem intensifies if the appraiser feels under pressure to support upward movements in share values, yet is slow to recognize the down movements in his or her appraisals. Dealing with the human factor seems almost beyond the fund manager's capacity.

In my prior article, "The Real Estate Appraiser—The Elusive Goal of Professionalism," I presented what the Appraisal Institute is doing through the enforcement of its Code of Professional Ethics and Standards of Professional Practice, and intensified educational activities to reduce the incidence of errors.[7] All these measures are helping. The counseling activities of the Appraisal Institute are very constructive ways to assist appraisers who somehow are deficient in their appraisals. Above all, it is appraiser's mental attitude and business philosophy concerning the proprieties of his or her practice that make the real difference. Attracting persons of high moral and personal character and, hence, quality to the business does not provide complete assurance, as the medical and legal professions have learned from

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6. James A. Graaskamp, "A Rational Approach to Feasibility Analysis," *The Appraisal Journal* (October 1972): 516.
7. White, pp. 351-354.

bitter lessons, but the opportunity for enhancing the consistency of valuation results as a direct consequence of the quality of those persons involved.

ALIENATING NATURE OF APPRAISERS' LANGUAGE

For no discernable reasons other than perhaps insecurity, it is puzzling as to why appraisers have seemingly deliberately embarked on a course of choosing words and expressions alien to the very fields of associated disciplines with which they should nurture a relationship.[8] Appraisers tend to deal frequently with finance officers and accountants. Appraisers' clients also generally have investment backgrounds to some extent and deal constantly with investment people.

Despite this interaction, appraisers have insisted on inventing phrases or using words that are essentially nondescriptive and must confuse, if not irritate, the readers of appraisal reports. An example is the constant reference to NOI after mortgage interest as an "equity dividend." The words "equity income" would be far more accurate. Frequently, gross revenue is referred to as gross income. Appraisers call depreciation and amortization "capital recapture" rather than labelling them as they are. They also "process" rather than convert NOI into its value. I will not dwell on other illustrations of inappropriate word use except to observe that appraisers appear to be weakening their status in spite of themselves and their peers who insist on going their own way in the lexicon world.

COMPENSATION AS A MEASURE OF STATUS

Appraisal has been a very lucrative occupation in the past 25 years. Although fees for individual values may seem modest to moderate, appraisers have learned to economize their operations through the inclusion of standard phraseology in many sections of the appraisal report. They tend to utilize a generalized presentation of national, regional, and local events that affect market value. The custom is to update this data once a year or as required. Similarly, comparable sales, once they are presented in a standard format, can be used for analyses in different reports over an extended time frame. Thus, in some instances, the report represents a major use of prior material that is relevant to the appraisal at hand. The computer has had less effect in cutting operating expenses than one would imagine. As one appraiser has put it, "We installed both microcomputers and a minicomputer primarily in our anxiety to remain state of the art and hence competitive. I doubt very much that they will be cost effective. Their chief advantage is the increased capacity to make more accurate professional judgments."

Compensation today is more skillfully computed than in the days when appraisers secretly (because fees ethically were not supposed to be related to

8. See John R. White and Peter Spies, "Towards Universally Accepted Semantics," *The Appraisal Journal* (January 1978): 67-78.

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the appraised value) used one-tenth of 1% of the appraised value as a norm. They would then charge more, say one-fifth to one-half of 1% for smaller assignments and less than one-tenth for the largest assignments. Today, appraisers estimate total hours at varying rates, depending on the level of skills and experience of associates to be assigned to the work. To this subtotal they add overhead and profit, frequently including their own time. In many cases, appraisers maintain computerized estimates for as many as 12 different categories of time, quite aside from client time. Expense reimbursement is subject to negotiation with the client. Responses to the questionnaire survey indicated that although firm fees for an appraisal are quoted, appraisers do not generally reveal their own hourly rates unless asked. In many smaller metropolitan areas, the hourly rates appear somewhat low for the extent of the responsibilities. In the 20 largest cities, hourly rates tend to be directly competitive with the city's leading law and accounting firms.

The responsibilities inherent in the appraisal process greatly influence the compensation appraisers charge and clients accept. For the select few involved in due diligence appraisals in connection with public issues of securities, the creation of new entities, and mergers and acquisitions; appraisers must, in effect, become self-insurors by charging significantly higher fees because liability becomes so great. Clients generally understand this and are receptive to fees based on the nature of the responsibility, rather than strict reliance on the appraisal amount or the hours required to accomplish the appraisal.

Some appraisers attribute the improvement in fees to the growing complexity of their work. This does appear to be a substantial influencing factor. It seems that the principal negative influence on fees is the relative shortage of contemporary broad-based communicators of the appraisal story. Those who have minimized or partially eliminated the boilerplate, or placed it wherever possible in the addenda and concentrated instead on giving the client the appraisal answer in a penetrating and analytical way, demonstrate their broad background in the art of appraising and are eventually sifted out of the marketplace and recognized.

What is the range of appraisers' pretax net incomes (expressed here in salary terms because many appraisers are sole practitioners or operate small partnerships or corporations)? The answer is both difficult and elusive because charges vary significantly throughout the country. For example, in the Southeast—notably Georgia, Alabama, and Louisiana—appraisal hourly rates are lower and this is reflected in compensation. In the highly industrialized areas in the near Midwest and Atlantic coast regions, compensation is usually very high. Comparison also becomes difficult because some appraisers are self-employed and thus nonsalaried. The following yearly figures may provide some idea of how well appraisers are faring economically.

Geographical Area	Trainee (College Only)	Career Midpoint	Proprietor, Sr. Partner, or Sr. VP-MAI
New York and Boston	$27,500	$65,000	$150,000-$200,000
Atlantic Coast	$25,000	$55,000	$125,000-$150,000
Deep South (GA, AL, LA, FL)	$20,000	$45,000	$ 80,000-$ 90,000
Southwest (TX, OK, AK, MO)	$22,000	$48,000	$115,000-$125,000
Midwest (IL, WI, MN, IN)	$23,000	$57,500	$125,000-$150,000
Far West (CA, WA, OR, AZ)	$23,000	$60,000	$135,000-$175,000

Source: Landauer Associates, Inc. Survey, 1986.

There are exceptions to these figures, of course. They must be treated with caution, but they do illustrate how well appraisers are doing. In many instances, the above figures are enhanced with annual cash bonuses and good fringe benefits that may include a 401(K) plan or its equivalent.

ECONOMIC EVENTS DEMAND ELEVATION OF THE APPRAISAL FUNCTION

Increased inflation in the late 1970s and the sharply more volatile financial conditions in the capital markets after President Carter's designation of Paul A. Volcker as Chairman of the Federal Reserve Bank forced appraisers to respond to extraordinary times not at all similar to events since the Appraisal Institute was founded in 1932. The effect was to make at least a fair proportion of appraisers aware of the powerful forces of erratically high interest and inflation rates, and a tightened money supply. Out of these demanding times a new and more respectful form of recognition for appraisers emerged. The times also created a link between appraisers and the broad financial community to a far greater extent than previously experienced. Appraisers began to earn respect and esteem for their mastery of techniques, which tended to resolve satisfactorily the problems of estimating value on a forecast basis.

The turbulent years between 1977 and 1986 were not without criticism of discounted cash flow (DCF) and lease-by-lease (LXL) analyses. Many appraisers adamantly believed that DCF was only an analysis tool that had no rightful place in income capitalization. Presumably the use of an overall rate of free and clear return was the only valid way to convert income into a present value (PV). These diehards simply never acknowledged that PV is the discounted worth of future expectations. Yet, there is a growing number of supporters of the LXL/DCF method. Peter F. Korparz, MAI, and Mark I. Roth have stated that:

> Appraisers, as a group, have tended to a) isolate themselves from the techniques utilized in the marketplace, and b) argue endlessly about appropriate

> valuation technqiues....Almost every step of the appraisal process requires some subjective judgment; however, given existing market data, the DCF technique involves the least subjectivity. Furthermore, since in today's market most major office building sales are based on the application of this technique, the appraiser should place the greatest reliance on DCF.[9]

Critics of the LXL/DCF method also say that procedures involving forecasting are, in any event, unnecessary today as we face the possibility of temperate economic times and very low inflation rates over the foreseeable future. Persons in the forefront of appraisal theory and indeed those who engage appraisers feel that LXL/DCF is equally necessary in tranquil or declining times, as in turbulent and inflationary times. The findings of the questionnaire survey were entirely supportive of the latter view.

APPRAISERS' PERSPECTIVES ON THEMSELVES

The appraisers surveyed demonstrated a surprising degree of objectivity and detachment in their views on their relative status today. Virtually all were supportive of the Code of Professional Ethics and Standards of Professional Practice, while at the same time acknowledging the difficulty of enforcement in today's climate of heightened due process and civil rights. Many, but not all, acknowledged the problem of appraisal's recognition as a profession in view of nonuniform educational standards and lack of licensing in each state. A fair number of the appraisers surveyed felt that the successful passing of a reasonable number of MAI courses is equivalent to a master's degree and solidified the contention that appraisers are professionals. At the least, they thought of themselves as well-motivated business people with professional objectives.

The questionnaire survey, as well as a review of appraisal literature from *The Appraisal Journal,* revealed that the 1950 to 1970 period did not produce any really significant new methodology nor particularly enhance appraisers' status. The majority of the appraisers surveyed agreed that their status had been significantly elevated with the advent of inflation and financial volatility. They were generally quick to recognize the importance of the computer, while still cautioning that the quality of the entered data remains essential to the final value estimate.

Perhaps the most interesting aspect of the questionnaire survey was the indirectly expressed conviction that the respondents are more elite than general MAI accredited appraisers, and better qualified to be considered professionals. There is considerable merit to this thesis. If anything, the questionnaire survey was biased in the selection of the sample by inviting top practitioners, article writers, and those active in the Appraisal Institute's

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9. Peter F. Korpacz and Mark I. Roth. "Changing Emphasis in Appraisal Techniques: The Transition to Discounted Cash Flow," *The Appraisal Journal* (January 1983): 44.

affairs to respond to the 20 questions. It was therefore quite natural for the respondents to consider themselves outstanding in their field.

CLIENTS' VIEWS ON APPRAISERS

The clients surveyed were less enthusiastic about appraisers' professional status than, quite naturally, the appraisers themselves. About half of these respondents felt that appraisers are deserving of recognition as professionals, yet many other answers to the questionnaire survey seemed less enthusiastic. One client spoke very bluntly about "made as instructed" appraisals. Others questioned the sufficiency of the educational requirements to support professional status and mentioned the absence of licensing. In general, an acknowledgment of appraisers' more advanced knowledge over the past several years was evident. It appears that the clients were less concerned with professional labels than with the quality and independence of the appraisal report. In this respect, appraisers tended to be seen in an improved light. The noninstitutional clients surveyed use appraisal services on a consulting, investment advisory basis to a greater extent than institutional clients. Appraisers engaged for advisory purposes gained enhanced professional status and recognition from the clients surveyed, over those who were constricted by the dictates of the formal appraisal or never in a position to act in the implementation of a report's findings.

THE WINDS OF CHANGE

The continuing disposition to narrow, rather than broaden appraisal-related capabilities inhibits appraisal's recognition by the public as a professional occupation. The emphasis has been on the mechanics of valuation methodology with the market seemingly acting as an incidental background. The restrictive nature of the valuation exercise casts the appraiser in the role of "numbers cruncher," rather than the eminently more desirable role of advisor. While advancement in appraisal techniques is very evident, there is very little indication that the appraisal profession is making a determined effort to enlarge its narrow sphere of activity. MAIs who have expanded their activities, usually do so as counselor's, industrial Realtors®, or simply as Realtors.®

TOWARDS MORE BROADLY BASED REAL ESTATE EXPERIENCE

Ideally, the appraiser should have attained a specified educational level and broad work experience before he or she advanced to the role of appraiser. There appear to be too many appraisers who have gained employment in a real estate appraisal office without any prior exposure in the marketplace to ownership, construction, sales, leasing, or management of real estate. Absence of a practical background may make the market consider the appraiser as a theorist or a methodologically dominated person devoid of any firsthand

knowledge or "feel" for the market and its players. This does not mean that any appraiser inexperienced in direct participation in the marketplace is not qualified. It does mean that it is more difficult to apply one's judgment in the absence of a more broad and direct background. And certainly experience alone is no assurance of competence. As Leon W. Elwood, MAI, once stated:

> I believe experience can teach lessons which may lead to sound judgment. I believe sound judgment is vital in selecting the critical factors for appraisal. But, I also believe the bright 17 year old high school student in elementary astronomy can do a better job estimating the distance to the moon than the old man of the mountains who has looked at the moon for 80 years. So, I find it difficult to accept the notion that dependable valuation of real estate is nothing more than experience and judgment.
>
> I would not give a red cent for an appraisal by the "expert" who beats his breast and shouts; "I don't have to give reasons. I've had 40 years experience in this business. And this property is worth so much because I say so."
>
> After all, value is expressed as a number. And, no man lives who, through experience, has all numbers so filed in the convolutions of his brain that he can be relied upon to choose the right one without explicable analysis and calculation.[10]

It is certainly difficult for everyone to have the perfect apprenticeship. For example, most institutional and governmental appraisers rarely have had the opportunity to learn by doing. As the late Dr. H.B. Dorau, professor of real estate at New York University was prone to observe, "the *next* best thing to knowing is knowing how...." (italics added).[11] However, to the extent circumstances permit, an appraiser's career will be definitely enhanced if he or she is willing to serve as a generalist for as many as five years before venturing into the more specialized, more disciplined role of the appraiser of income-producing properties. This must be made more clear to our young aspirants.

EFFECTIVE COMMUNICATION, A MUST

The problem of effective communication is by no means a deficiency in real estate alone. The national educational emphasis on technology has left the country with a state of literacy lower than that necessary for us to understand each other effectively. Indeed, some appraisers feel that refinement of the vexatious boilerplate language in appraisal reports is the primary means required to advance effective communication! A far more serious problem than the multiple pages of boilerplate in the typical report is the failure to make clear to the reader the exact nature of the appraisal problem, the means used to solve it, the documentation utilized in the solution, and the rationale for the value estimate. Back in 1962, John P. Dolman added to experience,

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10. L.W. Ellwood, *Ellwood Tables for Real Estate Appraising and Financing*, 4th ed. (Chicago: American Institute of Real Estate Appraisers, 1977).
11. Herbert B. Dorau, "Is Rote Right in Valuation?" *The Appraisal Journal* (October 1960): 419.

knowledge, and judgment, a fourth basic quality necessary for a good real estate appraiser—the ability to communicate.

> In other words, if he has experience, knowledge, and judgment, but cannot express himself in a proper report, he may continue to lag behind in professional recognition.[12]

Appraisers seriously lack the capability of organizing and writing a lucid report that reflects both the market's and their thinking in descriptive English with decent sentence structure. Far too often, the reader of an appraisal report is smothered by a combination of boilerplate, economic base and market data without adequate analysis or understanding and establishment of integral relationships to the problem, and pages of computer printouts without required explanation. Some appraisers revel in the thickness of their reports rather than being concerned with a succinct presentation of the problem and solution and wisely consign the balance of the material to an addenda where it belongs. It is not surprising that there was virtual unanimity expressed by the appraisers surveyed in their responses to the questions on report writing. Appraiser's lack of ability to organize and write clear appraisal reports is regarded as one of the major road blocks to full professional recognition. No amount of graphics can substitute for the necessary writing.

CONFRONTING THE GROWING COMPETITION

The questionnaire survey did not cover the subject of increasing competition because prior to the date the research was conducted, it was not regarded as a significant factor. However, during the course of the inquiries, it became apparent that many persons outside the recognized appraisal organizations are making appraisals or investment analyses that traditionally have been made by Realtor® fee appraisers. The biggest inroads have been made by national accounting firms. While most have employed MAIs, they also use certified public accountants (CPAs) to accomplish valuation and related work. CPAs are especially aggressive in hotel market analysis in which two or three firms have dominated the market. Economists, accountants, and engineers have made major inroads into the marketability and feasibility fields. In the case of feasibility studies, economists, accountants, and engineers have come dangerously close to actually rendering appraisal reports because they utilize a spreadsheet approach over a presumed absorption period in which the pretax NOI after expenses on a cash flow basis is discounted annually and then aggregated. Engineers have also dominated the environmental impact field at both the state and federal levels to the almost total exclusion of appraisers. A recent study points out the bleak future facing the appraisal industry if changes are not made. According to James H. Boykin, MAI:

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12. John P. Dolman, "Responsibilities of the Appraiser," *The Appraisal Journal* (January 1962): 52.

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> It is quite probable that much of the appraiser's business in future years will have been taken over by other professions or that the form of this business will have changed substantially.... Income property appraisals may succumb to the institutionalized, lengthy, unresponsive art form of today. The opportunity to provide market, feasibility, and highest and best use studies probably will be increasingly dominated by nonappraisers.[13]

What has become especially disturbing is the trend for large scale developers, brokers, investment bankers, and consultants to engage young persons with an MBA background and a foundation in mathematics to do all in-house investment analyses of properties to be bought, sold, or financed. Few of these companies place any significant importance on the MAI designation. Instead, they are intent on the analytical capability of the person and seemingly not concerned with the lack of a professional designation. This attitude is particularly evident in the largest metropolitan areas. It does not appear to be prevalent in the smaller metropolitan areas where among clients, the MAI designation has real significance and is respected. Nevertheless, appraisers must be alert to these competitive pressures. To the extent that appraisal is able to attract professionally qualified young people, an improved share of the total available appraisal business may result, and , competitors' invasion of the technical real estate services field may be reduced, if not eliminated.

PROBABLE STRUCTURAL CHANGES

The very small appraisal company, three professionals or less, must be alert to remaining "state of the art." The small company cannot handle as effectively large multiple location accounts and will have problems administering the normal "bunching up" of business because of limited human resources. The questionnaire survey responses indicated a real market for small appraisal office mergers or growth to accommodate expansion and handle the increasing number of national accounts with multiple properties. In the long run, fragmentation has been very limiting to the appraisal business. The appeal of remaining an independent business person with control of one's destiny is attractive to many; but the opportunities through adopting a deliberate policy of merger, acquisition, or growth, in which a wide variety of skills and experience can be offered to clientele appear greater. There will always be, however, an important place for the individualist who prefers to be small and control every phase of his or her professional destiny.

Appraisal organizations should also be less fragmented than they are now. Without taking sides on the relative merits of each association, the failure of the Appraisal Institute and the Society of Real Estate Appraisers (SREA) to merge has been a tragic event, one which again makes more

13. James H. Boykin, "Review and Prospects for Real Estate Appraisal Education," *The Appraisal Journal* (July 1985): 347-348.

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difficult and postpones the day of professional recognition. Both organizations must regard future merger efforts as a "must win" objective by agreeing to a merger plan that obviously cannot be perfect for all. Personal pride, feelings of uncertainty, and emotional judgments must be put aside for the sake of future generations of appraisers and for the sake of ultimately achieving full professional recognition. This requirement should be a high priority in both organizations. As Reaves C. Lukens, Jr., MAI, has stated:

> How can real estate appraisers expect public recognition and acceptance as authorities when there are more than 40 organizations offering "designations" and purporting to speak for real estate appraisers around the United States? The answer is, it can't.[14]

ASREC is also an affiliate of the NATIONAL ASSOCIATION OF REALTORS® (NAR), as is the Appraisal Institute. This small group of 600 members has been struggling to establish an identity and maintain its economic viability in an era when size has become essential to the realization of an organization's individuality. ASREC is more fraternal than professional in the sense that there are no formal educational or examination requirements. About 50% of the members are also MAIs. They are an elite group because they must demonstrate that they have performed counseling services for agreed fees, before they can be invited to membership. They have a very professional mind set and are proud of their organization and achievements.

It is not inconceivable to foresee a merger of ASREC and the Appraisal Institute to provide an even stronger professional organization that would cover the various appraisal functions previously discussed. The combined organization could then be divided into fields of specialization. This would enable individuals to pursue their major interests, while having the benefits of a larger professionally dedicated organization to represent members in educational, ethical, and licensing matters. Both the Appraisal Institute and ASREC would gain enormously from a merger. Appraisers would be presented an opportunity to enlarge their horizons and expand their skills. Counselors would be permitted, in due course, to become licensed and enjoy a truly professional status rather than attempt to survive on a fraternal nonprofessional basis.

THE NEED FOR REGULATION

There appears to be no way to avoid the need for some type of regulation of appraisers. It is unfair for the Appraisal Institute to carry this entire burden through its MAI designation and triannual certification program. Yet, if regulation does not eventually occur, the goal of professionalism will continue to elude appraisers' grasp. Currently there are only 12 states that have licensing requirements, 10 of which require a broker's license, with only two states having a separate licensing classification for appraisers.

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14. Reaves C. Lukens, Jr., "It's Time" *The Appraiser* (February 1984): 3.

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Because of the number of states and the highly localized nature of real estate, a system of state-authorized and -approved uniform designation and certification criteria administered by a professional trade organization such as the Appraisal Institute and supervised by the states under simple enabling legislation seems the solution to the dilemma of persuading the various states to adopt regulatory laws. In my previous article, "The Real Estate Appraiser—The Elusive Goal of Professionalism," the Appraisal Institute's solution to certification was outlined, and is one that I believe is equally acceptable as a means of achieving the desired result.[15] A prior condition to regulation would be the merger of the Appraisal Institute and the Society, hopefully with ASREC as well. In the event that further efforts to merge the Appraisal Institute and the Society fail, the Appraisal Institute must nevertheless persist in its efforts to introduce a certification program that it would administer. The chances of the success of such a program are significantly lessened, however, without a successful merger.

Even at best, however, the Appraisal Institute alone cannot solve the problems facing the appraisal industry, primarily because it has no jurisdiction over the majority of appraisers practicing today, with only about 19,000 being members or candidates. This includes those holding the RM designation. This is not to say that the Appraisal Institute is the only reputable appraisal organization in this country, but that even if all the accredited appraisal organizations were included, their members would represent only about one quarter of all those people in the marketplace calling themselves appraisers. Given this situation, the Appraisal Institute and other appraisal organizations have advocated some form of state regulation, much like that practiced by CPAs, to insure a certain level of competence and awareness of current techniques. On November 3, 1985, the Appraisal Institute's Governing Council passed the following resolution:

> That the Appraisal Institute support legislation and regulations adopting the Institute's Standards of Professional Practice and/or programs for the certification of appraisers when the legislation or regulations lead to and support a national program for the appraisal profession, similar to the Certified Public Accountant program for the accounting profession, that is based upon a certifying board for appraisers and an appraisal standards board to set standards for the profession.

There is universal appeal in the concept of a state-supervised certification program administered by the leading appraisal group. Presumably the Appraisal Institute could devise an examination that its staff could correct. Whatever the cost of such a program, it would still be inexpensive in view of the benefits of establishing another basis for the public's perception of appraisers' professionalism. The Appraisal Institute's certification program

15. White, pp. 351-353.

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could be maintained, but perhaps in a more rigorous way. The Appraisal Institute must take the initiative in establishing regulation. Candidates would not only have to pass the MAI examinations, but also those of the state-approved certification boards to obtain their licenses.

ELEVATION OF EDUCATIONAL STANDARDS

The question must be raised whether in the long run, not necessarily now, appraisers should first have a college degree, preferably in the liberal arts, in which English, history, and civics play a major role. In addition, should they have a master's degree in approved fields such as real estate, economics, mathematics, computer services, economic geography, accounting, finance, or city planning? Agreement must be reached to limit the number of fields in which a major could be chosen. This suggestion for advanced educational criteria may very well be dismissed as "overkill." The reasoning may be that a college degree in any one of the major fields is sufficient and the master's degree should not be required. Supporters of the college degree requirement maintain that the Appraisal Institute's course work, especially if strengthened with some of the subjects noted above, would be equivalent to a master's degree. Surely the Royal Institute of Chartered Surveyors (RICS) in Great Britain assumes that its general requirements are equivalent to a master's degree and sufficient to earn the coveted Fellow of the Royal Institute of Chartered Surveyors (FRICS) designation.

Stricter educational standards will inevitably evolve over time. It may be premature at this stage of the appraisal business's development to assume that it can attract persons willing to meet such demanding requirements. The problems with compromising the highest educational standards are the inevitable loss in the level of oral and written communication abilities and the possible reduction of the interpretive capacities by which to judge our actions as citizens possessing a substantial grounding in English, history, civics, and sociology. These otherwise essential courses are the most vulnerable to omission in the drive to complete course work more directly related to achieving one's career objectives.

DEFINITIVE ADVANCES IN THE PRACTICE OF REAL ESTATE APPRAISAL

All professions and near-professions have made significant strides in the past 25 years. The areas most directly competitive with appraisal—architecture, engineering, accounting, and city planning—have undoubtedly had increased recognition. In my opinion, architecture and accounting appear to have had more public recognition and increased perception as professions. Construction, civil engineering, and city planning, while no doubt moving forward, have enjoyed less public recognition.

Real estate appraisal has made particularly significant advances in the past 10 years for a wide variety of reasons. The major external reason was the increased volatility in the financial markets, which provoked significant changes in income capitalization methods. These changes were best accomplished by the LXL/DCF method. The second external reason was the continuing development of software programs, which provided a degree of accuracy and numerical flexibility never previously experienced. The interest in the use of computers was intensified by the continued decline in prices and the increasing utility of the personal computer. A third external reason for appraisers' increased prominence was the more complex nature of appraisal assignments and the purposes for which they were required. As more institutions became self-sufficient in appraising, the loss of mortgage appraisal business was easily compensated for by new types of business such as due diligence work in connection with new public securities issues, mergers, and consolidations, appraised value balance sheet assignments, sale or purchase needs, and so forth.

As mentioned earlier, one of the truly significant advances in appraisers' progress has been their evolving role as analysts and advisors. This is happening with increasing frequency in instances in which a formal appraisal is not required. Further, the ethical requirements of objectivity and professional detachment do not have to be observed by appraisers when they are providing services outside the usual appraisal format. Appraisers can then become much more valuable to their clients by acting as advisors, and, indeed, as advocates on the basis of their investment analyses. The importance of this enhancement in appraisers' status from a cog in a wheel to part of the motive power cannot be overemphasized. It will bring appraisers into the mainstream of development, finance, and investment activities; expand their horizons; and eventually broaden their knowledge and perception of the market.

"PURPOSE OF THE APPRAISAL" PRESENTS CONTINUING PROBLEMS

Too many statements of the purpose of the appraisal are couched in conventional language that fails to capture the reason for, as well as the special circumstances of, the appraisal assignment. The questionnaire survey revealed some deep concern or difficulty among appraisers with understanding or enunciating the purpose of the appraisal. Additional research through interviews with many appraisers indicated a continuing degree of confusion on the subject. The fundamental problem appears to be the conviction that physical real estate has an inherent asset value, that is, a bedrock figure, without regard to property interests. This conviction stems from a failure to grasp the bundle of rights theory that holds that market value consists of the valuation of defined property rights and interests, not necessarily the physi-

cal real estate alone. Many different interests may exist within the same realty. They include, but are not limited to:

- Type of entity in which ownership is held
- Type of property ownership such as fee simple, leasehold, or arrangements involving a master net lessee, subnet lessee, or gross lessee
- Liens and encumbrances against the property, evidencing some form of ownership interest, claim, or regulatory rights (such as rent control or zoning) that affect value, in addition to mortgages

The appraiser values the real estate subject to the rights, liens, claims, and interests of the parties involved in the real estate. If the purpose of the appraisal states that the client has requested an appraisal subject to some or all of those rights, interests, or claims, it is certainly conceivable that the market value may differ from the traditional definition of market value as all cash or its reasonable equivalent—the equivalent presumably being cash, plus a maximum of 75% mortgage at current interest rates.

The valuation problem became infinitely more complicated after the passage of the Economic Recovery Tax Act of 1981, which permitted deferred interest without current income tax liability. Such devices as subordinated ground leases, installment payments (usually without interest), equity participations of every imaginable type, deferred mortgage interest, and others were used to increase tax-sheltered returns. A recent article in *The Appraisal Journal* has drawn attention to the fact that many of the problems encountered in appraisal reports today are caused by the breakdown of communication resulting from the vagueness of terminology.

> Contrary to outward appearances, the crux of this problem is not the issue of what should or should not be included in the market value definition but what in each valuation situation the appraiser has or has not included....There is absolutely no possibility of a misunderstanding so long as the appraiser is careful to properly qualify what the estimate does in fact represent.[16]

The primary problem with the statements of purpose in appraisal reports is the occasional failure of the appraiser to state fully what the terms and conditions of the appraisal must be, since obviously radical differences in market value will result. Other appraisers refuse to recognize the financing on a property planned for tax shelter and adamantly hold that there can only be one value, that is, the free and clear value or its reasonable equivalent. Still others fail to see the distinction between a "wholesale" or institutionalized value and the property value at "retail," after subdividing the property interests into very small shares for the small investor. Profits to the syndicator (the wholesaler) and associated costs must be accounted for realistically.

Recognition of the foregoing, however, is no license for appraisers to support inflated values that cannot be justified over a reasonable time frame.

16. David C. Lennhoff, "Defining the Problem," *The Appraisal Journal* (April 1986): 203-204.

Many of the post-1981 syndications will not be able to meet such a test—evidence to this effect is mounting daily. It is appraisers' responsibility to try to identify the deal structurings that will provoke future problems and to discount the market value accordingly.

A clear understanding of the appraiser's responsibilities in an appraisal assumes the prequalification of the appraiser by the client. It is to the client's distinct advantage to choose an appraiser who has the education, training, and experience in the type of property to be appraised. No amount of painstaking instructions to the appraiser concerning the purpose of the appraisal will suffice if the appraiser is unable to carry out the assignment effectively or does not comprehend the full meaning of the client's needs.

Prequalification requires investigating the appraiser's background, experience, and work product; and talking to his or her clients. A personal interview is indispensable. Recommendations by others are insufficient reasons for eliminating a personal meeting. The client and appraiser must be on the same personal wavelength. It is essential to choose the right person, not just the designation, and to fit the person to the task. Once the appraiser is chosen, a fee may be negotiated. If a highly selective choice is to be made, the appraiser should not be subjected to the demeaning need to make a competitive bid.

Appraisers have been unfairly criticized in hindsight because subsequent events have not always borne out their valuations or predictions. In some cases, the criticism might have been deserved, but the difficulties of accurately forecasting the future place appraisers in the same precarious position as economists or stock market analysts. James E. Gibbons, MAI has stated:

> I also believe there should be more emphasis on "date of appraisal." If value is present worth or perceived futures, the as of date is a key consideration. No one could argue successfully that the future looked the same in 1974 as it did in 1978, or as it did in 1980, or 1982. Securities analysts face the same problem as appraisers, but the public seems more willing to understand their difficulties in handling economic variability than in the case of appraisers. This situation stems, no doubt, from the bricks and mortar, concrete aspect of real estate, which wrongly conveys impressions of stability. Looking at many REIT appraisals of 1972-73, one might not find the news expressed to be at variance with the widely shared opinions of that time concerning "future benefits." The loan underwriting, however, was aggressive....The same conditions exist today in the savings and loan field; and I believe the FHLBB is trying to correct underwriting problems by tinkering with the appraisal function. Their concern and desire for a "way out" are understandable.[17]

PROFESSION OR PROFESSIONAL DISCIPLINE?

The Appraisal Institute and many individuals in the appraisal business have made significant advances towards achieving recognition of appraisal as a

17. James E. Gibbons, letter to the author, June 20, 1986.

profession. The college degree requirement of the Appraisal Institute is one. The sharply improved quality and diversity of the Appraisal Institute courses are further evidence of such advances. A nationwide certification system is yet to be achieved and appears essential to full recognition. Uniform state license examinations administered by the Appraisal Institute would be an effective alternative solution to accreditation. The consistently high quality of the Appraisal Institute's publications also provides evidence. The conscientious nature of the review process for alleged violations of ethical conduct or standards is added support for professional recognition. Last, the infinitely more complex nature of the appraisal process demonstrates the extent of advances towards recognition. One can only fault the previously discussed tendency to avoid a broadening of services such as market analysis, feasibility studies, economic base analysis, deal structuring, and corporate relocation.

One test of professionalism is a willingness to serve the public without charge. Doctors and lawyers must do this on occasion in their everyday practices. Accountants, architects, and engineers usually reduce their billings; many appraisers do so as well. However, appraisers are generally not recognized as providing gratuitous appraisal or advisory services to deserving clients. Willingness to serve the public without charge is the least important requirement in any quest for professional recognition. The problem of appraisers' reluctance to do so will tend to solve itself, however, as they near their goal, because more appraisers will be willing to give of themselves under certain circumstances as further evidence of their professionalism.

At this stage, I would characterize the appraisal field as an advanced business service with dedicated appraisers possessing a professional attitude. The most significant aspect to report is how appraisers feel about themselves. The questionnaire survey revealed that at least half of the responding appraisers felt that they were in a profession. Many of the respondents felt some degree of professional attainment. This represents a healthy situation in which a serious intent is very apparent.

THE APPRAISER OF THE FUTURE

Ideally the future MAI will have the following attributes:

- A liberal arts college degree
- An MBA or MS in real estate, accounting, finance, mathematics, economics, economic geography, city planning, or computer services
- Three years of real estate experience in sales, leasing, financing, management, or development
- Accreditation within three years thereafter, through obtaining the MAI designation and a state-certified license based on tests prepared by the ruling appraisal organization

- Improved writing ability and sharply improved communication skills in dealing with clients and the general public
- Membership in a consolidated professional organization consisting of the Appraisal Institute, the Society, and ASREC

The future MAI's practice will differ in the following ways:

- Companies will be larger, with more diversified groups of professionals possessing competence in fields directly related to valuation
- Fee structures will fully recognize the importance of appraisers' professional contributions
- Full professional recognition will have been attained
- Lenders, investment bankers, developers, and owners will fully accept appraisers and show increased respect for their role and standing
- The ambivalence caused by the ethical requirements for an unbiased detached appraisal result will have been resolved, or a stronger statement of how advocacy may be practiced when the appraiser is acting as an investment or market analyst or advisor will have been issued

THE PROFESSIONAL TRADE ORGANIZATION OF THE FUTURE

If real estate appraisers are to be perceived as professionals rather than as business people with professional objectives (a very important distinction), then the two qualifying organizations, the Appraisal Institute and the Society, must merge, together with ASREC. This will set the stage for obtaining state enabling legislation that will permit the surviving organization to be the agent of the 50 states in establishing regulation requirements and essential examinations to be monitored by each state.

The various professional functions, such as marketability and feasibility analyses, appraising, economic geography, marketing, and general counseling could be subdivided so that members could pursue their favored areas of specialization under one strong professional organization. Ideally, a name change to the American Society of Valuers and Counselors would be appropriate. The British have accomplished this organizational structure quite effectively through the RICS, which permits specialization in many different areas of the real estate business.

Brokers, agents, managers, and owners could continue to be represented by NAR through their affiliated organizations. The concept is not to compete with NAR, it is merely to form an organization equipped to meet certain high standards by, among other requirements, rigorous examinations and insistence on adherence to a strict code of ethics and standards of professional practice. The renamed and consolidated organization would be represented by NAR and referred to as the professional side of appraisal as distinguished from the business side.

HOW INVESTORS AND LENDERS CAN BEST UTILIZE APPRAISAL SERVICES

Investors and lenders can make the most of appraisal services by first understanding the appraiser's background and then by becoming adept in the selection process. Appraisal as a near science has only been practiced since 1932 when the Appraisal Institute was created. The Appraisal Institute deserves high marks for improving educational standards and conceiving, as well as enforcing, a Code of Professional Ethics and Standards of Professional Practice. Appraisal's progress toward public recognition as a profession has been hampered by the localized nature of real estate and the fractionalization of the trade associations serving appraisers. In analyzing these various organizations, the Appraisal Institute stands out as possessing the highest standards and being the most professionally dedicated. Thus, the selection process for choosing an appraiser will generally, but not necessarily always, demand that he or she have the MAI designation.

In selecting the appropriate person to perform an appraisal, it is critical that the appraiser have direct experience in the property type for the planned assignment. The chance of making a selection mistake is reduced by engaging someone with documented experience in a particular property category. The breadth of an appraiser's skills and practice is very important in the selection process. Ideally speaking, the most qualified appraiser, in addition to the usual valuation skills, should have some direct field experience in leasing, sales management, or development. Truly, "the next best thing to knowing is knowing how."[18] This is not always possible because many appraisers start as interns or trainees and do not get the opportunity of "hands on" experience. However desirable field experience may be, it should not necessarily be considered an absolute requisite in qualifying an appraiser for engagements.

It is desirable, but not absolutely essential, that the appraiser possess a master's degree in a business-related subject. Graduate school majors that are especially helpful in developing appraising and counseling skills are mathematics, economics, finance, economic geography, and computer services. An ability to communicate orally and in writing is paramount. In terms of personality, an appraiser should be imaginative and creative yet possess a sense of perspective about the cyclical nature of market activity. In general, one can anticipate that the larger the appraisal practice, the better deadlines will be met. Medium to large size companies have appraisers with diverse skills and backgrounds for a broad comprehensive service. There is, however, a natural disposition for the single-family appraiser to specialize, and many appraisers of income properties will exclude them from their practices. My references here, however, are solely to appraisers of income properties. The highly essential qualities of judgment and maturity in an

18. Dorau, p. 419.

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appraiser can only be determined over time. However, a reading of the appraiser's prior reports is helpful in forming conclusions about his or her ability and may help the lendor avoid making a selection error.

Much emphasis must be placed on ensuring that the purpose of the appraisal is carefully and thoroughly explained by the client and that the appraiser clearly grasps the objectives of the assignment. It is important that the appraiser understands the so-called bundle of rights theory in regard to identifying the property interest to be appraised under specific terms and conditions. To the extent that the appraiser can state the purpose with clarity and simplicity, devoid of boilerplate language that may not even fit the particular assignment, there will be less misunderstanding and confusion in dealing with the client.

Clients must also understand the difference between a formal appraisal assignment and its requirements, and an investment analysis. A formal appraisal under the Code of Professional Ethics requires a fixed arbitrary valuation result, arrived at objectively and based on substantiated market evidence, using standardized valuation approaches. In contrast, an investment analysis usually provides a range of possible market values and is devoid of heavy market substantiation because the appraiser has been prequalified to act in an advisory capacity to his or her client rather than only as a dispassionate and professionally detached observer of the market scene as required in the formal appraisal report. Fiduciaries, in particular, can take significant advantage of appraisers' skills and extensive market knowledge by using them in advisory capacities. For example, in screening a property for possible purchase, it is senseless to obtain a formal appraisal. Instead, the investor should consider engaging an appraiser to verify rents, taxes, expenses, capital costs, neighborhood quality, internal rates of return (IRR), and so forth, without constricting him or her to a formal valuation result. However, when it is necessary to have annual valuations in explanation of a portfolio's performance, the formal appraisal report must be ordered.

CONCLUSION

The post-1975 period witnessed a significant change in the way in which appraisers made appraisals. The frenzied inflation-ridden market, the growing complexity of leases, and the complicated structure of transactions forced the creation of the LXL/DCF method of income capitalization. In the late 1970s, a computer software program was created allowing every lease term and condition, and every subsequent change to be entered into the computer for reporting and analysis purposes. This was similarly achieved for expenses. Together with the established discounting techniques for capitalization purposes, this software program enabled a quick, efficient, and infinitely more accurate presentation of the probable net income at assumed compound growth rates for revenue and expenses over an extended time frame.

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The new capitalization techniques solved a vexatious appraisal need and elevated some appraisers to a new standing with their clientele because their professional services became so much more effective. At the same time, appraisers obtained new clients. They were no longer completely reliant on the local savings and loans, commercial banks, attorneys, and investors for business. Pension funds, life insurance companies, realty trusts, publicly owned investment and development companies, and foreign entities constituted a stronger institutional linkage for appraisers. Mortgage loans, tax reduction, condemnation, and estate taxes were no longer the only reasons to engage appraisers. A new set of needs surfaced in the 1970s and thereafter, involving strange new concepts such as appraised value balance sheets, due diligence needs in public issues, and purchase or sale anticipations.

The vast bulk of routine appraisal work was not unduly influenced by either the more financially volatile economic times or the more advanced income capitalization methodology. The significant elevation in the perception of appraisers' standing has been mainly evident among a select few in major cities, with a concentration in financial markets such as New York, Boston, Chicago, Houston, Dallas, Los Angeles, and San Francisco. An elite class of appraisers has developed in the largest metropolitan areas over the past decade and, in a sense, has left the rest of the membership behind. It is this group that has heightened professional status and an improved institutional linkage with the financial services world. A new view of the quality of appraisers has emerged among investment managers, investment banking and stock brokerage companies, and other relatively new engagers of appraisal services. The more complex times and the more complex appraisal methodology have combined to elevate the standing of selected appraisers over many of their former peers.

Many appraisers have responded to these new opportunities by emerging from their provincial environment not only to become more technically proficient, but also to have more breadth of capability and to act in an advisory capacity to an increased extent. Those who have achieved these goals have developed enviable professional practices of the highest caliber. This is not unlike the degree of achievement in any other near-profession or profession. A certain number of appraisers will invariably rise above the multitude of practitioners. This elite corps possesses working artifacts, intelligence, mastery of technique, and a deep sense of perspective on the national and local economies and their effects.

This same distinctive group has experienced a significant evolution in market perception from essentially passive dispassionate observers of the market scene, to confidential allies and advisors to clients in both analysis and implementation. This new maturity has been especially identified by investment managers and bankers, and acquisition officers of trusts and other institutional entities. Insurance companies have not participated to the same

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extent in this evolutionary elevation of appraisers' status. They have preferred to seek their own counsel and, hence, have generally used only outside fee appraisers to make formal appraisals. Commercial banks and savings and loans have also not used appraisers wisely; their loan records over the past decade bear this out.

From the viewpoint of the typical investor or lendor, the most perplexing and annoying problem in dealing with appraisers is their tendency to be proficient in methodology at the expense of more broad capacities in marketability, feasibility, and implementation of valuation results. Appraisers have not been venturesome in acquiring skills in market and investment analysis. Their perspectives on the relationship of a particular real estate problem to the general economy need improvement. They have not proven to be particularly adept at market forecasting or allocating a reasonable portion of the total market to a project. Surprisingly, many appraisers still scoff at computer software and make obvious statements about the need for quality data. This points out the importance of selecting the right person or company to serve the client's needs.

Have appraisers achieved professional status? Unfortunately, the answer is no. A precedent need is for the three predominant professionally motivated organizations—the Appraisal Institute, ASREC, and the Society—to form a more powerful and effective umbrella organization that could then gain more widespread recognition for appraisers, analysts, and counselors.

This new organization under a new name (I prefer the American Society of Valuers and Counselors) could then press for the second precedent condition of professionalism, industry regulation, to be under its administration. Together with more stringent educational requirements, it is entirely possible that appraisers could gain almost universal acceptance as professionals by the end of this century. In the interim, appraisers should continue their dedication to professionalism in the manner in which they carry out their practices. As Charles F. Seymour, MAI, has stated:

> Although we like to tell each other that we have become a profession, I believe that it is much more accurate to describe real estate appraising today as a service business struggling to become a profession. That struggle will continue during the '80s. Progress will be made; there is even a chance that we will succeed![19]

19. Charles F. Seymour, "The Outlook for Real Estate Appraising in the '80s," *The Appraisal Journal* (April 1980):169.

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Dr. Kinnard has taught Finance and Real Estate, including valuation and investment analysis, since 1948. He retired from the University of Connecticut in 1981. While there, he was Professor of Finance and Real Estate, Director of the Center for Real Estate and Urban Economic Studies, Head of the Finance Department and Acting Dean of the School of Business Administration. Dr. Kinnard was twice included in Outstanding Educators of America and was a 1979-80 Beta Gamma Sigma Distinguished Scholar. He was also listed in Who's Who in the East and Who's Who in American Education. He is an Honorary Fellow in the Homer Hoyt Institute, and a member of Lambda Alpha.

Dr. Kinnard is past President of the American Real Estate and Urban Economics Association, and of the Connecticut Chapter of the Society of Real Estate Appraisers. He has been a visiting professor at major universities. He is a long-time faculty member for the Society of Real Estate Appraisers and the American Institute of Real Estate Appraisers, and has lectured for the Institute of Financial Education, the Mortgage Bankers Association of America, the American Society of Appraisers, the Institute of Property Taxation, and the International Association of Assessing Officers, among others.

Dr. Kinnard was Educational Consultant to SREA from 1965 to 1985. During that time, he authored or helped develop all the Society's courses and seminars. He has also been educational consultant to the Society of Industrial Realtors, the American Right of Way Association, and the National Institute of Real Estate Brokers.

Among Dr. Kinnard's more notable publications are Income Property Valuation, the text for SREA Course 201, and the first three editions of SIR's Industrial Real Estate. He has numerous articles in professional and academic journals, primarily on valuation and investment topics. He is a licensed real estate broker in Connecticut.

Within RECGC, Dr. Kinnard directs and reviews valuation, investment and market studies for both private and public clients. He testifies and consults nationally on the appropriate techniques applicable to valuation issues: including leased equipment, other tangible personal property, interests in real property, and going concerns. The nationwide practice is varied and wide-ranging, with emphasis on property tax appeals and expert testimony in litigation.

Dr. Kinnard is a Principal in the Real Estate Counseling Group of America, with which RECGC is affilicated. In 1985 he received the Alfred E. Reinman Award from the Society of Real Estate Appraisers, and the George F. Bloom Award from the American Real Estate and Urban Economics Association.

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CRITICAL IMPLICATIONS OF CONTROL AND THE CONCEPT OF AN APPRAISAL STANDARDS BOARD

William N. Kinnard, Jr.
Storrs, Connecticut

A Presentation at a Seminar on

Public and Private Control of Appraisal Procurement

The Real Estate Counseling Group of Connecticut, Inc.

I. Appraisal Procurement and Control: Why an Issue?

A. F, F & A A

1. Purported Role in Financial Institution Difficulties

2. Alleged Role in Federal Agency Losses

3. Misunderstood Role in Decision Making about Real Estate Investments

4. What is an "Accurate Appraisal"?

a. Whose Criteria (or Definition)?

b. Whose Decision (or Determination)?

c. Whose Interpretation?

B. "What Value?" vs. "Value of What?"

1. Confusion and inconsistency among:

a. Legislators

b. Regulators

c. Courts

d. Attorney/Advocates

e. Lenders

f. Developers

g. Real Estate Agents

2. Market Value

a. Specified Market Conditions
(1) Valuation Date
(2) Evanescence
(3) Asking the Wrong Question(s)

b. The Cash Equivalency Brouhaha
(1) "Cash in U.S. Dollars or the Equivalent Thereof"
(2) Cash Equivalency of What?
(3) "Money" vs. "Cash (or its equivalent)"

c. vs. Investment Value (or Investor Value)

d. vs. Use Value (or User Value)

e. Definitional Difficulties
   (1) The Humpty-Dumpty Syndrome
   (2) Redundancy can be an Evil as well as a Virtue
   (3) Linguistic Imprecision
      (a) Committee Efforts
      (b) Compromise

f. Asking the Wrong Questions (Revisited)
   (1) vs. Most Probable Selling Price

3. What Interest in Realty?

   a. Fee Simple
      (1) What is it? To Whom? (Don't ask a lawyer)

   b. "Unemcumbered Fee"
      (1) Often a Misnomer
      (2) Nonsensical for Investment Properties

4. Client Objectives

   a. Perceived Wants and Needs vs. Knee-Jerk Tradition

   b. "Value" at Sale
      (1) When? Today? Specified future date(s)? UNSPECIFIED FUTURE DATE?
      (2) What Conditions? Forced sale? Liquidation? Sale? "Normal" transaction?

      [Footnote: Is "Normal" normative or descriptive?]

      (3) Likely price or "needed" nominal price?
      (4) Terms of sale (especially financing)?

   c. Likely cash flow(s)
      (1) Cover client/lender needs and requirements
      (2) If underwriting is done properly, never need to find out whether the appraisal is done properly

C. Procurers, Prostitutes and Johns

1. Deregulation: Greed and Avarice Unleashed

   a. Points and Fee: "It's What's Up Front that Counts"

b. Underwriting vs. Booking Loans
   (1) Commissions, Fees, Bonuses for Volume (not Performance)
   (2) Participations and Secondary Market Sales
      (a) The Greater Fool Theory in Action
      (b) Due Diligence Ignored

2. The Appraisal/Appraiser as an (the?) Obstacle to the Deal

   a. "Doing Deals" vs. Making Loans

3. FDIC Non-Regulation

   a. Guideline Letters

   b. No Standards

   c. Rationale

4. FHLBB Retrogression

   a. The R41 Series of Memoranda: 1977-1986

   b. R41c
      (1) Nobody liked it (so it must have been close to the mark)
      (2) If it wasn't needed, why all the flurry of activity to build a substitute edifice?

   c. Current proposals on the table
      (1) Rescind R41c
      (2) Emulate Bank Regulators' Non-Standards (CEBA)
      (3) Have individual insured institutions adopt and enforce own standards: The fox in the hen house
         (a) Non-consistency: chaos
         (b) Non-enforceability: chaos in examinations
         (c) Delay in discovery: loss plus chaos
         (d) Non-preventice

II. An Appraisal Standards Board

A. Background and History

1. Professional Performance vs. Ethical Behavior

   a. Competence, Skills
      (1) Training
      (2) Experience

b. Conflict(s) of interest
(1) Objectivity (non-bias, non-advocacy)
(2) Measurement vs. advice

2. Inability of Individual Professional Appraisal Societies to Respond

a. Diversity of Organizations
(1) Proliferating plethora in profusion
(2) Differing objectives, membership

b. No Generally Accepted Appraisal Principles
(1) Not necessarily all bad: See FASB 15, for example
(2) No consensus
(3) No authority(s) to cite
(4) No standard yardstick for measurement

c. Inability, unwillingness to join or unite in one position

d. Inability to enforce ethical standards they have
(1) Due process bars
(2) Ponderous procedures
(3) Fear of suit (based on actual experience)

e. Inability, unwillingness to merge

3. 1979 Proposals

a. CREUES and AREUEA
(1) Appraisal Standards Board of North America
(2) Academic base and orientation
(3) Doomed: Mistrust and Jealousy

4. NACAO
(Post hoc propter hoc?)
a. Report Standards
b. Regulator Meetings, Dialogue

5. Standards Boards, Committees, Statements within Individual Organizations

B. Uniform Standards of Professional Appraisal Practice

1. Joint committee (ad hoc) of 9 appraisal organizations

2. Threat from outside (Barnard Subcommittee)

3. Created in months

4. Adopted, accepted by all 8 in U.S.

5. Reasonable starting point

C. The Appraisal Foundation (Self-Regulatory Organization)

1. Threat from outside

2. NACAO Nucleus

3. Added Members:

4. In place 12/87

5. Advisory, trusteeship only

6. Two "operating" Arms (subsidiaries)
   a. Appraisal Standards Board
   b. Appraiser Certification Standards Board

D. Pending Federal Legislation: H.R. 3675

1. Federal Regulatory Structure: Federal Interagency Appraisal Council

   a. All appraisal work (and appraisers) in "federally covered transactions" [anything that involves a loan, a guarantee or federal insurance]

   b. Prescribe Uniform Standards for "covered appraisals"

   c. Establish requirements to certify "covered" appraisers

   d. Oversee state certification programs

   e. May accept advice and materials from Appraisal Standards Board

2. State Certification System

   a. Federal Certification if state has none, or not acceptable

   b. Balkanization of appraisal and appraising (Muhammed must go to the mountain; appraising is close to being unique.)

E. Appraisal Outside Lending or "Federally Covered Transactions"

1. Need for consistency in standards

2. Inherent bias of any regulator or administrator: constricted view of the world.

3. Possibilities for different:

a. Terminology

b. Difinitions

c. Tools and Procedures

d. Concepts

e. "Principles"

III. Implications for Appraisal, Appraisers and Real Estate Activity

A. Gresham's Law for "federally covered transactions"

B. Shotgun marriage(s) of major appraisal organizations, for survival

C. Possible consistency within scope of FIAC

D. Increase in "valuation consulting", "advising", "analysis" by major appraisal firms (and accounting, securities, architectural, engineering firms)

1. More "property economists"

2. Not all to the bad

E. Virtual demise of small, independent, non-volume firm <u>unless</u> highly specialized

1. Property tax work

2. Litigation

3. Market and feasibility studies

F. Restructuring and redirection of appraisal education and training

1. Collegiate level

2. Professional association

3. Proprietary school, agency sponsorhip

G. Whether HR 3675 passes (as is or amended) or not, the perception, structure, procedures and education of appraisers and appraising will be irrevocably changed markedly and measurably by 2000-or earlier.

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February 24, 1988

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Dear Chief,

As I have already written to the other participants, I thought our program was a smashing success and I really enjoyed doing it. Many thanks to you for creating the original program and your diligence in making it happen here in Atlanta. I enjoyed the chit chat between you and John R. White and, as you can see, added some of mine.

I assume your associates have started sending out refund checks. I hope the records we provided were clear and adequate. We've already sent the hotel bill under seperate cover. If any of the speakers submit expenses to me I'll rush them to you right away.

Many thanks again. I hope you had a good trip home.

Yours very truly,

James D. Vernor, Ph.D.
Chairman, Department of Real Estate

JDV/lp:K

March 9, 1988

William N. Kinnard, Jr., SREA, MAI, CRE
President
The Real Estate Counseling Group of
Connecticut, Inc.
Holiday Mall, Box 558
Storrs, CT 06268

Dear Bill:

Thanks again for being so supportive of Georgia State and Wisconsin Real Estate Programs. We are in your debt and here are a few blue chips which we will cash in:

1. We have reserved Thursday, October 6, for a keynote presentation, even though that means shortening our Wednesday evening class.

2. The address of Ahmed Karoos, Ph.D.:

   Home: 6796 S. Detroit Ct.
   Littleton, CO 80122

   (303) 694-2999

   Business: Council of Energy Resource Tribes
   1580 Logan St., Suite 400
   Denver, CO 80203

   (303) 832-6600

3. Relative to opportunity cost stuff, I have enclosed an excerpt from our AHTNA appraisal and the readings from the appendices.

The Portland Electric decision should be read in light of the Montana Power and Light decision. We are also looking to receive the AEUK case recently decided in Alaska.

Earlier I sent you a copy of comments proposed for the Barnard Committee. Actually things went better than the comments as the questions by Congressmen Craig and Barnard allowed me to pound at the inability of volunteers in a good-old-boy network to produce studies or reform them.

Crawford, the California savings and loan commissioner, came out after the hearing really excited about my comments. As usual, I talk better than I write--play a better game than I practice!

Really regret missing your comments in Atlanta. Maybe we can do something similar on the West Coast in early 1989. Thanks again for being so generous with your time.

Your check is churning through the University Process so, Lord knows when it will appear!

Best of everything,

Professor James A. Graaskamp
Chairman, Real Estate & Urban Land Economics

JAG:mjf

Enclosures

Georgia State University
University Plaza • Atlanta, Georgia 30303

THE DEPARTMENT OF REAL ESTATE
Analytics * Investments * Markets * Planning * Development
(404)651-2760

February 24, 1988

Mr. John R. White
Landauer Associates, Inc.
Real Estate Counselors
335 Madison Ave.
New York, NY 10017-4683

Dear John,

Your kind letter and Jim Graaskamp's response to you reached my desk on the same day! The mailmen must all be Northerners! I agree with the "Chief's" sentiments entirely. While we would love to have you visit any time, you really shouldn't feel that you owe us anything for the Feb. 12 meeting. We realize the snowstorm must have been severe to keep you away but Jim Graaskamp was delighted to steal all the extra time anyway.

The program ran great. The participants were all sincerely appreciative, and David Haddow was a sincere stand by. I considered the program highly successful artistically as well as from the standpoint of support for our alumni groups. I was proud to be associated with the names on the program. Many thanks to you. We are in your debt.

Yours very truly,

James D. Vernor, Ph.D.
Chairman, Department of Real Estate

cc: Professor James A. Grasskamp

JDV/lp:K

The School of Business
University of Wisconsin-Madison

Graduate School of Business
1155 Observatory Drive
Madison, WI 53706
608/262-0391

December 14, 1987

Mr. M. Danny Wall
Chairman
Federal Home Loan Bank Board
1700 G Street, N.W.
Washington, D.C. 20552

Dear Mr. Wall:

On October 2, the Federal Home Loan Bank Board withdrew its proposed revisions on R41-C which it had put forth in May of this year and replaced it with a new proposal that would "instruct the management of each insured institution to develop, implement, and maintain appraisal policies and practices." Presumably, this capitulation on efforts to improve appraisals was necessary to accomplish requirements of the Competitive Equality Banking Act.

I was appalled that the Federal Home Loan Board stated the new proposal "emphasizes the exercise of discretion by management rather than the individual components of an acceptable appraisal . . . and will foster both cost efficiency in the appraisal process and competitive policy with the banking industry."

The banking industry has no appraisal standards, and pressure to reduce appraisal fees has driven the good appraisal firms from the mortgage lending business. Everywhere I go, appraisers complain of the unethical pressures brought by borrowers and bankers to accommodate loan requirements. Gresham's Law has driven quality real estate research out of the market. Good appraisal requires many hours of professional investigation, but good appraisals are essential if we are to protect the integrity of our financial institutions.

To claim that flexible standards create cost efficiency is black humor. "Flexible standards" and "cost efficiency" are responsible for the loss of many billions of dollars by the FSLDIC. Almost every fraud has had appraisal documents from accommodating appraisers who were carefully selected to be cheap and superficial. Appraisal professionals have publicly argued for standard specifications for institutional appraisals so that they understand their assignment and so that costly amendments to the original appraisal are not required when loans are subdivided among different lenders with other requirements or are sold in the secondary market. "Flexible standards" make no administrative sense for FSLDIC and destroy the basis for demonstrating malfeasance by the lender or the appraiser. Of course that is exactly why lenders are pushing the Board to abandon R41-C or similar regulations.

At the very least, the Federal Home Loan Bank Board should require that appraisers be hired by work for the savings and loan industry <u>without borrower input</u> to the selection process. In addition, the loan officer should sign his concurrence with the appraisal report conclusions and indicate that he ha read the appraisal. Finally, the appraisal report should include specific, objective market research data to demonstrate effective demand for the property.

Those of us who believe appraisal is critical to social equity, integrity of financial institutions, and efficiency of capital allocation have been betrayed by the Federal Home Loan Bank Board's abandonment of the ideals expressed by R41-C. The yielding of the Board to political pressures within the savings and loan industry and the charlatans in the banking and appraisal industry may not be noticed in current capital markets. But it will be noticed when the FSLDIC loses <u>many additional billions of dollars</u> in the years ahead.

This note is prompted by a career which has been dedicated to improving the appraisal process. I believe my credentials allow me to make these charges and this letter is not instigated by any professional society to which I belong. I have attached a short vita to indicate to you

and your fellow board members that I have some basis for my perceptions on the Board's proposed appraisal changes. In time I will address these comments to appraisal organizations and the U.S. Savings and Loan League.

With deepest regret,

James A. Graaskamp

James A. Graaskamp, Ph.D., SREA, CRE,
Chairman, Real Estate and Urban Land Economics

JAG:mjf

Enclosure - Vita Sheet

xc - Prof. Jon G. Udell

Office of Regulatory Policy,
Oversight and Supervision

January 13, 1987 S.b. 1988

Dr. James A. Graaskamp
Chairman, Real Estate and Urban Land Economics
Graduate School of Business
University of Wisconsin
1155 Observatory Drive
Madison, Wisconsin 53706

Dear Dr. Graaskamp:

I am responding to your letter of December 14 on behalf of Chairman Wall. Your letter contained your expressions of regret with regard to what you have perceived as the Board's capitulation on efforts to improve appraisal standards.

The Federal Home Loan Bank Board's (Board) revised appraisal standards were mandated by the Competitive Equality Banking Act (CEBA), which required that the Board have standards consistent with the federal banking agencies. The previous R-41c standards were issued as a memorandum, not a formal regulation, and had been subject to litigation over the Board's authority to enforce them. By adopting a regulation with a policy statement, we believe that we met the requirements of CEBA while not retreating from our history of high appraisal standards. The banking agencies adopted appraisal guidelines (not regulations) last month and you may be interested to know that a source for the guidelines was R-41c.

You will note that the policy statement that accompanies the rule contains many of the appraisal standards previously set forth in R-41c. While we cannot use formal enforcement action based on lack of compliance with a single element of the policy statement, we believe we have enhanced enforcement ability when an institution either does not have appropriate appraisal policies or fails to follow them in a safe and sound manner. All institution-generated policies will be carefully scrutinized by examiners, not just for evidence of their existence and their "quality", but for evidence that they are faithfully followed.

We share your concerns that the Board's new rule may be perceived by some managers as an excuse to lower or abandon their appraisal standards. We assure you,however, that our examination and supervisory staffs will do their utmost to see that this does not happen. The Board continues to support and expect only the best in appraisal work.

Thank you for writing.

Sincerely,

Darrel W. Dochow

Darrel Dochow
Executive Director

cc: Secretariat

SOCIETY OF REAL ESTATE APPRAISERS®

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copy sent to Udell

February 1, 1988

James A. Graaskamp, Ph.D., SREA, CRE
Chairman, Real Estate and Urban Land Economics
University of Wisconsin-Madison
Graduate School of Business
1155 Observatory Drive
Madison, WI 53706

Dear Jim:

Thank you for the copy of your letter to Chairman Wall regarding the new appraisal regulations of the Bank Board.

The Society is currently preparing testimony to deliver before Congressman Barnard's Subcommittee later this month. The issue of Bank Board appraisal policies is one we will address.

I am forwarding a copy of your letter to Congressman Carroll Hubbard, Chairman of the Oversight and Investigation Subcommittee, who will be conducting a hearing tomorrow on the issue of FSLIC recapitalization with Danny Wall as the only witness.

Sincerely,

Don Kelly

Donald E. Kelly
Legislative Counsel

DEK/cw

cc: Bill T. Hylton, SRA, Chairman, Public Affairs Committee

Jim - will mail you HR3675 when printed by GPO

Congressional Record

INTRODUCTION OF THE REAL ESTATE APPRAISAL REFORM ACT OF 1987

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Georgia [Mr. BARNARD] is recognized for 5 minutes.

Mr. BARNARD. Mr. Speaker, I am today introducing the Real Estate Appraisal Reform Act of 1987. This legislation requires the establishment, by the Federal Government, of uniform appraisal standards and appraiser qualification requirements for real estate transactions in which the Federal Government has substantial financial or public policy interests. These appraisal standards and appraiser certification requirements will be enforced by State appraiser certifying agencies, authorized in the legislation.

Mr. Speaker, each year, billions of dollars in real estate loans and investments are made in which appraisals play a crucial role. Whether the transaction involves a multimillion-dollar commercial real estate project, the sale of hundreds of millions of dollars of mortgage backed securities, or the issuance of a $90,000 residential mortgage, it is a real estate appraiser who establishes the value of the property which collateralizes the loan or investment. It is a real estate appraiser who provides lenders and investors with assurance that in the event of a default, the property securing the project will be sufficient to cover all or most of the outstanding loan balance or the financial commitments made to investors. Without a real estate appraisal, most lenders will not lend and most investors will not invest in real estate related financial transactions.

But if there is a default in a real estate transaction and the appraisal has been faulty or abusive—if through incompetency or a desire to please a participant in the transaction, it grossly overvalues the collateral—the consequences can be catastrophic: Financial institutions can fail or sink into problem status; arms-length investors can lose their investments; financial markets can be disrupted; and innocent mortgage borrowers forced into backbreaking debt.

Mr. Speaker, the Federal Government has a vital financial and public policy interest in all of this: The Federal Deposit Insurance Agencies—the FSLIC and FDIC—are obligated to pay off depositors in financial institutions that fail because of bad real estate loans buttressed by bad appraisals. Agencies like the Federal Housing Administration, the Veterans' Administration, and the Farmers Home Administration, are required to reimburse commercial lenders when borrowers default on federally guaranteed residential mortgages and collateral is insufficient to pay off outstanding loan balances. Fannie Mae and Freddie Mac suffer millions of dollars in losses when there are defaults on mortgages they have purchased and collateral has been overvalued. The SEC's responsibility to assure accurate public disclosure of the market values assigned by appraisers to real estate securing mortgage backed securities, suffers when those appraisals are negligent. The statutory functions of other Federal agencies, like the General Services Administration and the Federal Highway Administration, have even been compromised because appraisals commissioned by those agencies turned out to be faulty.

The central cause of these problems, Mr. Speaker, is that the real estate appraisal industry is basically unregulated throughout the country. In more than 40 of the 50 States, anyone can perform real estate appraisals without having to demonstrate basic competency and without having to obtain a real estate appraisal license. If an individual wants to be a barber, a beautician, a plumber, or an electrician anywhere in America—let alone a physician, an attorney, an accountant, an engineer, or an architect—they are required to prove basic skills and submit to supervision by an appropriate State agency. Moreover, if an attorney or an accountant wishes to practice before the Federal Government or in areas governed by Federal statute, their professional conduct and the standards they use in their practice, are subjected to Federal supervision. But a real estate appraiser, who is responsible for establishing the value of properties collateralizing loan and investment transactions worth tens and even hundreds of millions of dollars each, is not subject to any systematic competency testing or supervision.

Mr. Speaker, the nature and extent of real estate appraisal abuses and their impact on Federal and private sector interests, have been carefully documented by the Government Operations Committee's Commerce, Consumer and Monetary Affairs Subcommittee, which I chair. In the mid-1980's, a series of hearings by the subcommittee into financial institution insolvencies and the role of insider misconduct in those insolvencies, uncovered a startling number of faulty and fraudulent appraisals in the real estate loan portfolios of virtually every failed and failing institution. What we found was that these abusive appraisals were used to fool bank examiners. They were used to make a dangerous or even fraudulent real estate loan appear secure, by having in the loan file an appraisal which assigns an unrealistically high market value to the property collateralizing the loan. As a consequence of these findings, the subcommittee launched a separate 15 month probe into the nature and extent of real estate appraisal abuse and their impact on Federal and private sector interests. The result of that probe was a report issued by the subcommittee in September of last year entitled "Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in the Secondary Market." That report concluded that "faulty and fraudulent real estate appraisals have become an increasingly serious national problem whose effects are widespread, prevasive, and costly. Abusive appraisals have contributed directly to the insolvency of hundreds of the Nation's financial institutions and have helped cause billions of dollars in losses to mortgage lenders, private mortgage insurers, investors in mortgage backed securities, and to numerous Federal agencies, particularly those that administer the Federal Deposit Insurance funds and mortgage guaranty programs." The report assigned blame for this problem in equal parts to real estate appraisers; to individuals involved in real estate transactions who pressure appraisers into overvaluing collateral sufficiently to "make the deal go"; and to the Federal Government itself, whose appraisal policies and practices in connection with their statutory functions, is disjointed, uneven, and ineffective.

Mr. Speaker, as a former banker and as a strong advocate of marketplace solutions to marketplace problems, it is not often that I offer legislation that provides for governmental action. But this is such an occasion. The Federal Government has a pressing financial and public policy interest in assuring that real estate appraisals are performed professionally and independently by truly qualified individuals. Just yesterday at subcommittee hearings on fraud by senior officials of financial institutions, the U.S. attorney for the Northern District of Illinois testified that at seven recently failed S&L's, senior officers, "working with corrupt appraisers, have falsely inflated the value of security for loans to finance projects in which the officers had an interest, or could receive kickbacks or 'commissions.' Typically, a condominium development carrying a high interest rate was inflated in value so that the savings and loan was financing the project at a rate of 100 percent or more. This is a pattern of fraud seen throughout the country in failed institutions." This results in losses in the hundreds of millions of dollars.

My bill requires a new Federal Interagency Appraisal Council, with advice from appraisers, to establish uniform appraisal standards and appraiser certification requirements in connection with real estate transactions in which the Federal Government has substantial interests. It leaves to the 50 States, primary enforcement responsibility for these standards and requirements. There is no Federal "grab for power" here. Only a recognition that both Federal and State governments have legitimate interests to protect. Nor is any massive bureaucracy created by my bill. In point of fact, the legislation merely articulates and centralizes in a new agency statutory powers already available to—but ineffectively or unevenly exercised by—more than half a dozen Federal agencies. Moreover, taxpayers will not—I repeat, will not—pay for the activities of the new Federal Interagency Council. Costs of the Council will be borne by extremely small fees imposed on commercial, for-profit users of federally certified appraisals and on certified appraisers themselves. We estimate that the annual fee imposed on certified appraisers will be no more than $75 per year; and that even a multimillion-dollar commercial transac-

tion would produce user fees of only several hundred dollars.

Mr. Speaker, my legislation represents a carefully crafted solution to a serious national problem. In some measure, appraisers themselves are the principal victims of the current unregulated status of their industry. When appraisers are pressured to overvalue property in order to make a speculative real estate transaction look sound, there is little incentive for the appraiser to say "No." If they resist the pressure, they are fired from the job, never to be hired again. On the other hand, if the appraiser produces the market valuation demanded, he or she has repeat business to gain and little to lose: There is no certification or license to lose; and no supervisory system to monitor the appraiser's conduct. All of that would change under my legislation.

In a very real sense, Mr. Speaker, the real estate appraisal industry is at a crossroads: If appraisers want to be recognized and respected as the professionals they truly are, then they have to be willing to assume the obligations of professionalism. That means, the ability to demonstrate competency; to be bound by an enforceable code of ethics; and to meet continuing education requirements. If, on the other hand, real estate appraisers are content with the status quo and with "business-as usual;" if they wish to continue as the "handmaidens" of others, then I predict perilous times for their industry, including an increase in law enforcement and liability problems. I also fear a continuing loss of public confidence in the safety and soundness of many real estate transactions.

There are those, undoubtedly, who will oppose some of the specifics of my legislation and others who will resist any Federal involvement in this area, notwithstanding the Federal interests that are at stake. And there will be time during hearings on the bill to debate its merits and for others to propose different solutions. While I am strongly convinced of the merits of my approach and will press hard for its adoption, I do intend during the course of legislative hearings to keep an open mind, particularly on those provisions that make Fannie Mae and Freddie Mac part of the Interagency Council.

I am including at this point, Mr. Speaker, a section-by-section analysis of my bill:

SECTION-BY-SECTION ANALYSIS OF H.R. 3675, THE REAL ESTATE APPRAISAL REFORM ACT OF 1987

SUMMARY

The Barnard bill requires the establishment of federal appraisal standards and appraiser qualification requirements for real estate transactions in which the Federal Government has substantial financial or public policy interests. These standards and requirements will be enforced by state appraiser certifying agencies, authorized in the legislation.

The bill establishes a Federal Interagency Appraisal Council composed of representatives of existing federal agencies whose functions encompass real estate related financial transactions and whose programs have been negatively impacted by faulty and fraudulent appraisals. It also authorizes the establishment of state appraiser certifying boards. The Federal Interagency Appraisal Council would exercise three standards-setting functions: (1) determining which categories of real estate related financial transactions are of sufficient financial or public policy importance to the Federal Government to require, in connection with those transactions, that appraisals be performed according to uniform standards and by qualified individuals; (2) establishing uniform appraisal standards for such "federally covered" real estate transactions; and (3) setting minimum qualification or certification requirements for individuals who appraise property in federally covered transactions. So that appraisal standards and appraiser qualification requirements are uniform throughout the Federal Government, the existing authority of twelve federal agencies to promulgate such standards and requirements is transferred to the new Interagency Council. Members of the Council will serve on a full-time basis, only for 3 years after the date of enactment (final standards must be adopted within that timeframe) and on a part-time basis thereafter. A small staff structure will remain in place. The activities of the Council will be funded by small user fees imposed on commercial, for-profit real estate projects using certified appraisers; and, by a small annual fee on certified appraisers, not to exceed $100.

The legislation authorizes and provides incentives for, the creation of state appraiser certifying agencies. These agencies or boards will be responsible, under grants of authority from state legislatures, for enforcing the federal appraisal standards and certification requirements.

Section 1. Short Title—The Act is cited as the "*Real Estate Appraisal Reform Act of 1987*".

Section 2. Findings—Expresses a congressional finding that (1) appraisals of property collateralizing real estate loans and investments are a critical component of such loans and investments because they provide lenders and investors with assurance that in the event of a default, loans can be repaid and investment losses minimized; (2) faulty and fraudulent real estate appraisals that substantially overvalue property securing loans and investments have become a pervasive national problem whose effects are extremely harmful and costly to the Federal Government and to private sector mortgage lenders, insurers, and investors; and (3) the quality of appraisals and the independence of appraisers would be greatly enhanced by the establishment of a regulatory structure requiring the adoption of federal appraisal standards and appraiser certification requirements, with enforcement by approved state appraiser certifying agencies.

Title I: Federal Interagency Council

Section 101. Establishment—Establishes the Federal Interagency Appraisal Council.

Section 102. Transfer of Functions—The bill transfers to the Council, the existing statutory authority of twelve federal agencies to promulgate appraisal standards and appraiser qualification requirements, assuring uniformity among the numerous federal agencies presently exercising such authority. Except for appraisal standards and appraiser qualification requirements, the affected federal agencies will retain their authority to enforce compliance with their statutes and regulations (so that, for example, the banking agencies would retain authority to treat appraised market values of financial institution real estate assets in any way they saw fit for regulatory purposes; and the VA and FHA would continue to be able to suspend fee appraisers who violate those agencies' policies, practices, and procedures).

Section 103. Functions of Council—

(a) In general: Describes the major functions of the Council as follows: The issuance of rules describing categories of real estate-related financial transactions which are sufficiently important to the Federal Government so as to constitute "federally covered transactions" under the Act; the adoption of uniform standards for the performance of real estate appraisals in connection with federally covered transactions; the establishment of minimum qualification requirements for the certification of persons who will be performing appraisals in connection with such transactions; the monitoring of the activities of state appraiser certifying agencies; and, transmittal of an annual report to the Congress describing the Council's work.

(b) Uniform appraisal standards: Uniform standards prescribed by the Council for performance of real estate appraisals in federally covered transactions shall be designed to produce an accurate assessment of the market value of the subject property, including recognition of differences in the types of property to be appraised (i.e., residential vs. commercial); shall describe the contents of and the manner in which an appraisal shall be performed for such transactions; shall permit certain functions in connection with the appraisal to be performed by non-certified persons so long as the final appraisal document is approved and signed by a certified person; shall prohibit the performance of appraisals by persons who have any financial interest in the property being appraised; and may incorporate appraisal standards promulgated by a government agency or by the appraisal industry itself, if such standards meet the requirements of the Act.

(c) Appraiser certification requirements: Requirements prescribed by the Council for the certification of persons to perform appraisals in federally covered transactions shall prescribe a code of ethical responsibility and a level of education (the bill does not require a college degree); work experience, knowledge, and continuing education, which must be satisfied; shall recognize and reflect different skill levels necessary to appraise different types of property; shall describe procedures, including testing requirements, under which a certification will be granted; shall modify certification requirements in the case of appraisers who can demonstrate 5 years of satisfactory appraisal practice; shall set forth criteria under which disciplinary action shall be taken against a certified appraiser.

(d) Procedures for establishing appraisal standards and appraiser certification requirements: Appraisal standards and appraiser certification requirements shall be adopted only after public hearings and an opportunity for interested parties to be heard.

(e) Time for proposal and adoption of standards and requirements: Uniform appraisal standards shall be proposed not later than 18 months and adopted in final form not later than 24 months after enactment. Appraiser certification requirements shall be proposed not later than 12 months and adopted not later than 18 months after enactment.

(f) Overseeing approved state appraiser certifying agencies and certified appraisers: Whenever the Council determines that an action of an approved state appraiser certifying agency or of a certified appraiser is contrary to the purposes of the Act, the Council may request modification of a certifying agency's policies or practices as they apply to certified appraisers. With respect to certified appraisers themselves, the Council itself can take disciplinary action for serious violations of appraisal standards and appraiser certification requirements, if a state certifying agency does not exist. In taking such actions, the Council shall adopt

written procedures and provide all affected parties with an ample opportunity to be heard. Disciplinary actions taken against certified appraisers, shall be subject to judicial review.

(g) Designation of certain real estate transactions as federally covered: Rules prescribed by the Council may designate as a federally covered transaction any transaction involving a purchase, lease, or sale of, or investment in, real estate or real estate related securities if in connection therewith (1) an agency or instrumentality of the United States purchases or sells real estate or real estate related securities or leases real estate; insures the deposits of a financial institution making real estate loans or investing in real estate projects; insures or guarantees the payment of a mortgage loan in the event of a borrower default; or regulates the offering and sale to the public of mortgage-backed securities; or (2) the Council determines that the public policy interest of the United States requires a designation as a federally covered transaction. Any real estate related financial transaction described above which involves the appraisal of property having a value of $1 million or more, shall be a federally covered transaction.

Section 104. Council Membership—The Council shall have twelve voting members from each of the following federal agencies: the five federal bank regulatory agencies, the Securities and Exchange Commission, the Veterans Administration, the Federal Housing Administration of DHUD, the Federal National Mortgage Association, the Federal Home Loan Mortgage Association, GSA and Farmers Home Administration. Persons appointed by the President shall serve for a 3-year fixed term. The Council shall have two nonvoting ex officio members from each of the following agencies: Internal Revenue Service of Treasury and the Department of Transportation.

Council members shall serve on a full-time basis only during the 36-month period following enactment and shall serve on a part-time basis thereafter.

Section 105. Chairman; Meetings—The chairman of the Council shall be elected for a 3-year term by the Council members. Meetings may be held at the call of the Chair or by a majority of Council members.

Section 106. Administrator and Staff—The Council shall have an administrator, who shall carry out the general administrative functions of the Council; a general counsel; a chief counsel for enforcement; and eight additional officers including a director for appraisal standards, a director for appraiser certification, and a coordinator for state certifying activities.

Section 107. General Powers of Council—The Council is authorized to hold hearings, sit and act, take testimony, receive evidence, issue subpoenas, and provide information and perform research. Rules promulgated by the Council shall be subject to the provisions of the Administrative Procedure Act. A seal of office shall be made for the Council and judicial notice shall be taken of such seal.

Section 108. Advisory Committees—There shall be within the Council two advisory committees which shall provide advice, information, analyses, and recommendations to the Council concerning its functions. The Real Estate Appraiser Committee shall consist of twelve members, ten from the appraisal industry and two from the public. The Real Estate Appraisal User Committee shall consist of fourteen members appointed by the chairman, as follows: two members each from the thrift industry, the commercial banking industry, the mortgage banking industry, the mortgage insurance industry, the securities industry, the home builders and the real estate industry. The Council shall meet with and consult the advisory committees before adopting uniform appraisal standards and appraiser certification requirements and at such other times as the Council considers necessary.

Sections 109 and 110. Appropriations and User Fees—The legislation authorizes a 2-year appropriation of $19 million to the Council and establishes a user fee mechanism for funding the future work of the Council and for paying back the initial $19 million appropriation. Specifically, the bill authorizes the Council to assess and collect (1) from each person who obtains an appraisal for a federally covered transaction that is a commerical, for-profit transaction, a small, graduated fee based on the appraised value of the subject property not to exceed $5,000 (even a multi-million dollar project would result in a user fee of only several hundred dollars); and (2) from each person who receives a certification under the Act, an annual fee not to exceed $100. Although Council funding will be from nontaxpayer sources, the Council will continue to be subject to the congressional budget process.

Section 111. Transfer and Allocation of Appropriations and Personnel—Directs OMB to determine which unexpended appropriations and personnel from agencies performing appraisal standards and appraiser qualification functions, should be transferred to the new Council.

Section 112. Savings Provisions—Establishes that Executive Branch and judicial proceedings underway at the time of enactment shall not be affected by the transfer of functions.

Title II: Establishment and Approval of State Appraiser Certifying Agencies

Section 201. Establishment and Approval of State Appraiser Certifying Agencies—

(a) Establishment: Authorizes the establishment of state appraiser certifying agencies in order to assure state supervision of the activities of certified appraisers. Permits a state to establish requirements for appraisers in addition to any federal requirements for certification, if such additional requirements pertain to appraisals in non-federally covered transactions and if the additional state imposed requirements do not discriminate against certified appraisers. The legislation also requires a state appraiser certifying agency to recognize a certified appraiser who has been certified by another state in connection with "temporary practice" in the state.

(b) Approval of state appraiser agency by Council: Requires that a state appraiser certifying agency under the Act be approved by the Federal Interagency Council. Establishes criteria for such approval including, a grant of authority by the state adequate to permit the certifying agency to properly monitor and discipline appraisers; assurance that the state's laws require appraiser access to adequate and reliable information regarding property values and the terms and conditions of real estate sale transactions; independence of the agency from state licensing agencies, such as a real estate licensing board.

(c) Revocation of approval: The Council may revoke approval of an approved state appraiser certifying agency upon a written determination that any of the major conditions on which the approval was based has changed significantly. Before any such revocation, the Council shall furnish the state with 90-days advance notice and an ample opportunity to provide reouttal information or to correct the changed conditions.

Section 202. Certification of Appraisers—Establishes procedures for obtaining a certification. Requires a state agency to grant a certification to perform appraisals in federally covered transactions in that state, if the person is found by the certifying board to satisfy the certification requirements established by the Federal Interagency Council. This section also authorizes the Federal Interagency Council to directly certify a person to perform appraisals in federally covered transactions in a state if the person meets certification requirements and if the state in which the person will be appraising does not have an approved state appraiser certifying agency. During the 24-month period following the date of enactment of the Act, the Council is required to certify a person to perform appraisals in federally covered transactions if the person registers with the Council and agrees to abide by generally recognized appraisal standards and a code of ethics. This interim certification can be extended for 12 additional months if the Council determines that the state in which the person is certified to perform appraisals is in the process of establishing a state certifying agency. The Council is also authorized to waive any requirements under the Act relating to certification of a person to perform appraisals if it makes a written determination that there is a scarcity of certified appraisers in a particular state and if the person for whom such requirements are to be waived has a satisfactory record of appraisal performance.

Section 203. Government Employees Who Perform Appraisals—This section permits federal and state government employees who perform appraisals in connection with their official responsibilities, to be exempted from the requirements of the Act unless the heads of their agencies decide otherwise.

Title III: Appraisals in Federally Covered Transactions

Section 301. Violations in Obtaining and Performing Appraisals—It shall be a violation of the Act for a person to (1) knowlingly seek, obtain or give money or any other thing of value in exchange for the performance of an appraisal by a person who is not a certified appraiser in connection with a federally covered transaction; and (2) for a person who is not a certified appraiser to knowingly provide an appraisal to a person in connection with a federally covered transaction. Fines are established for such violations. Proceedings for violations of this provision may be conducted by an approved state appraiser licensing agency or by the Council. Decisions are subject to judicial review.

Section 302. Use of Certified Appraisers by Federal Agencies—Beginning 24 months after enactment, federal agencies using fee appraisers shall use only certified appraisers in a federally covered transaction.

Title IV: General Provisions and Definitions

Section 401. Definition of terms found in the Act.

Section 402. Responsibilities Under State and Federal Law Not Affected—Nothing contained in the Act shall be construed to alter, modify or impair any responsibility under state or federal law imposed on appraisers, lenders and other persons who are parties to real estate related financial transactions.

Section 404. Federal Agency Reports Regarding Disciplinary Actions—Any federal agency that initiates a disciplinary action against a certified appraiser shall report that fact to the state certifying agency and to the Council.

100TH CONGRESS
1ST SESSION

H. R. 3675

To reorganize and consolidate in a new Federal agency certain functions of the Federal Government relating to real estate appraisals and to authorize State appraiser certifying agencies, for the purpose of protecting the financial and public policy interests of the United States in certain real estate-related financial transactions.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 20, 1987

Mr. BARNARD introduced the following bill; which was referred to the Committee on Government Operations

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A BILL

To reorganize and consolidate in a new Federal agency certain functions of the Federal Government relating to real estate appraisals and to authorize State appraiser certifying agencies, for the purpose of protecting the financial and public policy interests of the United States in certain real estate-related financial transactions.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Real Estate Appraisal Reform Act of 1987".

SEC. 2. TABLE OF CONTENTS.

The contents of this Act are as follows:

Sec. 1. Short title.
Sec. 2. Table of contents.
Sec. 3. Findings.

TITLE I—FEDERAL INTERAGENCY COUNCIL

Sec. 101. Establishment.
Sec. 102. Transfer of functions to Council.
Sec. 103. Functions of Council.
Sec. 104. Council membership.
Sec. 105. Chairman; meetings.
Sec. 106. Administrator and staff.
Sec. 107. General powers of Council.
Sec. 108. Advisory Committees.
Sec. 109. Authorization of appropriations.
Sec. 110. Authority to assess and collect fees.
Sec. 111. Transfer and allocation of appropriations and personnel.
Sec. 112. Savings provisions.
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TITLE II—APPROVAL OF STATE APPRAISER CERTIFYING AGENCIES; CERTIFICATION OF APPRAISERS

Sec. 201. Approval of State appraiser certifying agency.
Sec. 202. Certification of appraisers.
Sec. 203. Government employees who perform appraisals.

TITLE III—APPRAISALS IN FEDERALLY COVERED TRANSACTIONS

Sec. 301. Violations in obtaining and performing appraisals.
Sec. 302. Use of certified appraisers by Federal agencies.

TITLE IV—GENERAL PROVISIONS AND DEFINITIONS

Sec. 401. Definitions.
Sec. 402. Responsibilities under State and Federal law not affected.
Sec. 403. Federal agency reports of disciplinary and enforcement actions.

SEC. 3. FINDINGS.

The Congress finds as follows:

(1) Real estate appraisals, by establishing market values for property securing loans and investments, provide interested Federal agencies and private sector lenders, investors, and insurers with reliable assurance

that they will be protected against catastrophic losses in the event of defaults on such loans and investments.

(2) Faulty and fraudulent real estate appraisals that overvalue property securing loans and investments have become a pervasive national problem whose effects are extremely harmful and costly to federally insured financial institutions; to Federal agencies and instrumentalities which guarant repayment of mortgage loans or which provide liquidity to mortgage markets; to investors in mortgage backed securities; and to mortgage lenders, insurers, and others who participate in real estate-related financial transactions.

(3) A dominant cause of abusive appraisals is pressure on appraisers, by persons involved in real estate-related financial transactions, to assign artificially high market values to properties which serve as collateral for such transactions.

(4) The quality of appraisals and the independence of appraisers would be greatly enhanced by the establishment of a regulatory structure for the appraisal industry, requiring the adoption of Federal appraisal standards and appraiser certification requirements by a new Federal agency and enforcement of such standards and requirements by State certifying agencies.

TITLE I—FEDERAL INTERAGENCY APPRAISAL COUNCIL

SEC. 101. ESTABLISHMENT.

There is established the Federal Interagency Appraisal Council.

SEC. 102. TRANSFER OF FUNCTIONS TO COUNCIL.

(a) IN GENERAL.—There is transferred to the Council the authority of the following Federal agencies and instrumentalities to establish and regulate appraisal standards and appraiser qualification requirements in furtherance of their statutory responsibilities.

(1) FEDERAL BANK REGULATORY AGENCIES.—The Federal bank regulatory agencies in connection with assuring the safety and soundness of real estate lending and investment by federally insured financial institutions and preserving the assets of the Federal deposit insurance funds.

(2) VETERANS' ADMINISTRATION AND FHA.—The Veterans' Administration and the Federal Housing Administrator relating to the establishment of accurate market values for property held by them as security on insured and guaranteed residential mortgage loans.

(3) FEDERAL NATIONAL MORTGAGE ASSOCIATION AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION.—The Federal National Mortgage As-

sociation and the Federal Home Loan Mortgage Corporation in connection with establishing the value of property securing mortgages purchased and the sale of those mortgages to the public and to Federal home loan banks in the form of mortgage-backed securities.

(4) SECURITIES AND EXCHANGE COMMISSION.—The Securities and Exchange Commission in connection with assuring the accurate disclosure of market values assigned by appraisers to real estate securing mortgage-backed securities offered and sold to the public.

(5) FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL.—The Federal Financial Institutions Examination Council relating to recommending appraisal standards and appraiser qualification requirements in connection with the real estate loans and investments of insured financial institutions.

(6) GENERAL SERVICES ADMINISTRATION.—The General Services Administration in connection with the Federal Government's receiving fair value when it purchases, sells, or leases properties on behalf of the Federal Government.

(7) FARMERS HOME ADMINISTRATION.—The Farmers Home Administration in the Department of

Agriculture in connection with residential Rural Housing Loans secured by real estate.

(b) EXTENT OF AUTHORITY TRANSFERRED.—

(1) The transfer of authority to the Council under this section includes all aspects of the appraisal standards and appraiser qualification functions vested in any component of the agency or department from which such authority is transferred.

(2) In carrying out any function transferred by this Act, the Council may exercise any authority available by law (including appropriation Acts) with respect to such function to an officer of the agency from which such function is transferred, and the actions of the Council in exercising such authority shall have the same force and effect as when exercised by the such officer.

(3) Agencies and instrumentalities whose authority is transferred under this section shall not establish policies, practices, or procedures which are in conflict with Council rules, actions, and decisions authorized by this Act.

SEC. 103. FUNCTIONS OF COUNCIL.

(a) IN GENERAL.—The Council shall—

(1) issue rules describing categories of real estate-related financial transactions which constitute federally covered transactions under this Act;

(2) prescribe uniform standards for the performance of real estate appraisals in connection with federally covered transactions;

(3) establish requirements for the certification of persons who are qualified to perform appraisals in connection with such transactions, including a code of ethics;

(4) directly grant certification to and supervise the activities of persons qualified to perform appraisals in federally covered transactions in States which do not have an approved State appraiser certifying agency;

(5) monitor and oversee the activities of approved State appraiser certifying agencies; and

(6) transmit an annual report to the Congress not later than January 31 of each year describing—

(A) the activities of the Council during the preceding year; and

(B) problems encountered by the Council during the preceding year in carrying out its functions under this Act.

(b) UNIFORM APPRAISAL STANDARDS.—Uniform standards prescribed by the Council for performance of real estate appraisals in federally covered transactions—

(1) shall be designed to produce an accurate assessment of the market value of the subject of the appraisal;

(2) shall prescribe the contents of and the manner in which an appraisal shall be performed for purposes of such transactions, and the factors which may be considered in performing such an appraisal;

(3) shall require the use of state-of-the-art appraisal techniques;

(4) shall allow work on which such an appraisal is based to be performed by a person who is not a certified appraiser under this Act to perform such appraisals if the final appraisal document is approved and signed by a person who is a certified appraiser under this Act;

(5) shall prohibit the performance of such an appraisal by any person—

(A) who is hired or paid to perform such appraisal by the borrower in a real estate project; or

(B) who is a real estate broker or agent who represents a purchaser or seller of the property which is the subject of the appraisal, or who is

employed by a person who represents a purchaser or seller of the property or who has any financial interest in the property;

(6) may incorporate any standards recommended by the Real Estate Appraisal Advisory Committee or promulgated prior or subsequent to the date of the enactment of this Act by a public entity, by the Appraisal Foundation, or by a professional appraisal organization, if such standards fulfill the requirements of paragraphs (1) through (5); and

(7) shall recognize and reflect differences in the types of real estate on which appraisals are performed in federally covered transactions.

(c) APPRAISER CERTIFICATION REQUIREMENTS.—Requirements prescribed by the Council for the certification of a person under section 202 to perform appraisals in federally covered transactions as certified appraiser shall—

(1) prescribe a code of ethical responsibility and a level of competency, including education, work experience, knowledge, and continuing education requirements which a person must satisfy to qualify for certification to perform appraisals in federally covered transactions;

(2) prescribe the procedures and testing requirements under which a certification to perform appraisals in federally covered transactions shall be granted;

(3) in the case of appraisers who can demonstrate 5 years of appraisal practice and a satisfactory record of performance, take account of, and be appropriately modified to reflect, such prior experience;

(4) set forth the criteria and circumstances under which disciplinary action, including suspension or revocation of a certification, should be taken against a person who has been granted a certification;

(5) to the greatest extent practicable insure the performance of accurate and independent appraisals in federally covered transactions by persons granted a certification under such requirements; and

(6) recognize and reflect differences in the skills required to perform appraisals on different types of real estate on which appraisals are performed in federally-covered transactions.

(d) PROCEDURES FOR ESTABLISHING APPRAISAL STANDARDS AND APPRAISER CERTIFICATION REQUIREMENTS.—Appraisal standards and appraiser certification requirements prescribed under this section shall be prescribed by regulation in accordance with procedures set forth in title 5, United States Code, including the holding of public hear-

ings with respect to any standards and requirements proposed to be established.

(e) TIME FOR PROPOSAL AND ADOPTION OF STANDARDS AND REQUIREMENTS.—

(1) APPRAISAL STANDARDS.—Appraisal standards prescribed under this section shall be proposed not later than 18 months after the date of the enactment of this Act and adopted in final form not later than 24 months, after the date of the enactment of this Act.

(2) CERTIFICATION REQUIREMENTS.—Appraiser certification requirements prescribed under this section shall be proposed not later than 12 months after the date of the enactment of this Act and adopted in final form not later than 18 months after the date of the enactment of this Act.

(f) OVERSEEING APPROVED STATE CERTIFYING AGENCIES AND CERTIFIED APPRAISERS.—(1) Whenever the Council determines that an action of an approved State appraiser certifying agency, or of a certified appraiser, is contrary to the purposes of this Act, the Council shall take such appropriate action within its power to accomplish those purposes, including—

(A) providing written notice to the approved State appraiser certifying agency describing the policies, practices, and procedures of the State agency which

are contrary to the purposes of this Act and requesting that appropriate modifications be made; and

(B) with respect to a certified appraiser, taking disciplinary action for serious violations of appraisal standards, the Code of Ethics, or other requirements, including suspension or revocation of certification and imposition of a fine of not more than $5,000 for each violation, when a State licensing agency fails to carry out this Act or when the violations occur in a State that does not have an approved certifying agency.

(2) The Council shall adopt written procedures for taking actions described in paragraph (1) which shall include—

(A) in the case of an action under paragraph (1)(A), a full opportunity to be heard for the approved State certifying agency with respect to which the action is taken;

(B) in the case of a disciplinary action under paragraph (1)(B), timely notice and description of all allegations which are the basis of the action and an adequate opportunity to respond to such allegations.

(3) A decision by the Council in an action under paragraph (1)(B) shall be subject to judicial review.

(g) DESIGNATION OF CERTAIN REAL ESTATE TRANSACTIONS AS FEDERALLY COVERED TRANSACTIONS.—

(1) DESIGNATION BY COUNCIL.—The Council shall—

(A) determine which real estate-related financial transactions are of sufficient financial or public policy importance to the United States as to require that an individual who performs an appraisal in connection with such a transaction should be a certified appraiser and that the appraisal be performed in accordance with uniform standards and other requirements under this Act; and

(B) prescribe rules describing such transactions and designating them as federally covered transactions for purposes of this Act.

(2) TRANSACTIONS WHICH MAY BE DESIGNATED, GENERALLY.—Rules prescribed by the Council under this subsection may designate as a federally covered transaction any transaction involving the purchase, lease, or sale of, or investment in, real estate or real estate-related securities if in connection therewith—

(A) an agency or instrumentality of the United States—

(i) purchases or sells real estate or real estate-related securities or leases real estate;

(ii) insures the deposits of a financial institution making mortgage loans, making other loans for which real estate serves as collateral, or investing in real estate;

(iii) insures or guarantees the payment of a mortgage loan in the event of a borrower default; or

(iv) regulates the offering and sale to, or trading by, the public of securities collateralized by real estate or real estate mortgages; or

(B) the Council determines that the public policy interests of the United States require designation of the transaction as a federally covered transaction.

(3) TRANSACTIONS INVOLVING $1,000,000 OR MORE.—Rules prescribed by the Council under this section shall designate as a federally covered transaction any transaction described in paragraph (2) which involves the appraisal of property having a value of $1,000,000 or more.

(4) TIME FOR PROPOSAL AND ADOPTION OF RULES DESIGNATING FEDERALLY COVERED TRANSACTIONS.—Rules prescribed by the Council under this section shall be proposed not later than 18 months, and

adopted in final form not later than 24 months after the date of the enactment of this Act.

SEC. 104. COUNCIL MEMBERSHIP.

(a) NUMBER AND APPOINTMENT.—

(1) VOTING MEMBERS.—The Council shall have 12 voting members, who shall be appointed by the President from among the most senior officials at each of the following agencies, after consultation with the head of each respective agency:

(A) The Federal Home Loan Bank Board.

(B) The Office of the Comptroller of the Currency.

(C) The Federal Deposit Insurance Corporation.

(D) The Board of Governors of the Federal Reserve System.

(E) The National Credit Union Administration.

(F) The Securities and Exchange Commission.

(G) The Veterans' Administration.

(H) The Federal Housing Administration of the Department of Housing and Urban Development.

(I) The Federal National Mortgage Association.

(J) The Federal Home Loan Mortgage Association.

(K) The Farmers Home Administration in the Department of Agriculture.

(L) The General Services Administration.

A person appointed under this paragraph shall be selected for appointment on the basis of the experience and background of the person relating to the role of appraisals in connection with the functions or programs of their agency.

(2) NONVOTING MEMBERS.—The Council shall have 2 nonvoting ex officio members, of whom 1 shall be appointed by each of—

(A) the Commissioner of the Internal Revenue Service; and

(B) the Secretary of Transportation;

from among senior officials of the Internal Revenue Service and the Department of Transportation whose duties relate to real estate appraisals.

(3) TERMS.—A person appointed under this subsection—

(A) shall serve for a 3 year term;

(B) may serve more than 1 term as a member of the Council.

(b) APPOINTMENT OF REPLACEMENT.—If a member of the Council leaves the agency from which the member was appointed, he or she shall cease to be a member of the Council and the head of that agency shall appoint another person from that agency to serve as a member of the Council.

(c) PAY AND SERVICE OF MEMBERS.—

(1) 36-MONTH PERIOD FOLLOWING DATE OF ENACTMENT.—During the 36-month period following the date of the enactment of this Act, members of the Council shall serve on a full time basis and be paid by the agency from which they are appointed at the maximum rate of basic pay in effect for level V of the Executive Schedule.

(2) AFTER 36-MONTH PERIOD.—After the period described in paragraph (1), members of the Council—

(A) shall serve on a part-time basis as necessary to carry out the functions of the Council;

(B) shall not be paid any amount in addition to amounts they are paid for employment by the respective agency from which they are appointed; and

(C) shall be reimbursed for expenses they incur while engaged in official business of the Council.

(3) REIMBURSEMENT OF PAY AND EXPENSES.—The Council shall reimburse each agency from which a member of the Council is appointed for the pay and expenses of the members of the Council.

SEC. 105. CHAIRMAN; MEETINGS.

(a) CHAIRMAN.—

(1) ELECTION.—The Chairman of the Council shall be elected by the Council from among its members.

(2) TERM.—The term of office of the Chairman shall be 3 years.

(b) MEETINGS.—

(1) IN GENERAL.—The Council shall meet at the call of the Chairman or a majority of its members so often as there is business to be conducted.

(2) QUORUM.—A majority of members of the Council shall constitute a quorum but 3 members may hold hearings.

(3) VOTING.—Decisions of the Council shall be according to the vote of a majority of its voting members.

SEC. 106. ADMINISTRATOR AND STAFF.

(a) ADMINISTRATOR.—Within 60 days after the election of the Chairman, the Chairman shall nominate and the Council shall appoint an Administrator who shall—

(1) carry out the general administrative functions of the Council; and

(2) be paid the maximum annual rate of basic pay in effect for GS–18 of the General Schedule.

(b) GENERAL COUNSEL.—The Council shall have a General Counsel who shall be nominated by the Chairman and appointed by a majority vote of the Council within 60 days after election of the Chairman. The General Counsel shall—

(1) provide legal assistance to the Council concerning the programs and policies of the Council; and

(2) be paid at the maximum annual rate of basic pay in effect for GS–18 of the General Schedule.

(c) CHIEF COUNSEL FOR ENFORCEMENT.—The Council shall have a Chief Counsel for Enforcement who shall be nominated by the Chairman and appointed by a majority vote of the Council within 60 days after election of the Chairman. The Chief Counsel for Enforcement shall—

(1) carry out section 103(f); and

(2) be paid at the maximum annual rate of basic pay in effect for GS–18 of the General Schedule.

(d) ADDITIONAL OFFICERS.—

(1) APPOINTMENT AND FUNCTIONS.—The Council shall have such additional officers as may be appointed by the Chairman, and such additional officers shall include the following:

(A) The Director for Appraisal Standards.

(B) The Director for Appraiser Certification.

(C) The Coordinator for State Certifying Activities.

(D) The Director of Congressional Relations.

(E) The Director of Public Information.

(F) The Director of Management and Budget.

(G) The Director of Policy, Planning, and Research.

(2) OFFICERS REPORT TO ADMINISTRATOR; OTHER FUNCTIONS PRESCRIBED BY COUNCIL.—Each officer of the Council appointed under this subsection shall—

(A) report directly to the Administrator;

(B) in addition to any functions vested in or required to be delegated to such officer, perform such additional functions as the Council may prescribe; and

(C) be paid at a rate established by the Council.

(3) DESCRIPTION OF FUNCTIONS.—Within 90 days after appointment of the Administrator, the Administrator shall submit to the Council for its approval a detailed description of the functions of each officer appointed under this subsection.

(e) STAFF.—With the approval of the Council, the Administrator may appoint such additional staff personnel as the Administrator considers appropriate who shall be paid at a rate established by the Council.

(f) APPLICABILITY OF CERTAIN CIVIL SERVICE LAWS.—Except as otherwise provided in this Act, the officers and staff of the Council shall be appointed subject to the provisions of title 5, United States Code, governing appointments in the competitive service.

(g) EXPERTS AND CONSULTANTS.—With the approval of the Council, the Administrator may procure temporary and intermittent services under section 3109(b) of title 5 of the United States Code, at rates for individuals not to exceed the daily equivalent of an annual rate of basic pay established by the Council.

(h) STAFF OF FEDERAL AGENCIES.—Upon request of the Council, the head of any Federal agency is authorized to detail, on a reimbursable basis, any of the personnel of such agency to the Council to assist the Council in carrying out its duties under this Act.

SEC. 107. GENERAL POWERS OF COUNCIL.

(a) HEARINGS, MEETINGS, AND RESEARCH.—The Council may, for the purpose of carrying out this Act, hold hearings, sit and act at times and places, take testimony, receive evidence, issue subpoenas, provide information, and perform research, as the Council considers appropriate.

(b) RULES.—

(1) IN GENERAL.—The Council may prescribe such rules and regulations as the Council determines necessary or appropriate to administer and manage the functions of the Council.

(2) APPLICABILITY OF TITLE 5.—The Council shall prescribe such rules and regulations as are authorized in accordance with chapter 5 of title 5, United States Code.

(c) CONTRACTS.—

(1) IN GENERAL.—Subject to the provisions of the Federal Property and Administrative Services Act of 1949, the Council may make, enter into, and perform such contracts, grants, leases, cooperative agreements, or other similar transactions with Federal or other public agencies (including State and local governments) and private organizations and persons, and may make such payments, by way of advance or reimbursement, as the Council may determine necessary or appropriate to carry out functions of the Council.

(2) SUBJECT TO APPROPRIATIONS.—Notwithstanding any other provision of this Act, authority of the Council to enter into contracts and to make payments under this subsection shall only be effective to the extent, and in such amount, as is provided in advance in appropriation Acts.

(d) OBTAINING OFFICIAL DATA.—The Council may secure directly from any department or agency of the United States information necessary to enable it to carry out this Act. Upon request of the Administrator, the head of such department or agency shall furnish such information to the Council.

(e) GIFTS.—The Council may accept, use, and dispose of gifts or donations of services or property.

(f) MAILS.—The Council may use the United States mails in the same manner and under the same conditions as other departments and agencies of the United States.

(g) ADMINISTRATIVE SUPPORT SERVICES.—The Administrator of General Services shall provide to the Council on a reimbursable basis such administrative support services as the Council may request.

(h) POWERS OF MEMBERS AND AGENTS.—Any agent of the Council may, if so authorized by the Council, take any action which the Council is authorized by this section to take.

(i) DELEGATION.—Except as otherwise provided in this Act, the Council may delegate any function to such officers and employees of the Council as the Council may designate, and may authorize such successive redelegations of such functions within the Council as may be necessary or appropriate. No delegation of functions by the Council under this subsection or under any other provision of this Act shall relieve the Council of responsibility for the administration of such functions.

(j) REORGANIZATION.—The Council may allocate or reallocate functions among the officers of the Council, and establish, consolidate, alter, or discontinue such organizational entities within the Council as may be necessary or appropriate.

(k) ACQUISITION AND MAINTENANCE OF PROPERTY.—

(1) AUTHORITY.—The Council may acquire (by purchase, lease, condemnation, or otherwise), construct, improve, repair, operate, and maintain—

(A) research and testing sites and facilities;

(B) quarters and related accommodations for employees and dependents of employees of the Administration; and

(C) personal property (including patents), or any interest therein;

as may be necessary to carry out the purposes of this Act.

(2) LIMITATION.—The authority granted by paragraph (1) shall be available only with respect to facilities of a special purpose nature that cannot readily be reassigned from similar Federal activities and are not otherwise available for assignment to the Council by the Administrator of General Services.

(l) USE OF FACILITIES.—

(1) AUTHORITY.—With their consent, the Council may, with or without reimbursement, use the research, equipment, services, and facilities of any agency or instrumentality of the United States, of any State or political subdivision thereof, or of any foreign government, in carrying out any function of the Council.

(2) USE OF FACILITIES BY OTHER PERSONS.—The Council may permit public and private agencies, corporations, associations, organizations, or individuals to use any real property, or any facilities, structures, or other improvements thereon, under the custody and control of the Council for Council purposes. The Council shall permit the use of such property, facilities, structures, or improvements under such terms and rates and for such period as may be in the public interest, except that the periods of such uses may not

exceed 5 years. The Council may require permittees under this subsection to recondition and maintain, at their own expense, the real property, facilities, structures, and improvements used by such permittees to a standard satisfactory to the Council.

(3) USE OF PROCEEDS.—Proceeds from reimbursements under this section may be credited to the appropriation of funds that bear or will bear all or part of the cost of such equipment or facilities provided or to refund excess sums when necessary.

(4) ACQUISITION OF REAL PROPERTY.—Any interest in real property acquired pursuant to this title shall be acquired in the name of the United States Government.

(m) GIFTS AND BEQUESTS.—The Council may accept, hold, administer, and utilize gifts, bequests and devises of property, both real and personal, for the purpose of aiding or facilitating the work of the Council. Gifts, bequests, and devises of money and proceeds from sales of other property received as gifts, bequests, or devises shall be deposited in the Treasury and shall be available for disbursement upon the order of the Council.

(n) FUNDS TRANSFER.—The Council may, when authorized in an appropriation Act in any fiscal year, transfer funds from one appropriation to another within the Council.

(o) SEAL OF ADMINISTRATION.—The Council shall cause a seal of office to be made for the Council of such design as the Council shall approve. Judicial notice shall be taken of such seal.

(p) ANNUAL REPORT.—The Council shall, as soon as practicable after the end of each fiscal year, make a single, comprehensive report to the President and the Congress on the activities of the Council during such fiscal year.

SEC. 108. ADVISORY COMMITTEES.

(a) IN GENERAL.—The Council shall have 2 advisory committees, to be known, respectively, as the Real Estate Appraiser Committee and the Real Estate Appraisal User Committee.

(b) FUNCTIONS AND COMPOSITION.—

(1) REAL ESTATE APPRAISER COMMITTEE.—The Real Estate Appraiser Committee shall provide advice, information, analysis, and recommendations to the Council concerning real estate appraisal standards prescribed under section 103 and requirements for certification of appraisers under section 202, and shall consist of 12 members appointed by the Chairman, as follows:

(A) 8 members appointed from among persons who have substantial experience in the profession of real estate appraisal and who are nomi-

nated by a professional appraiser organization which—

(i) adheres to the Uniform Standards of Professional Appraisal Practice; and

(ii) has adopted and enforces competency requirements and a code of ethics.

(B) 2 members appointed from among persons nominated by the Appraisal Foundation.

(C) 2 members appointed from among persons in higher education or members of the general public who can demonstrate a high degree of knowledge of the role of appraisals in real estate-related financial transactions.

(2) REAL ESTATE APPRAISAL USER COMMITTEE.—The Real Estate Appraisal User Committee committees shall provide advice, information, analysis, and recommendations to the Council concerning the use of appraisals in real estate-related financial transactions, and shall consist of 14 members appointed by the Chairman, as follows:

(A) 2 members appointed from among persons representing the thrift industry.

(B) 2 members appointed from among persons representing the commercial banking industry.

(C) 2 members appointed from among persons representing the mortgage banking industry.

(D) 2 members appointed from among persons representing the mortgage insurance industry.

(E) 2 members appointed from among persons representing the securities industry.

(F) 2 members appointed from among persons who are home builders.

(G) 2 members appointed from among persons who are realtors.

(c) MEETINGS AND CONSULTATIONS WITH ADVISORY COMMITTEES.—The Council shall meet and consult with the Real Estate Appraiser Committee and the Real Estate Appraisal User Committee—

(1) before adopting uniform appraisal standards and appraiser certification requirements under section 103;

(2) at such other times as the Council considers necessary to assist the Council in carrying out its functions; and

(3) not less than twice each year during the first 3 years after completion of appointments to the Council.

SEC. 109. AUTHORIZATION OF APPROPRIATIONS.

For purposes of this Act there are authorized to be appropriated to the Council $19,000,000 for the 24-month period beginning on the date of the enactment of this Act.

SEC. 110. AUTHORITY TO ASSESS AND COLLECT FEES.

(a) ASSESSMENT AND COLLECTION.—The Council may assess and collect—

(1) from each person who receives a certification under this Act to perform appraisals in federally covered transactions, an annual fee of not more than $100;

(2) from each person who obtains an appraisal for a federally covered transaction that is a commercial for-profit transaction, a fee of not more than $5,000, which shall be determined on a graduated basis with respect to the value of the transaction;

in such amounts as are authorized by Congress and sufficient to support the activities of the Council under this Act.

(b) USE OF AMOUNTS COLLECTED.—Amounts collected by the Council under this section may only be used to—

(1) support its activities under this Act; and

(2) reimburse the general fund of the Treasury for amounts appropriated to and expended by the Council during the 24-month period following the date of the enactment of this Act.

(c) SUBMITTAL OF BUDGET TO CONGRESS.—The Council shall submit to the Congress not later than 160 days after the date of the enactment of this Act a budget for its operations during the 2-year period following such date which includes a formula for collection of amounts under this section and allocation of such amounts among activities of the Council.

SEC. 111. TRANSFER AND ALLOCATION OF APPROPRIATIONS AND PERSONNEL.

(a) IN GENERAL.—The personnel employed in connection with, and the assets, liabilities, contracts, property, records, and unexpended balance of appropriations, authorizations, allocations, and other funds employed, held, used, arising from, available to, or to be made available in connection with the authorities, functions, and offices, or portions thereof, transferred by section 102, subject to section 202 of the Budget and Accounting Procedures Act of 1950, shall be transferred to the Council for appropriate allocation. Unexpended funds transferred pursuant to this subsection shall be used only for the purposes for which the funds were originally authorized and appropriated.

(b) EFFECT ON PERSONNEL.—

(1) LIMITATION ON SEPARATION AND REDUCTION IN GRADE AND COMPENSATION.—The transfer under this Act of full-time personnel (except special

Government employees) and part-time personnel holding permanent positions shall not cause any such employee to be separated or reduced in grade or compensation for one year after the date of transfer to the Council.

(2) CONTINUATION OF COMPENSATION RATE.—Any person who, on the day preceding the effective date of this Act, held a position compensated in accordance with the Executive Schedule prescribed in chapter 53 of title 5, United States Code, and who, without a break in service, is appointed to a position of employment by the Council having duties comparable to the duties performed immediately preceding such appointment shall continue to be compensated in such new position at not less than the rate provided for such previous position, for the duration of the service of such person in such new position.

(c) INCIDENTAL TRANSFERS.—

(1) DETERMINATIONS BY DIRECTOR OF OMB, GENERALLY.—The Director of the Office of Management and Budget, within 180 days after the date of the enactment of this Act, shall make such determinations as may be necessary with regard to the functions, offices, or portions thereof transferred by this Act, and shall make such additional incidental dispositions of

personnel, assets, liabilities, grants, contracts, property, records, and unexpended balances of appropriations, authorizations, allocations, and other funds held, used, arising from, available to, or to be made available in connection with such functions, offices, or portions thereof, as may be necessary to carry out this Act.

(2) DETERMINATIONS BY DIRECTOR OF OMB REGARDING TRANSFERS WITHIN SENIOR EXECUTIVE SERVICE.—After consultation with the Director of the Office of Personnel Management, the Director of the Office of Management and Budget may, at such time as the Director of the Office of Management and Budget provides, make such determinations as may be necessary with regard to the transfer of positions within the Senior Executive Service in connection with functions and offices transferred by this Act.

SEC. 112. SAVINGS PROVISIONS.

(a) IN GENERAL.—All orders, determinations, rules, regulations, permits, grants, contracts, certificates, licenses, and privileges—

(1) which have been issued, made, granted, or allowed to become effective by the President, any Federal entity or official thereof, or by a court of competent jurisdiction, in the performance of functions which are transferred under this Act to the Council, and

(2) which are in effect at the time this Act takes effect,

shall continue in effect according to their terms until modified, terminated, superseded, set aside, or revoked in accordance with relevant provisions of law by the President, the Council, or other authorized official, a court of competent jurisdiction, or by operation of law.

(b) PROCEEDINGS.—

(1) IN GENERAL.—This Act shall not affect any proceeding, including notices of proposed rulemaking, or any application for any license, permit, certificate, or financial assistance pending on the effective date of this Act before any Federal entity, and applications, to the extent that they relate to functions transferred under this Act, shall be continued. Orders shall be issued in such proceedings, appeals shall be taken therefrom, and payments shall be made pursuant to such orders, as if this Act had not been enacted, and orders issued in any such proceedings shall continue in effect until modified, terminated, superseded, or revoked by the Council, by a court of competent jurisdiction, or by operation of law. Nothing in this paragraph shall be deemed to prohibit the discontinuance or modification of any such proceeding under the same terms and conditions and to the same extent that such pro-

ceeding could have been discontinued or modified if this Act had not been enacted.

(2) ISSUANCE OF RULES.—Federal entities may issue rules providing for the orderly transfer to the Council of proceedings continued under paragraph (1).

(c) ABATEMENT.—No suit, action, or other proceeding commenced by or against any officer in the official capacity of such individual as an officer of any Administration or agency, functions of which are transferred by this Act, shall abate by reason of the enactment of this Act. No cause of action by or against any agency, functions of which are transferred by this Act, or by or against any officer thereof in the official capacity of such officer, shall abate by reason of the enactment of this Act.

(d) CONTINUANCE.—

(1) SUITS NOT AFFECTED.—Except as provided in paragraph (2)—

(A) this Act shall not affect suits commenced before the effective date of this Act, and

(B) in all such suits, proceedings shall be had, appeals taken, and judgments rendered, in the same manner and effect as if this Act had not been enacted.

(2) SUBSTITUTION OF PARTIES.—If, before the date on which this Act takes effect, any agency, or of-

ficer thereof in the official capacity of such officer, is a party to a suit, and under this Act any function of such agency or officer is transferred to the Council, then such suit shall be continued with the Chairman or other appropriate official of the Council substituted or added as a party.

(e) JUDICIAL REVIEW.—Orders and actions of the Council in the exercise of functions transferred under this Act shall be subject to judicial review to the same extent and in the same manner as if such orders and actions had been by the agency or office, or part thereof, exercising such functions immediately preceding their transfer.

(f) STATUTORY REQUIREMENTS.—Any statutory requirements relating to notice, hearings, action upon the record, or administrative review that apply to any function transferred by this Act shall apply to the exercise of such function by the Council.

SEC. 113. REFERENCE.

With respect to any function transferred by this Act and exercised on or after the effective date of this Act, reference in any other Federal law to an official empowered with a function transferred by this Act be deemed to refer to the Council.

SEC. 114. TRANSITION.

With the consent of the head of the agency concerned, the Council may use the services of such officers, employees, and other personnel of any agency from which functions or offices have been transferred to the Council and funds appropriated to such functions or offices for such period of time as may reasonably be needed to facilitate the orderly implementation of this Act.

TITLE II—APPROVAL OF STATE APPRAISER CERTIFYING AGENCIES; CERTIFICATION OF APPRAISERS

SEC. 201. ESTABLISHMENT AND APPROVAL OF STATE APPRAISER CERTIFYING AGENCY.

(a) ESTABLISHMENT.—

(1) IN GENERAL.—In order to assure an adequate number of certified appraisers for the performance in a State of appraisals in federally covered transaction and to assure effective supervision of the activities of certified appraisers, a State may establish a State appraiser certifying agency.

(2) EXISTING STATE AUTHORITY NOT LIMITED.—This section shall not be considered to limit the authority of a State to establish requirements for appraisers in addition to any requirements for certification under this Act if such additional requirements pertain

to performance of appraisals other than for federally covered transactions and if the requirements imposed by the State do not discriminate against certified appraisers.

(3) TEMPORARY PRACTICE.—A State appraiser certifying agency shall recognize on a temporary basis the certification of a certified appraiser issued by another State if—

(A) the property to be appraised is part of a federally covered transaction;

(B) the certified appraiser's business is of a temporary nature and incidental to his or her practice in another State or States; and

(C) the certified appraiser registers with the appraiser certifying agency in the State of temporary practice, describing the real estate to be appraised and estimating the time necessary for completion of the appraisal.

(b) APPROVAL OF STATE APPRAISER CERTIFYING AGENCY BY COUNCIL.—

(1) IN GENERAL.—A State appraiser certifying agency shall be an approved State appraiser certifying agency if the State agency is approved by the Council under this subsection.

(2) APPROVAL BY COUNCIL.—The Council may approve a State appraiser certifying agency if it issues a written finding that—

(A) the agency agrees to recognize and enforce standards, requirements, and procedures prescribed by the Council;

(B) the agency is granted authority by the State which is adequate—

(i) to permit the agency to carry out its functions under this Act;

(ii) to monitor and investigate the performance of appraisals and the conduct of appraisers in federally covered transactions, including the power of subpoena; and

(iii) to discipline persons who perform appraisals in federally covered transactions. for violations of appraisal standards, the code of ethics, and appraiser certification requirements, including authority to impose fines and to suspend and revoke certifications issued pursuant to this Act;

(C) the State's laws assure the ready availability to appraisers in the State of adequate and reliable information regarding property values and

the terms and conditions of real estate sale transactions;

(D) the agency is empowered and agrees to furnish to the Council information regarding—

(i) certification policies, practices, and procedures in the State;

(ii) disciplinary actions carried out by the agency, including providing written notice to the Council within 30 days after the initiation pursuant to subparagraph (B)(iii) of any disciplinary action or proceeding against a certified appraiser;

(iii) disciplinary actions which relate to the performance of appraisals and which are carried out against certified appraisers by other State agencies;

(iv) such other information as is determined by the Council to be necessary to carry out its functions under this Act; and

(E) the agency is independent from other State agencies which issue certifications or licenses under State law.

(c) REVOCATION OF APPROVAL.—

(1) IN GENERAL.—The Council may revoke approval of an approved State appraiser certifying agency

upon a written determination that any of the major conditions on which the approval was based has changed significantly.

(2) OPPORTUNITY TO BE HEARD OR CORRECT CONDITIONS.—Before revoking an approval of an approved State appraiser certifying agency, the Council shall provide to the agency—

(A) written notice of the intention of the Council to revoke such approval not less than 90 days before revoking such approval; and

(B) ample opportunity to provide rebuttal information or to correct the changed conditions.

SEC. 202. CERTIFICATION OF APPRAISERS.

(a) IN GENERAL.—A person shall be a certified appraiser if the person is certified to perform appraisals in federally covered transactions by an approved State appraiser certifying agency or by the Council. The Council shall adopt rules establishing procedures and requirements for certification of a person under this section.

(b) CERTIFICATION BY APPROVED STATE APPRAISER CERTIFYING AGENCY.—An approved State appraiser certifying agency shall certify a person to perform appraisals in federally covered transactions in that State if the person is found to satisfy the certification requirements prescribed by the Council under section 103 and agrees to abide by the

uniform standards of professional appraisal practice and the code of ethics prescribed by the Council under that section.

(c) CERTIFICATION BY COUNCIL.

(1) IN GENERAL.—The Council may certify a person to perform appraisals in federally covered transactions in a State if—

(A) the person is found to satisfy the certification requirements prescribed by the Council under section 103; and

(B) the State in which the person will be certified to perform such appraisals—

(i) does not have an approved State appraiser certifying agency; or

(ii) has an approved State appraiser certifying agency that is in violation of this Act.

(2) INTERIM CERTIFICATION.—An approved State certifying agency, or in a State which does not have such an agency, the Council, shall certify a person to perform appraisals during the 24-month period following the date of the enactment of this Act in federally covered transactions specified by the agency or Council at the time of such certification, if the person—

(A) applies to the agency or the Council for such certification; and

(B) agrees to abide by generally recognized appraisal standards and a high degree of ethical conduct in performing any appraisal before the effective date of uniform appraisal standards and certification requirements prescribed by the Council under section 103, and to abide by other requirements prescribed by the Council under such section after they become effective;

unless the agency or the Council makes a written finding that the person is not qualified to perform appraisals in federally covered transactions and describes the reasons for such finding.

(3) EXTENSION OF INTERIM CERTIFICATION.—The Council may extend for 12 months a certification under paragraph (2) if the Council issues a written determination that the State in which the person is certified to perform appraisals is in the process of establishing an agency which is likely to be approved under section 201.

(d) WAIVER OF APPRAISER CERTIFICATION REQUIREMENTS FOR STATE HAVING SCARCITY OF QUALIFIED APPRAISERS.—The Council may waive any requirement under this Act relating to certification of a person to perform appraisals if the Council makes a written determination—

(1) that there is a scarcity of certified appraisers to perform appraisals in connection with federally covered transactions in a State; and

(2) that the person for whom such requirements shall be waived has a satisfactory record of appraisal performance.

SEC. 203. GOVERNMENT EMPLOYEES WHO PERFORM APPRAISALS.

This Act does not require an employee of a Federal or State Government agency who performs real estate appraisals in connection with the employee's official responsibilities to obtain a certification unless required to do so by the head of such employee's agency.

TITLE III—APPRAISALS IN FEDERALLY COVERED TRANSACTIONS

SEC. 301. VIOLATIONS IN OBTAINING AND PERFORMING APPRAISALS.

(a) VIOLATIONS.—It shall be a violation of this section—

(1) for a person to knowingly seek, obtain, or give money or any other thing of value in exchange for the performance of an appraisal by a person who is not a certified appraiser in connection with a federally covered transaction; and

(2) for a person who is not a certified appraiser to knowingly provide an appraisal to a person in connection with a federally covered transaction.

(b) PENALTIES.—A person—

(1) who violates subsection (a)(1) shall be subject to a fine of not more than $25,000 for the first violation, and not more than $50,000 for each subsequent violation; and

(2) who violates subsection (a)(2) shall be subject to a fine of not more than $5,000 for the first violation and not more than $10,000 for each subsequent violation.

(c) PROCEEDING.—

(1) IN GENERAL.—A proceeding with respect to a violation of this section shall be an administrative proceeding which may be conducted by an approved State appraiser certifying agency or by the Council in accordance with the procedures set forth in subchapter II of chapter 5 of title 5, United States Code.

(2) JUDICIAL REVIEW.—Notwithstanding any other provision of law—

(A) a decision of an approved State appraiser certifying agency under paragraph (1) shall be subject to review by the court of appeals of the State; and

(B) a decision of the Council under paragraph (1) shall be subject to review by the United States Court of Appeals for the District of Columbia;

in accordance with chapter 7 of title 5, United States Code.

SEC. 302. USE OF CERTIFIED APPRAISERS BY FEDERAL AGENCIES.

Notwithstanding any other provision of law, any Federal agency that uses the services of a fee appraiser after 24 months after the date of the enactment of this Act shall obtain those services from a certified appraiser if the services are obtained in connection with a federally covered transaction.

TITLE IV—GENERAL PROVISIONS AND DEFINITIONS

SEC. 401. DEFINITIONS.

For purposes of this Act:

(1) ADMINISTRATOR.—The term "Administrator" means the Administrator of the Council appointed under section 106(a).

(2) CERTIFIED APPRAISER.—The term "certified appraiser" means a person who is certified under section 202.

(3) APPROVED STATE APPRAISER CERTIFYING AGENCY.—The term "approved State appraiser certifying agency" means a State appraiser certifying agency approved under section 201(b).

(4) COUNCIL.—The term "Council" means the Federal Interagency Appraisal Council established by section 101.

(5) FEDERALLY COVERED TRANSACTION.—The term "federally covered transaction" means a transaction designated by the Council to be a federally covered transaction under section 103(g).

(6) REAL ESTATE-RELATED FINANCIAL TRANSACTION.—The term "real estate-related financial transaction" means any transaction involving—

(A) the sale, lease, purchase, or exchange of real property, including interests in property;

(B) the financing of the purchase or sale of real property;

(C) the refinancing of real property; or

(D) use of real property as security for a loan or investment, including mortgage-backed securities.

(7) STATE APPRAISER CERTIFYING AGENCY.—The term "State appraiser certifying agency" means any agency or instrumentality of a State the functions

of which relate to the regulation of persons who perform appraisals in real estate-related financial transactions.

(8) FEDERAL BANK REGULATORY AGENCIES.—The term "Federal bank regulatory agencies" means the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of Comptroller of the Currency, the Federal Home Loan Bank Board, and the National Credit Union Administration.

(9) CHAIRMAN.—The term "Chairman" means the Chairman of the Council elected by the Council under section 105.

SEC. 402. RESPONSIBILITIES UNDER STATE AND FEDERAL LAW NOT AFFECTED.

(a) RESPONSIBILITIES UNDER STATE AND FEDERAL LAW.—This Act shall not be construed to alter, modify, or impair any responsibilities which are not inconsistent with this Act and which are imposed by State or Federal law on appraisers, lenders, and other persons who are parties to real estate-related financial transactions.

(b) AUTHORITY OF FEDERAL AGENCIES AND INSTRUMENTALITIES.—Except for the functions of establishing appraisal standards and appraiser qualification requirements, this Act shall not be construed to relieve any Federal agency

or instrumentality of any authority to carry out its statutory responsibilities.

SEC. 403. FEDERAL AGENCY REPORTS OF DISCIPLINARY AND ENFORCEMENT ACTIONS.

Any Federal agency which initiates, or causes the initiation of, a disciplinary or enforcement action against a certified appraiser for a serious violation of Federal or State law shall report to the Council and to the appropriate approved State appraiser certifying agency—

(1) regarding the initiation of such action within 45 days after such initiation; and

(2) regarding the disposition of such action within 45 days after such disposition.

○

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Congress of the United States
Committee on Government Operations
House of Representatives

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HEARING ON H.R. 3675, THE REAL ESTATE APPRAISAL REFORM ACT OF 1987

THURSDAY, FEBRUARY 25, 1988

House of Representatives

Subcommittee on Commerce, Consumer and Monetary Affairs

Committee on Government Operations

Washington, D.C.

Committee Hearings

of the

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THURSDAY, FEBRUARY 25, 1988

House of Representatives

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The subcommittee met, pursuant to notice, at 10:00 o'clock a.m., in Room 2247, Rayburn House Office Building, the Honorable Doug Barnard, Jr. [chairman of the subcommittee] presiding.

Present: Representatives Barnard, Spratt, Craig, and Inhofe.

Subcommittee Staff Present: Peter S. Barash, staff director, Faye Ballard, clerk.

Full Committee Staff Present: Russell Mathews, minority professional staff.

recommendations that you are making are going to be very, very seriously considered.

I have no personal objections to licensing corporations. Now I know that everybody that works for Price Waterhouse and Arthur Andersen and I could go on and on are not CPAs.

They operate computers and they do a lot of other things but the material that they finally get to that proper individual in those corporations, when that signature goes on it, that is what makes the difference so I have no problem with that.

We have a vote on the Floor and I think it would be a good time to recess just briefly. Thank you all very briefly for being with us this morning.

Mr. BARBATELLI. Thank you.

Mr. KERSLAKE. Thank you.

Mr. BARNARD. The Committee stands in recess for ten minutes.

[Recess taken.]

Mr. BARNARD. The subcommittee will please come to order. Our next witness this morning, I think, in some circles could be better identified as Mr. Real Estate for he is Professor James Graaskamp who is Chairman of the Real Estate and Urban Land Economics at the University of Wisconsin, the Graduate School of Business.

I had the pleasure of knowing Professor Graaskamp now for

several years and I can certainly say that I admire him. I certainly respect his knowledge and understanding of the real estate field. He conducts seminars all over the country and recently I had the pleasure and honor of being with him in Atlanta, Georgia at a seminar that he conducted for the Georgia State University.

So Professor Graaskamp, I certainly want to welcome you to these hearings and we look with interest in hearing from you as to your opinions of this legislation.

STATEMENT OF JAMES GRAASKAMP, CHAIRMAN, REAL ESTATE AND URBAN LAND ECONOMICS, UNIVERSITY OF WISCONSIN, GRADUATE SCHOOL OF BUSINESS.

Mr. GRAASKAMP. Thank you, sir, and I would like to welcome you to those of us who have been trying to reform appraisal for about 25 years. My mentor and my first Ph.D. was in real estate under Richard Radcliff who was regarded as the preeminent theorist in the last several decades in appraisal theory. My second Ph.D. is in risk management which seems to cover exactly the subject matter that we are talking about here.

We come to this with whole hearted endorsement of your legislation. We feel that ultimately it should be extended to other aspects. A major area of government guaranty is in the pension area and that is, of course, involving more and more real estate where appraisal practices also need review.

But that industry is attempting to review them on their own. We headed up the research for the Pension Real Estate Association on appraisal practice, policy and protocol for those who manage [redacted] those funds as well as those who do the appraisal. [redacted] They are moving toward an industry standard via a letter of engagement since there are probably only approximately 200 appraisers who they feel are

qualified to do large scale investment properties, which says something about the state-of-the-art.

My credentials, in addition to being an academic, which in real estate circles one has to live down, ~~is~~ are that we run our own appraisal group called Landmark Research. We do litigation from coast to coast, ~~and we do that~~ and my wife tells me that probably we are not a profit making organization, we are simply an extension of the education process, ~~that~~ to get the attention of the major societies, we have to beat their leading people in court in order to establish methodology and practice.

We have seen the quality of appraisals decline as sophistication of real estate has increased steadily over the last 20 years and only in the last two or three years has there been any significant response.

For example, the American Institute of Real Estate Appraisers had not issued a single white paper on a single appraisal question from about 1951 when they did one on subdivisions until two years ago when they finally addressed the issue of how to appraise for securities prospectus or a limited partnership and so forth.

There simply has been no industry leadership for responding to the appraisal side of issues of financial information as there has been in the accounting side.

Let me give you one very simple example. Appraisal is in

the business of forecasting. They have no definition of forecasting nor what are the rules that would apply to that process.

A very basic principle in accounting is that a forecast requires a range estimate in which all elements of the range be plausible and supported, ~~that~~ if, in fact, you are going to deal with hypotheticals, ''if then'' kinds of statements, you are doing a projection and a projection is only permitted to have limited circulation to a client where the accountant would be present to answer questions.

If, on the other hand, the accountant is preparing a forecast which will have general circulation, where presumably those that may rely on it are not there to address questions directly to those that prepared it, he is not permitted to use hypothetical assumptions, ~~and~~ yet virtually every appraisal we are talking about in terms of income properties that have gone awry for lenders have been based on appraisal projections in which hypothetical assumptions were used and the appraiser has always hidden behind the fact that "gee, if you bought my assumption on page one, then my conclusion is valid even if the assumption itself were insane".

Now they are encouraged to do that by a lending fraternity that has always been anti-appraisal. Obviously, an appraisal chills the deal as far as the lending officer is

concerned and there is a considerable bias against the appraisal unless it is a controllable appraiser.

That is a word which the major bank lending officers use all the time. A major bank said that to me just the other day and I couldn't believe that they would use that word while I was around. An appraiser should be controllable. It is exactly the opposite of the function that he is supposed to perform.

Isn't it ironic that at the closing, the lender requires at least one percent of the loan fees for an insurance premium in case the collateral should burn down, but would never require that they spend one percent of the project to find out if it would rent up and yet the real collateral is that will it rent up.

There is a total anti-appraisal bias. Indeed, the recent language in the collapse of R-41C, I think, is really significant. In the recent repudiation of R-41C based, of course, on the CEBA legislation, Chairman Dennis Wall made an incredible statement.

In repudiating R-41C he said, ''It wasn't cost effective and competitive with the bank's appraisal standards'' and yet the banks have no appraisal standards and the President of the American Institute of Real Estate Appraisers said so directly.

Now what is cost effective? If you have just lost $25

billion dollars and the FSLDIC is broke and they are going to lose another $25 billion dollars because as Mr. Crawford pointed out so beautifully that each of those projects eats money while you sleep, what is cost effective if it doesn't mean spending adequate money to do a professional job of appraisal and using the appraisal as a legitimate portion of the underwriting process.

Currently, it is used simply as a CYA document in case the auditor should ask if you had one. Neither are the auditors trained in the banking business to read an appraisal knowledgeably.

Now I would submit that while many of you think that this legislation is punitive on the appraiser, I would suggest instead it is a curb on the banker. I would suggest that it would be the only defense of the appraiser against his client because he can go back and say, ''I can't do it that way. My certification and my living depends upon me doing it this way and this way is going to take so many people hours to accomplish and is going to cost you so much to get the job done'' and now the appraiser can be truly independent because he has a rock on which he can lever professionally.

Currently he can't do that. The minute he stands up to a lender, he loses the job, he doesn't get asked back, and very quickly he is out of that particular business. It is a

Gresham's law going on which drives the good appraiser out of anything that has to do with lending and related enterprises thereto.

That industry is not driven by market demand for space which is the specialty of the appraiser. It is driven by the fees and the commissions and profit centers of the short term owners of those properties and the risk is being borne by the Federal government and ultimately the taxpayer.

The loan program approved by FSLDIC is a bandaid on a gaping wound and sooner or later you, in Congress, are going to have to find $50 billion dollars to recapitalize FDIC and FSLDIC. It is as basic as that.

Now I realize it is un-American to regulate from the Federal government, that risk is a part of doing ~~the American~~ business the American way but in this case the risk is being taken by the Federal government, by FSLDIC and FDIC.

It is another basic tenet of business that I learned at my father's knee, that those who pay the piper get to call the tune. You are going to pay the piper for $50 billion bucks and therefore, the Federal government gets to call the tune. It is basic.

Now I would be happy to answer questions because I can go on and on about appraisal reform for days.

[The prepared statement of James Graaskamp follows:]

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Mr. BARNARD. I appreciate that, Professor. In your outline which you have shared with us and you have covered a lot of this, you have covered most of it, I was interested in your response to the arguments in opposition to the legislation.

I think you probably covered all that I had any questions on.

Mr. GRAASKAMP. If I could, I would like to comment on several of those.

Mr. BARNARD. All right. Let me ask you this question first. Professor, some have suggested that the appraisal abuse problem should be left to each of the 50 states and that because the Federal government does not certify doctors, lawyers or accountants that we should not have federal certification requirements for appraiser. How would you respond to that statement?

Mr. GRAASKAMP. Well, there are multiple responses to that. First of all, I think it should be clear that almost all of the real estate organizations other than a few of the more enlightened appraisal organizations are opposed to this because it is going to impose on their commissions, fees and so forth.

The American Bankers Association, the National Association of Realtors, the Mortgage Bankers Association, the National Association of Home Builders would all find their style

curbed, as it should be, by this legislation. They are extremely effective at the state level.

Almost all of them have direct access to the governor's office and the governor's office would be those appointing whatever agencies will implement this at the state level. They will gut this issue and delay it and dilute it at the state level and you are going to end up with 50 different rules.

Now that is totally unrelated to the fact that real estate finance is now totally detached from the property. Real estate finance is a national and international market in which a standard set of financial data should be available and for which there is a standard way of doing business.

This has made, of course, a tremendous difference in the residential area as we have already seen. The securitization of the commercial area is coming on us very quickly and I would suspect that most of the institutions which are regulated under this particular law will not keep any more than 25 percent of the loans that they make, that, in fact, they will be securitized and sold off across the country.

~~That~~ therefore it is absolutely critical that there be a standardized appraisal process underlying that securities market which moves across not only state lines but national boundaries as well.

To leave that to a 50-state group in which the parochial interests of the small trade organizations in those states ~~which~~ that have embedded political organizations would be foolhardy. The appraisal industry has no political base, no political clout, no political sophistication which is one of the reasons they are where they are now.

Mr. BARNARD. Mr. Craig.

Mr. CRAIG. Thank you very much, Mr. Chairman. Mr. Graaskamp, I have not only appreciated your testimony, I have looked through your combined comments and it is always exciting for me to be with someone like you who obviously has a great grasp of the problem and the general issue.

We just don't have any disagreement. I do have some concerns because I think we both see the problem. The extent to which this Committee has worked to expose the problem has been extensive and we know what the problem is.

I think maybe we differ on how we arrive at a solution and we don't differ all that much because I recognize the responsibility of the Federal government as it relates to its own risk or the risk it assumes.

I guess the difference comes in how you approach it. Let me ask you this question with this explanation. I think we all recognize the extent ? is involved in finance or at some arm of finance in this country.

We also, my Chairman and I tend to disagree on how we got

the CPAs to where they are today. Be that as it may, we do recognize that the CPAs got to where they are because the Federal government or an entity of the Federal government set a standard or standards and said, ''If you want to play the game, you play to this standard or you don't play.''

Mr. GRAASKAMP. I think there is a good model there. In the securities area, the SEC came down on the standard because the CPAs were dilly-dallying.

Mr. CRAIG. That's right.

Mr. GRAASKAMP. And embarrassed them, and rather than be embarrassed again, they got their act together and passed these rules.

Mr. CRAIG. But they didn't license, did they? They just established a standard and said, ''Do you want to play in our ballpark and our ballpark happens to be so big and so powerful that you are not going to play unless you play there, you have to play by these standards.''

Mr. GRAASKAMP. In one small sector, right.

Mr. CRAIG. Professor, I guess my concern is because the Federal government is so involved with a phenomenal liability to the tunes of the billions of dollars you have referred, if we are so all powerful, is it not possible for us to set a minimum standard for all of these entities involved and say, ''That is the way the game will be played if you want to play with us'' and is it not possible then

that those 50 entities would have to at least establish that as a minimum standard?

Mr. GRAASKAMP. Well, I am not sure that that is not what you are doing by creating this Federal interagency group with the two groups, one to establish the standards and one to establish the certification process.

Mr. CRAIG. And one to conduct this certification process until such time.

Mr. GRAASKAMP. Well, I think the certification process is that the states have a certain time to be responsible and if they don't, then the Federal Interagency has the power to go forward and impose that and I think that it is a very intelligent way to go about it.

Mr. CRAIG. Well, that is where we disagree but I thank you for your testimony. It was very valuable.

Mr. BARNARD. I believe you wanted to respond briefly on some of the other aspects of your testimony.

Mr. GRAASKAMP. Yes. Your question was why appraisers if doctors, lawyers and accountants were not necessarily Federally licensed, I think there are several reasons for that.

One, the damage that each of them can do at the individual level, there is a basic limit and currently there is an adequate malpractice or malfeasance insurance program available for which each of them pays huge fees, in many

cases perhaps a third of their professional income going to malpractice insurance.

There is no such insurance program for appraisers as underwriters have widely appreciated the fact that there is no professional standard as yet and secondly, the amount of damage that one appraiser can do financially is so much greater.

Many of the institutions that you looked at in your investigation were put out of business by one appraiser and ironically, the appraisers who got the highest fees were the ones that did the most damage because it was the only time the client really appreciated the value added by the appraiser was when he got a fraudulent appraisal, he was willing to pay him for it. If he got an honest appraisal, he probably wasn't willing to pay him for it.

So you have a complete different set of circumstances here in that the insurance is not available and the amount of damage that can be done is incredible in terms of the total dollar values that are involved.

In this case, the Federal government does not insure doctors against their mistakes. The doctors are having to do that themselves and having a great deal of difficulty doing it I might add.

But in this case, the Federal government does insure institutions and what we are really talking about is not

just appraisal forms, we are talking about an entire change in the business culture which has gone for at least 40 years using appraisers as tools, as controllable misinformation sources in order to go ahead and justify what they wanted to do from a transaction standpoint and totally subverted the function of the appraiser as a check and balance on the judgment of the underwriter.

So we are talking about a massive impact that has to be made on the lending fraternity here in terms of how they regard the appraisal as part of the lending underwriting process. That requires the clout that the Federal government has, not a group of volunteers that meet in Chicago or Washington twice a year to discuss how many angels on the head of a pin relative to appraisal theory.

The volunteers have moved at a glacial pace and although many of them are ~~men~~ persons of good will and many of them ~~are men~~ are persons of great competence, they have not been able to maintain their constituency and the dues paying power of their membership at a level where they can enforce their own standards.

The appraiser that caused the damage to Beverly Hills Savings and Loan still has his designation. I was just recently ~~testifying~~ in a securities fraud case in which all of the appraisals had been altered and not only was the appraisal of the acquiring company on a roll-up exaggerated, every

appraisal of the apartment projects being acquired was understated except one which happened to be owned by the syndicator's son which was appraised correctly and highly.

In that case, there was an official from one of the appraisal organizations who condoned that and said that they were a little sloppy but that education would solve all of that. I can't believe that. Not one of the MAIs that had signed any of those appraisals have yet been called to task for that work.

Mr. BARNARD. That is very contrary to what you see in the CPA industry when you find faulty audits as have occurred in several of the big, big bank failures, the agencies have actually brought litigation against those CPAs and have extracted large, large fines because the fact is that their audits or their certifications did not measure up.

Mr. GRAASKAMP. I have been called in on at least a dozen cases of institutional financial where the lawyers were going to sue the appraisers only to discover that their insurance is written on a discovery basis and as soon as there was a hint that there was a problem, the malpractice coverage had been cancelled before there was official discovery and as a result there was no coverage.

Mr. BARNARD. Mr. Spratt, do you have any questions?

Mr. SPRATT. We had testimony last week and I am sorry I am late and first let me apologize but I assure you I read your

testimony and I appreciated your comments just then, we had testimony last week from MGIC and also testimony from a relocation service.

The relocation service introduced the idea of quality control over the appraisers they retained by using a variance analysis on the appraisal results and granted, they are able to use such a variance analysis more easily than a lending institution would be able to implement such a program because they make a quick turnaround sale of the properties they take in for relocation purposes.

But have you given any thought or study to some sort of system for variance analysis or quality control over the selection and use of appraisers which are lending institutions insured by the government might be required to maintain so that examiners could come in and check the quality control log to see if appraisers of recognized ability were being used?

Mr. GRAASKAMP. Yes. There are all kinds of those studies that have been done. At the universities we have several different types of market comparison systems which are virtually automatic and much more reliable than the appraisal element but which have never been introduced.

With the right data base, I can do a single family appraisal for about five bucks that is much more reliable than the one you can get from the guy in the field but the

industry doesn't really want to hear about that for obvious reasons.

There has been a good study just done down here at the University in Richmond, I am trying to think of the name, what is the major university in Richmond, Virginia?

Mr. SPRATT. University of Richmond.

Mr. GRAASKAMP. University of Richmond, okay.

[Laughter.]

Mr. SPRATT. Is it VPI, Virginia Tech?

Mr. GRAASKAMP. No, University of Richmond and they analyzed 350 appraisals and appraisers and so forth in terms of the bias and it was incredible. Statistically they obviously knew what the transaction price of the single family home was before they did their appraisal because they never came under it. You can't do that by accident.

Theoretically, you should be above or below it 50 percent of the time. The chi square showed that that almost never happened. There was a distinct bias in the appraisal. So those methods exist and the industry doesn't want to hear about them nor do they want to try them.

I have worked with MGIC from the outset. I wrote the original briefs as a graduate student for Max Karl as we went into the various states so I have tracked on that very closely.

Mr. SPRATT. Have you been retained by any savings and loan

associations, banks or other lenders or purchasers of real estate mortgages to develop systematic appraisals?

Mr. GRAASKAMP. Not before the fact. I am working for First Republic currently but in general, lenders don't want to see honest appraisers coming along the track. You can kill an awful lot of good deals that way.

Mr. BARNARD. He is a former banker. I am glad for that reason.

[Laughter.]

Mr. GRAASKAMP. The only time our firm gets called in is when one of the major banks has a proposal before them from a good customer, a relationship as they say, and they don't want to tell them ''no'' so they let me do it for them.

Mr. SPRATT. One of my continuing concerns has been the examiner coming into an institution for an examination cold on the facts, opens a loan file and if that loan is not delinquent, if it is not manifestly under collateralized, if it is not made to somebody who has defaulted in the bank or other nearby banks in the past, it is likely to be approved even though it is grossly under collateralized, even though the interest may have been packaged into the principal and loaned up front to the borrower and the appraisal if it is well done, if the brochuremanship is there, if it is on a nice letterhead and if there are apparent comparables to support it will only lead the examiner to put the file back

in the cabinet and go on to other files that are red flagged.

What can we do to give the examiner better insight into where there are incipient loan problems and that there is under collateralization despite, notwithstanding, an apparent appraisal? What can we give him externally in the bank or the S&L that would allow him to detect those appraisals that are not reliable and likely won't pan out if the loan goes bad?

Mr. GRAASKAMP. I think that the reason R41-C died was internal pressure in the Home Loan Bank because the loan officer had to sign the appraisal and say that he had read it, for one thing, and that he agreed with the assumptions and conclusions for another. [redacted] I think that made R41-C totally unacceptable to the lending officer because he now would be accountable along with the appraiser for the product and if you wanted to do one thing, it would be to make somebody accountable in the bank for the appraisal.

Mr. SPRATT. Well, if that accountability breaks down though, if somebody bets on the come and believes that real estate will keep inflating and they will be bailed out of another appraisal, you still have the problem and I am trying to bolster the roll of the third party which comes in and makes an objective appraisal of the situation and is able to tell when somebody hasn't been accountable, somebody

has fudged the appraisal.

Let me give you one idea and ask you if it is practical since you have worked on developing systems. I used to try condemnation cases for the State Highway Department, also, and when we did an interstate appraisal or a major road appraisal, major road condemnation, we would obviously retain certain appraisers.

The Highway Department was pretty scrupulous about whom they retained and the Federal government was pretty scrupulous. They review appraisers, demanded that we obtain quality appraisers, that their work be of a high quality and there was a lot of variance analysis involved.

One of the first things we required was a sales brochure and extensive documentation of all relevant comparable sales within a certain period of time. We had criteria for what was relevant and comparable, but we catalogued any kind of comparable sale in the vicinity of a certain stretch of that interstate before we undertook to do any work and then we drew off those catalogues, the appraisers drew off that data bank and referenced those documented, demonstrated comparables in defending the values that they derived for various parcels of property.

Would it be impractical today to require lenders to maintain a data bank of comparables so that the examiner could go and check the comparables to see if the appraiser

had chosen the right comparables or had chosen all the comparables and considered all comparable sales relevant to a particular piece of property?

Mr. GRAASKAMP. I think that is a part of it. The problem today is that comparable sales are no longer a really good reliable tool. Theoretically we would all like to use that as a base but most of the prices as reported are now engineered prices where the CPAs on both the buyer and the seller's standpoint have come to terms as to how to structure it most favorably for corporate accounting purposes, for the Internal Revenue Service, for partnership purposes, et cetera and therefore, excepting very few of the major transactions, the price as reported is not a reliable price.

In fact, what often is reported is the price on the offer to purchase and those of us who are in the business know the real deal gets negotiated sometime between the offer to purchase and the closing and the closing price is not reported and quite often today, you really make up the difference on the adjustments on the closing price for everything from toxic waste to other attributes in the deal.

So the only problem with that is that the gross comparable sales price can be very misleading and therefore, judicial selection, shall we say, by the bank or by the appraisers would continue.

Mr. SPRATT. Well, a good comparable data sheet includes

the information as to how the appraiser established the actual purchase price.

Mr. GRAASKAMP. The adjustments are really tough. The theory relies on cash equivalent price but it is getting tougher and tougher to figure out what the cash equivalent price was.

Mr. SPRATT. Because there are so many exogenous factors.

Mr. GRAASKAMP. Too many other variables going on. The other thing is that there are so many intangibles being traded. For example, one of my major cases right now is the Boca Raton Hotel case being assessed by the Boca Raton assessor at the gross sales price and yet ~~you~~ VMS bought a going business that had all kinds of personalty, which had a book of business of future conventions, which had in this case the Boca Raton club in which people pay exorbitant fees per year just for the right to go and spend money there and so forth and a lot of that is intangible personal property. How much was really for the real estate in that transaction is really hard to pin down.

Basic case just before the Supreme Court in New Jersey which we ~~tried~~ testified, a regional shopping center, how much of the value of the regional shopping center is in the operating agreement which creates special monopolistic advantages for the majors in exchange for their participating for 30 years, providing parking, chipping into the merchants association

and so forth and so the brick and mortar is worth maybe $15.00, triple net a month, but people pay $22.00 to be in essentially what is a joint marketing effort which under the laws in New Jersey is clearly a franchise marketing scheme in which the developer is selling entree to this joint marketing effort rather than a piece of real estate.

Now what is the real estate price, land and building that should be taxed, or what is the collateral value of that? We are getting into some really messy issues on income property which make cash equivalent comparable prices a tough game and therefore, we are much more into lease-by-lease cash flow analysis of the properties which by the way originated at the University of Wisconsin. We, 25 years ago built those first cash flow models which are the precedent today.

So what you have is a sophistication which means essentially more income property appraisals for the accountants. The fastest growing appraisal firms in the country right now are the Big Eight accounting firms.

Mr. BARNARD. Mr. Craig.

Mr. CRAIG. Thank you very much, Mr. Chairman. Mr. Graaskamp, the discussion has been fascinating to me and I go back to some of your comments in your opening statement about the lender really being the person calling the tune currently.

Now under this proposed law with the changes going on in

the establishment of standards and certification, I assume, no, I don't assume, let me ask these questions of you. As you read the law do you see this as a minimum standard?

Mr. GRAASKAMP. I don't see it as any standard at all. What you have set up was a board that would establish standards. That is a critical element. I guess I would question the membership of the board. I would see that there should be more outside talent than just the Big Eight appraisal firms or appraisal agencies. The accountants should have a major role in it because we are really talking about financial information and the appraisal has become a fine art of financial dis-information.

Mr. CRAIG. All right. You are talking about tremendous sophistication and all of the variables that exist.

Mr. GRAASKAMP. There are multiple user groups.

Mr. CRAIG. Go ahead.

Mr. GRAASKAMP. You are talking about multiple user groups. Certainly Fannie Mae, Freddie Mac, with their uniform residential appraisal form are coming a long way. Where you go from there, you really have either incompetence or fraud. So that is one user group that has an interest in one sector of the area.

But the really big losses to your major institutions have been on the side of development loans, construction lending and arbitraging really from an apartment house to a

condominium conversion, ~~a company of that sort~~.

Mr. CRAIG. Can you approach that problem through this law?

Mr. GRAASKAMP. Yes. The advisory board properly constituted could go a long way to establishing the standards for that and it is not that difficult. Most of the stuff is out there if they would follow some of the models.

Mr. CRAIG. Can all of that fit in appraisal standards or are we talking about financial institutions' practices?

Mr. GRAASKAMP. Well, financial institution's practices is another problem.

Mr. CRAIG. Yes. What I am hearing from you--

Mr. BARNARD. I think that is covered by the agencies though.

Mr. GRAASKAMP. I think what we really need is--

Mr. CRAIG. But fraud still goes on.

Mr. BARNARD. But management practices are determined by the Federal agencies, OCC, Home Loan Bank Board, Federal Reserve.

Mr. CRAIG. Mr. Chairman, I understand that. I guess what I am trying to get at here in understanding your comments which have been very valuable to me and the sophistication of the problem we are dealing with, I think I know a little bit about that is that this--well, what I am hearing from you is that to the extent of the problem, this may be an effort

in the right direction, it takes out a certain portion of the problem but it is not a cure all to the situation you are referring to.

Mr. GRAASKAMP. Let me put it this way. We have a relatively unique situation. Ordinarily, quality and getting your money's worth, a professional fee, should be a demand pull kind of thing. People would want to buy that. In the case of the loan officers, they don't want to buy that. In fact, they would tend to suppress the appraiser that provided that kind of objectivity and criticism.

Mr. CRAIG. And this will change that?

Mr. GRAASKAMP. What you are really doing is giving the appraiser something that he can push off from and push back against the lender whom we can't push back from now. He has no basis. He can't say, ''Hey, I can't do that because I am going to lose my license. I can't make that assumption because here are the standard rules that I am working on.'' The guy in the field wants a standard that he can defend himself with against the other guy that is willing to write anything the lender tells him to write.

Mr. CRAIG. So in other words you are saying that this is going to build a little more backbone?

Mr. GRAASKAMP. It builds backbone.

Mr. CRAIG. But fraud will continue to exist where fraud has always existed.

Mr. GRAASKAMP. That has always been the case at any place.

Mr. CRAIG. All right.

Mr. GRAASKAMP. What I am saying is what we have here is an institutional counter incentive and what we are trying to do is change that institutional counter incentive so that the appraiser can truly be independent and I don't think that the professional organizations that have spoken here with the possible exception of the Society of Real Appraisers have really represented the folks in the field.

I talk to hundreds of them. I teach the American Bankers Associations' real estate finance school. In fact, I am the dean of it. I have taught appraisers from coast to coast. Our school developed the computer system that they are using.

I listen to them every day and most of the appraisers in the field want this legislation and they feel that the institutional organizations that are speaking for them have other agendas. They are concerned about their power, their political stature. They are being embarrassed by the fact that this is going one.

What is more is they think that, wow, if there is a certification by the Federal government that says this particular individual has passed certain examinations, has met standards, has been working for several years and continues to meet those standards and so forth, maybe they

don't need us as an MAI or an SREA, that a certification by the Federal government would be a higher standard and suddenly, their membership starts to wane.

There are many people out there who will not hire a certified appraiser because they don't want the somewhat obsolete dogmatic methodology which is still being taught by those organizations.

So I don't think you have heard from the guy in the field, the honest, competent individual who would like a fair shot at a lending business as well as all the other types of appraisal businesses that there are is in favor of this kind of legislation.

He liked R41-C. He could finally push back against the lender and say, ''Hey, you know, this is the way it should be done and this is the way I am going to do it and your own people say this is the way it should be done'' and he had a lever that he could be professional and that is what we are trying to provide here.

Mr. CRAIG. Thank you.

Mr. BARNARD. Professor Graaskamp, I appreciate very much your being here today. It has been very enlightening hearing your testimony. I think it has been well appreciated and certainly we understand the credibility of it because of your profession and your experience in it. Thank you very much and I hope that you will feel free to

give us any suggestions and advice as this legislation goes forward.

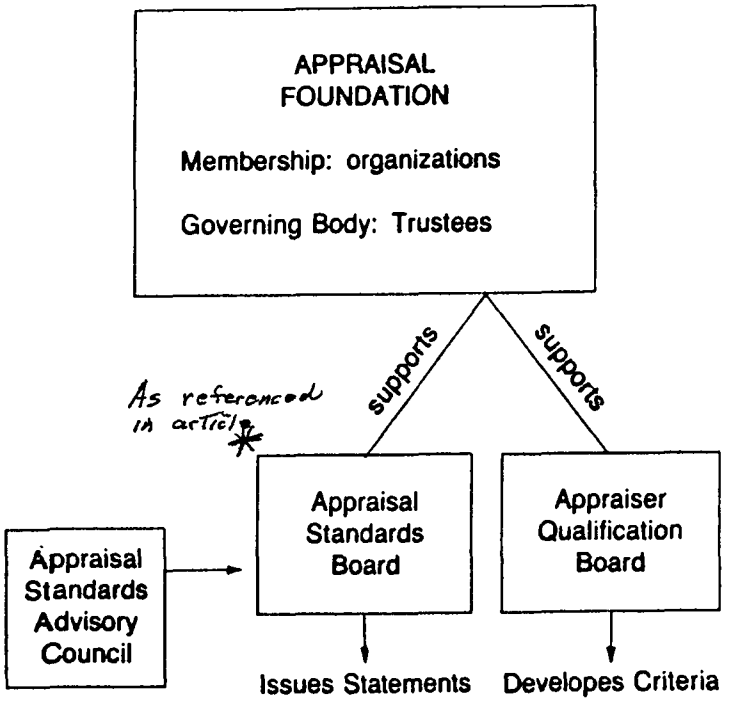
Mr. GRAASKAMP. Thank you, sir.

Mr. BARNARD. Our last panel today will consist of Mr. Walter Bohorfoush, vice president and chief appraiser of the Chevy Chase Savings Bank and Mr. Dominick S. Pompeo who is a real estate appraiser and consultant in Brooklyn, New York, if you gentlemen will take the witness stand.

Gentlemen, we appreciate very much your being here today. We also appreciate your patience in waiting so attentively but we can't hear from everybody at the same time. That is one of the problems we have so we have to take them in some order but we do appreciate your being here. Without objection, your entire testimony will be included in the record and if possible, we would like for you to summarize within say ten, 12 or 15 minutes. We will first hear from Mr. Bohorfoush.

EXHIBIT A

CHART A



State Administrators

Use Criteria Developed by the Appraiser Qualification Board to:

1. Check education and experience and administer examination (before issuing certificates for state certified real estate appraisers)

2. Supervise continuing education program for renewal of certificates

and

Enforce the Standards developed by the Appraisal Standards Board (with penalties for violation)

State and Federal Regulators

Adopt (when appropriate) the Standards Developed by the Appraisal Standards Board

and

Restrict Certain Types of Appraisal Services to State Certified Real Estate Appraisers (certified by states that use the criteria developed by the Appraiser Qualification Board)

March 7, 1988

Peter Barash
Subcommittee on Commerce,
Consumer and Monetary Affairs
B-377 Rayburn House Office Building
Washington, D.C. 20515

RE: HEARING ON H.R. 3675, THE REAL ESTATE APPRAISAL REFORM ACT OF 1987

Dear Mr. Barash:

Thank you for the opportunity to testify in support of Congressman Barnard's Appraisal Reform Bill. On reading the transcript I wish I had talked in succinct bullets rather than a rambling commentary.

However, I did want to comment on the major request of the gentlemen from Marshall and Stevens and Valuation Associates. More appraisal is moving toward large firms, particularly accounting firms and full service real estate firms that operate regionally or nationally, because they can send a large number of personnel into a given area to do a project quickly or scatter personnel to multiple properties of a client throughout the country. They are correct on their request for company licensing because States will use their licensing laws to protect their local appraisers from national competition.

Florida already prohibits appraisals by those who are not licensed in Florida and the license requires three years of prior residency. The alternative is to share the fee with a local appraiser who signs the report as though it were his. Ultimately there should be a provision whereby the Federal Interagency Board can certify a limited number of executives in the private sector and government employees in the public sector to operate in all fifty states without State certification. That will prevent States from being used by local trade associations to restrict competition or fight back against the loss of most high ticket appraisal business to Big Eight accounting firms. Cancellation of a national license will also give the Federal Certification Board an opportunity to punish the national firm that continually prostitutes its good name to pander to investment banking, syndication, or securitization prospecti. Believe me, some of the worst appraisals are being done by some of the old line national firms.

Thank you for the opportunity to comment.

James A. Graaskamp, Chairman
Real Estate and Urban Land Economics

February 25, 1988

TO: The Committee on Government Operations, 100th Congress
First Session

FROM: Professor James A. Graaskamp, Ph.D., SREA, CRE
Chairman, Real Estate and Urban Land Economics
University of Wisconsin, School of Business
Madison, Wisconsin

RE: IN SUPPORT OF H.R. 3675 TO ORGANIZE AND CONSOLIDATE FEDERAL MATTERS RELATING TO APPRAISALS IN LEGISLATION TO BE CITED AS REAL ESTATE APPRAISAL REFORM ACT OF 1987.

I. Credentials and Bias of the Commentator.

II. Statement in Support of Legislation as Drafted.

III. Response to Arguments in Opposition to Legislation as Drafted.

A. Fragmentation of Appraisal Profession undermines capacity to define standards, certify appraisers, to enforce sanctions, and to finance reform.

B. The historical weakness of appraisal organization has been and will be exploited by the powerful political organizations who represent primary customers for appraisal services and who have a vested interest in preserving a compliant appraisal trade with the trappings of independence.

C. There is a traditional, pervading anti-appraisal bias of mortgage loan officers who are represented by the powerful alliance of significant lobby groups including the ABA, USS&L, MBA, NAR, and NAHB at both Federal and State levels.

D. Real estate transactions and developments are driven by the commissions and fees of the deal makers rather than effective demand for space, which is the subject matter of appraisal. If accounting could trace the source and application of mortgage funds, it is probable that the losses of FDIC and FSLDIC represent the fees paid those who would oppose rigorous appraisal.

E. Citizens can sue doctors, lawyers, and accountants, who must finance malpractice claims with huge private insurance premiums and lose their licenses. However, the federal taxpayer will fund the deficits of FDIC and FSLDIC caused by negligent loan officers and compliant appraisers. Who will pay the employees of the defunct lender or the property owner whose net worth is crushed by an over supply of unneeded, newly built, competitive space?

F. The need for efficient allocation of capital, safety of the depositor and established real estate investor, as well as protection against insider profits in the banking industry, require congressional action on H.R. 3675 as drafted.

I. Credentials and Bias of the Commentator.

Our presentation to the committee is prompted by a career in developing appraisal theory, practice, and education, and not as a member of any professional group. We are here at our own expense other than travel monies provided by the University outside funds as the Dean of the University of Wisconsin Business School felt that educators have a significant vested interest in advancing contemporary methods and education for the appraisal process.

The resume in Appendix A will speak for itself, but it should be noted that we have received the highest awards for appraisal education and improvements to appraisal theory from the Society of Real Estate Appraisers, the American Institute of Real Estate Appraisers, and Lambda Alpha, the national honorary fraternity for urban land economics. Much of our consulting activity involves the use of appraisal in litigation, securities fraud, pension real estate, and bank lending on commercial investment properties. We have read hundreds of appraisals for investment properties by all the major appraisal firms on properties located from coast to coast. The general quality is from poor to average. Our conclusion has been that the majority of clients find appraisal mysterious, manipulative, and hopefully a tool for advocacy. The fees are too low for a professional piece of work because the clients seldom perceive the value added by careful research of the real estate market and the property. The lender will require at least one percent (1%) of loan proceeds for fire insurance in case the collateral should burn down but would never spend one percent (1%) of project cost to be reasonably certain the project would rent up. But the rental market is the true source of collateral value; many lenders today can only hope that their real estate interest burns down.

Our bias is that appraisal reform must be brought about by demand pull so that major clients for appraisal services, such as lenders, pension funds, and public agencies acquiring properties by eminent domain must be <u>forced</u> to recognize their own economic self-interest and to purchase responsible appraisal services at prices that justify responsible, professional appraisal work.

II. Statement of Support for H.R. 3675 of Real Estate Appraisal Reform Act of 1987.

Sound appraisal practices are critical to the security of our financial institutions and pension programs as well as the efficient allocation of capital in our economy. Sound appraisal practice is a fulcrum of social equity in matters of real estate taxation, eminent domain compensation, and allocation of costs and benefits of public infrastructure. Nevertheless, the appraisal process is controlled by 19th century economic theory, regulatory anarchy, and self-serving clients who desire

advocacy rather than objectivity from presumably independent appraisers. To talk of appraisal reform is to expect massive business culture reform and social engineering of mind sets, economic interests, and juvenile concepts of enterprise that can only be accomplished by Federal intervention. With time, the Federal role of creating objective review of appraisal standards and certification requirements could be returned to the private sector once the real estate industry had learned it could survive with truly independent, professional appraisal services.

The creation of a Federal Interagency Appraisal Council is a timely and critical catalyst for much needed reform of the appraisal process, which has become parochial, paralyzed by internal, self-serving political struggles, and subverted by the investment industry to protect the fees of loan officers rather than the funds of savers. None of the Federal regulators as individual agencies have been able to withstand the internal political pressures created by the regulated in order to establish meaningful reforms of appraisal methods, the appraisal role in the lending process, and the independent role of the appraiser as a check on counterproductive incentives to make marginal loans. The diverse interests of the Council would prevent a travesty such as the recent repudiation of R-41C by the Federal Home Loan Bank Board. The arguments presented by Chairperson Dennis Wall were that appraisals performed to the standards required of R-41C were not cost effective in terms of competitive costs relative to the banking system, a statement which is no less astonishing when you consider that the lenders expect a Federal Agency and Congress to pay the $25-50 billion loss which can be attributed to the implicit conspiracy of loan officers/developers/ appraisers. These forces would have more difficulty subverting a Council of diverse interests and constituencies. In the future, the Council can be expanded to include the Internal Revenue Service, the Federal Highway Department, and other agencies involved in eminent domain acquisitions.

Of critical importance for implementation is the time pressure applied in the proposed legislation to provide appraisal standards and certification standards for review within twelve months of enactment and for installation within eighteen months. Any effort by the private industry will be deliberately stalled and extended for reasons to be discussed below. The enormous funding required for putting an adequate system in place is covered by a Federal loan for $19 million which could never be assembled by the private sector in a timely fashion. The historical <u>volunteer</u> efforts of the private professional appraisal groups have worked at a glacial pace and is a significant factor in the current vacuum of appraisal standards and enforcement. Where would the appraisal industry raise $19 million to fund a huge two-year effort? How soon could the private industry have an effective program without the money to employ full-time professionals to inaugurate the program? Only a Federal Council can enforce collections of fees and charges to

support long-term funding of the program as contemplated by the legislation. The industry admits the cost to penalize abusers with existing designations has been a prime factor in the breakdown of private enforcement sanctions, so where would the money be found to install and to impose regulation if States fail to act as required by the industry proposal? It is important that a centralized Federal Council can operate to certify and to sanction those who abuse if the States fail to act since most States will fail to act for reasons discussed below. Nevertheless, States should be given the opportunity to be responsible legislators.

III. Response to Arguments in Opposition to Legislation as Drafted.

The appraisal profession is fragmented and lacks the institutional capacity to define standards, to certify appraisers, or to enforce sanctions on those who abuse designations. The current effort of eight appraisal organizations to create a foundation and model of self-discipline in the image of the certified public accountant is doomed to delay, dilution, and defeat for lack of funds to pay full-time staff, lack of consensus within a profession that has fought merger for years, and lack of legal clout to control its customers or designated members.

Appraisal reform is a Legislative issue that will generate significant resistance from a variety of trade organizations who have a vested interest in the status quo as stated above. None of these professional groups speak for the practicing appraisers in the field who have integrity and competence and who need and desire Federal Assistance to protect their independence and objectivity from mortgage lenders, real estate brokers, builders, and developers. Congress should recall that the Independent Society of Real Estate Appraisers has testified in favor of H.R. 3675 because these appraisers recognize that the professional organizations cannot impose sanctions without a power of subpoena, disclosure, and freedom from counter suits against those appraisers who pander to those parts of the industry that make their living from fees, commissions, and salaried bonuses based on volume. The position of the American Institute of Real Estate Appraisers (AIREA) is totally compromised because it is dominated by its parent organization, The National Association of Realtors, and because many designated members of AIREA are loan officers rather than independent appraisers.

We submit that the goals of most professional appraisal organizations to maintain their prestige, control of standards, and cash income from membership is in conflict with the goals of its competent individual members who are unable or unwilling to do appraisals for mortgage lenders at the cost of objectivity and independence. We have talked to dozens of designated members who believe that Federal involvement is the only hope for realistic reform and for public sanctions against tractable appraisers. Appraisers who think for themselves recognize the platitudes of the professional societies as the conditioned response of American business to any suggestion of government regulation.

There are natural institutional disincentives for thorough and objective appraisals which have been discussed in a symposium conducted by the Lincoln Institute in Cambridge, and a monograph on that subject, which we prepared for that symposium, is provided in Appendix B. There is a deep anti-appraisal bias among mortgage loan officers who state that appraisals are a necessary evil for regulatory purposes. The appraisal guidelines issued in January, 1988 by the FDIC, Federal Reserve and Controller of Currency reveal this bias blatantly in the statement

> "...undue reliance should not be placed upon the collateral value in lieu of an adequate assessment of the borrower's repayment ability..."

The lenders issue non-recourse loans on commercial properties and yet disregard the reliability of cash flow from the property as the source of repayment. Even the President of the American Institute, Terrell R. Oetzel, commented editorially in the December, 1987 issue of The Appraiser, as follows:

> On August 10, 1987, the Competitive Equality Banking Act of 1987 was signed into law. This act directed the Federal Home Loan Bank Board to implement appraisal standards consistent with the appraisal standards of the federal banking agencies. Quite frankly, the federal banking agencies do not have any appraisal standards. Therefore, the Federal Home Loan Bank had to withdraw their proposed rule (R41-C).

If the bankers and mortgage bankers sincerely wanted to improve mortgage loss ratios, they could have moved toward competitive equality by adopting the standards set by R41-C. Training of auditors to look for standardized appraisal methods that were the same for all members in all states would facilitate audit efficiency, appraiser understanding of his assignment, and consistent documentation for mortgage finance in the national capital markets. Instead bankers forced a rule that allows every institution to have their own definition of a prudent appraisal policy - the same rule that will cost the Federal Government $25-50 billion dollars to refinance FDIC and FSLDIC.

Defeat of rigorous appraisal standards is a major policy, albeit unwritten, of The American Bankers Association (ABA), U.S. Savings and Loan League (USSLL), The Mortgage Bankers Association of America (MBA), The National Association of Realtors (NAR), and the National Association of Home Builders (NAHB). We have taught hundreds of their members over the years and we are currently the Nominal Dean of Real Estate Finance courses for the ABA on the University of Wisconsin Campus each July. Few of these students are interested in learning how to critique an appraisal and they all know how to shop an appraisal for the right value commitment by the appraiser.

These same professional real estate associations control state legislative committees and generally have great influence in the Office of the Governor of each state, so that if they are unable to frustrate H.R. 3675 by crippling amendments or outright defeat, they will dilute and delay state legislation necessary to put permanent certification and enforcement into operation at the state level. We would suggest to you that if it were possible to retrace the source and application of all mortgage funds that have gone awry, that brokerage commissions, lender fees, developer profits and leasing commissions, and other profit centers would represent the $25-50 billion that will be funded eventually by the Federal Government Agency insuring the lending institution. No wonder so many sectors of the real estate industry fear rigorous appraisals and objective market studies as a test of any transaction.

The sanctimonious defenders of American tradition argue that lawyers, doctors, and accountants are not regulated by the Federal Government, but then those who are hurt by the negligence of lawyers, doctors, and accountants can sue for damages, sue to withdraw their licenses, and collect from insurance resources that do not include billions of federal dollars. Who does the depositor or the out-of-work employee of a bankrupt financial institution sue for damages done by an appraiser? How often does an appraisal organization successfully remove the designation of its own member? Who but the Federal Government provides significant insurance for the damages of malpractice by the loan officer and his implicit conspiracy with the borrower and the appraiser?

The conventional wisdom is that economic progress requires risk taking and the real estate industry lenders want Congress to take all the risks. At the moment the Federal Government lacks the laws and administrative powers to punish even the most fraudulent judgments by loan officers, appraisers, and borrowers. Another conventional wisdom of American business culture is that those who pay the piper get to call the tune and in real estate mortgage lending Congress and the tax payers are expected to pay the piper. Therefore, the taxpayer has every right to require real estate appraisal reform by H.R. 3675. The citizen has every right to impose banking rules which promote efficient allocation of scarce capital, which provide safety incentives for savers, and which prevent insider profits more blatant than those in the stock market.

APPENDIX A

JAMES A. GRAASKAMP

PROFESSIONAL DESIGNATIONS

SREA, Senior Real Estate Analyst, Society of Real Estate Appraisers

CRE, Counselor of Real Estate, American Society of Real Estate Counselors

CPCU, Certified Property Casualty Underwriter, College of Property Underwriters

EDUCATION

Ph.D., Urban Land Economics and Risk Management - University of Wisconsin

Master of Business Administration, Security Analysis - Marquette University

Bachelor of Arts - Rollins College

ACADEMIC AND PROFESSIONAL HONORS

Chairman, Department of Real Estate and Urban Land Economics,
School of Business, University of Wisconsin
Urban Land Institute Research Fellow
University of Wisconsin Fellow
Omicron Delta Kappa
Lambda Alpha - Ely Chapter
Beta Gamma Sigma
William Kiekhofer Teaching Award (1966)
Larson Teaching Award (1985)
Alfred E. Reinman, Jr. Award - Society of Real Estate Appraisers (1986)
Charles B. Shattuck Memorial Award, AIREA (1987)
Urban Land Institute Trustee
Research Committee - Pension Real Estate Association (PREA)
Richard T. Ely Real Estate Educator Award from Lambda Alpha
Homer Hoyt Foundation Fellow

PROFESSIONAL EXPERIENCE

Dr. Graaskamp is the President and founder of Landmark Research, Inc., which was established in 1968. He is also cofounder of a general contracting firm, a land development company, and a farm investment corporation. He is formerly a member of the Board of Directors and treasurer of the Wisconsin Housing Finance Agency. He is currently a member of the Board and Executive Committee of First Asset Realty Advisors, Inc., a subsidiary of First Bank Minneapolis. He is the designer and instructor of the Urban Land Institute (ULI) School of Real Estate Development and the American Bankers Association (ABA) National School of Real Estate Finance. His work includes substantial and varied consulting and valuation assignments such as investment counseling to insurance companies and banks, court testimony as an expert witness and the market/financial analysis of various projects, both nationally and locally, for private and corporate investors and municipalities. Currently is a member of Salomon Brothers Real Estate Advisory Board.

APPENDIX B

See James A. Graaskamp Collection of Teaching Materials

I. Manuscripts

A. Published Books

12. 1984 Real Estate Valuation Colloquium:

A Redefinition of Real Estate Appraisal Precepts and Practices

Chapters 3 and 14 by James A. Graaskamp

"The Need for Redefinition and Reform of The Appraisal Process" (Chap. 3)

and

"Industrial Constraints on Redefinition and Reform of The Appraisal Process" (Chap. 14)

AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS
of the NATIONAL ASSOCIATION OF REALTORS®

April 16, 1987

James A. Graaskamp, Chairman
Real Estate Department
University of Wisconsin
Madison, WI 53705

Dear Professor Graaskamp:

We have read with interest the interviews with you in Pensions & Investment Age, in December 1986 and March 1987, and noticed that you mentioned the proposals for self-regulatory structures for the appraisal profession. We have also seen the brochure concerning the seminar at which you are speaking on April 23. Donald Conley, our General Counsel, suggested that I send you a copy of the Appraisal Institute's proposal. This information includes a Position Paper and chart describing the proposal, in addition to a draft of Model Certification Legislation and summaries of the Congressional report that recommends the certification of real estate appraisers.

We are working closely with the Society of Real Estate Appraisers and other appraisal groups on the recommendation for self-regulatory structures for the appraisal profession.

We have heard from Lee Minnerly that you plan to attend the research forum sponsored by the Appraisal Institute on May 16 and 17. I look forward to meeting you at the research forum, for I have heard of you frequently, starting when my husband and I were students at the University of Wisconsin and continuing in conversations with many appraisers, including Dave Peatfield. Last week I met Fred Rendahl at Real Estate Research Corporation, who I understand is one of your students.

I hope you find the enclosed information helpful. Please feel free to contact us if you would like additional information.

Sincerely,

Debra Anthony

Debra Anthony
Director of Legal and
Legislative Affairs

DA:ne
0576r/69

Although Prof. Graaskamp did not author the following papers, these documents are included because of his dedication to appraisal reform -

NEWS FROM THE APPRAISAL INSTITUTE...

For Release: **IMMEDIATELY**

Contact: Janet Laurain
312/329-8461

CHICAGO (September 29, 1986)--The House Subcommittee on Commerce, Consumer, and Monetary Affairs, a congressional subcommittee chaired by Congressman Doug Barnard, Jr., (D-GA), has released the results of an investigation into the impact of fraudulent and inadequate real estate appraisals on lending institutions. The subcommittee found that faulty appraisals, inappropriate lending practices by financial institutions, and the lack of proper regulatory mechanisms has resulted in a loss of billions of dollars by federally insured banks and thrift institutions.

In response to this problem, the subcommittee has called for the creation of a nationwide, industry-regulated appraiser certification and review system. This recommendation is consistent with proposals made by the American Institute of Real Estate Appraisers in its testimony before the subcommittee last December. Peter D. Bowes, MAI, president of the Appraisal Institute, complimented the subcommittee on its comprehensive analysis of a complex problem and praised its suggestion that all states make full real estate sales and loan data, which are essential to accurate appraisals, available to the public.

In addition to the establishment of a nationwide certification system for appraisers, the subcommittee urged that lending institutions be required to strengthen their current policies and internal controls on real estate loans.

- more -

AMERICAN INSTITUTE OF
REAL ESTATE APPRAISERS
of the National Association of Realtors

MAI RM

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Bowes noted that the Appraisal Institute, which is dedicated to raising the quality of appraisal services and preventing abuses such as those mentioned in the report, is currently developing a proposed, self-regulatory structure for the appraisal profession, similar to that recommended by the subcommittee. "The Appraisal Institute agrees that appropriate action is required and looks forward to working with legislators on the implementation of an effective program," Bowes said.

The American Institute of Real Estate Appraisers, founded in 1932, awards the MAI (Member, Appraisal Institute) and RM (Residential Member) designations and is the only appraisal organization affiliated with the NATIONAL ASSOCIATION OF REALTORS®. Members and candidates of the Institute subscribe to a strict Code of Professional Ethics and Standards of Professional Practice. Continuing education for appraisers is encouraged through a certification program.

# # #

Appraisal

From page 1

mony we delivered in December 1985, and they've identified that there are a number of culpable people."

Bowes added that the Appraisal Institute is now ready to move to the next step—getting legislation drafted and implemented to institute a self-regulatory structure.

The appraisal industry, lenders and financial regulators all share the blame for faulty appraisals, according to the report.

A prime source of the problem is lenders' ignorance or misunderstanding of the role of an appraisal, it said. "The prevailing attitude among (officials of lending institutions) is that the appraisal is simply an obstacle to overcome or a rubber stamp needed to establish the maximum amount of a loan. Worse still, many such officials maintain that it is not difficult to find an accommodating appraiser who can be counted on to come up with whatever results are desired," the report said.

It also cited implicit, and sometimes explicit, threats that if the appraiser fails to "come up with the numbers" needed to justify the transaction the appraiser will not get future business. Appraisal Institute officials said such pressures are sometimes placed on appraisers, but they added that the professional background and training of appraisers who are members of the Appraisal Institute gives them recognition in the business community that enables them to resist such pressures.

The report noted that only about one-third of the 150,000-250,000 appraisers now working across the nation are affiliated with a highly regarded professional organization. Bowes said his estimate is even lower, with as few as one-tenth of all appraisers covered by meaningful standards through membership in respected professional organizations.

The effective absence of federal regulation and minimal regulation by states were other factors highlighted by the report. It noted that only 12 states have any form of licensing or certification for appraisers, and in most of those instances the regulations are enforced through the real estate licensing mechanism.

"Indeed, that most state regulations place appraisers within the real estate licensing framework is fraught with potential problems since real estate sales stress wholly different legal, contractual and client-agent relationships than those involved in an appraisal assignment, and, unlike the appraiser, a real estate agent or broker has a vested interest in seeing that a sale/loan transaction is consummated," the report said.

The subcommittee report also charged that the appraisal industry's enforcement of its own codes of ethics and standards of professional practice has been ineffective.

"For many years, leading appraisal groups have had procedures for disciplining their members for cause, including admonishment, censure, reprimand, suspension and expulsion. These procedures, however, have been applied so sparingly that they have become almost meaningless as an effective enforcement tool," it said.

"Indicative of this industrywide failure to deal with poor performance and misconduct, out of some 1,600 complaints screened and submitted for further consideration within four of the leading appraisal groups . . . only about 10 percent of the complaints resulted in meaningful disciplinary action, which translates to a miniscule four-tenths of 1 percent in terms of the total membership" of about 40,000, the report said.

Bowes said there is some disagreement about what constitutes "meaningful" discipline. "We think it is a quality education of those who are educable and expulsion of those who are not, with gradations in between," Bowes said.

Appraisal Institute officials noted that the institute recognized the enforcement problem several years ago and has implemented a new system of enforcement that is proving to be more effective than when the report was researched. They added that the proposed certification system would provide even more effective enforcement.

In addition to a national certification system, the report recommended a variety of other steps to improve appraisal quality. Among these were proposals to give the federal banking agencies authority to discipline appraisers and establish uniform requirements concerning appraisals. The report also called upon VA and FHA to correct "ongoing deficiencies" in their existing appraisal review and monitoring procedures. In addition, it called upon the Federal National Mortgage Association and the Federal Home Loan Mortgage Corp. to consider reducing their reliance on lenders to be responsible for appraiser selection and appraisal quality.

"Indeed, that most state regulations place appraisers within the real estate licensing framework is fraught with potential problems since real estate sales stress wholly different legal, contractual and client-agent relationships than those involved in an appraisal assignment, and, unlike the appraiser, a real estate agent or broker has a vested interest in seeing that a sale/loan transaction is consummated," the report said.

It also recommended that the federal bank regulators, plus VA, FHA, Fannie Mae, Freddie Mac and other government agencies that use appraisals, develop procedures for sharing information on problem appraisers with each other and with the appraisal industry. Appraisal Institute officials said the institute favors information-sharing, but only if rights of due process are fully maintained to prevent unsubstantiated accusations from resulting in punishment.

Institute officials praised the recommendation that all states make available to the public full real estate sales and loan data, which are essential to accurate appraisals. This also would benefit the public, they noted, by reducing the time needed to perform an appraisal.

The report's authors acknowledged that Fannie Mae, Freddie Mac and others have taken steps recently to improve the quality of appraisals they use.

SUMMARY OF SUGGESTED SELF-REGULATORY STRUCTURES FOR THE REAL ESTATE APPRAISAL PROFESSION

Proposed by the American Institute of Real Estate Appraisers

The Governing Council of the American Institute of Real Estate Appraisers (Appraisal Institute) passed a resolution in November 1985

> "that the Appraisal Institute support legislation and regulations adopting the Institute's Standards of Professional Practice and/or programs for the certification of appraisers when the legislation or regulations lead to and support a national program for the appraisal profession, similar to the Certified Public Accountant program for the accounting profession, that is based upon a certifying board for appraisers and an appraisal standards board to set standards for the profession."

The Certified Public Accountant system includes an independent Financial Accounting Standards Board appointed by a foundation and a state Board of Accountancy established by statute in each state that administers minimum qualification criteria established by the AICPA. The CPA system identifies those members of the accounting profession who are qualified to perform certain types of more difficult work, such as auditing financial statements upon which the public relies. The CPA system does not prohibit persons who are not "certified" from stating that they are accountants and doing some types of accounting work.

The essential elements of a regulatory program include an independent Real Estate Appraisal Standards Board, an independent Real Estate Appraiser Qualification Board, appropriate legislation for the state certification of qualified appraisers, state enforcement provisions with penalties for violations of standards and other rules, and the adoption by federal and state regulatory agencies of appropriate requirements relating to both the qualifications of appraisers and appraisal standards.

The suggested self-regulatory structures for the real estate appraisal profession are as follows:

A. Real Estate Appraisal Standards Board

The Appraisal Institute recommends the establishment of a broad based Real Estate Appraisal Foundation to select and appoint the members of a Real Estate Appraisal Standards Board (in addition to arranging funding for, and approving the budgets of, such Standards Board). The Appraisal Institute also recommends that an Appraisal Standards Advisory Council (composed of a minimum of 20 real estate related organizations) be created to work closely with the Real Estate Appraisal Standards Board in an advisory capacity.

B. Real Estate Appraiser Qualification Board

The Appraisal Institute recommends that the Real Estate Appraisal Foundation also establish a Real Estate Appraiser Qualification Board to develop minimum requirements for the certification and recertification of qualified real estate appraisers, furnish the qualification criteria to each state, and assist each state in establishing and maintaining an appropriate system for the certification and recertification of qualified real estate appraisers. The requirements to become "certified" would include: appropriate education and experience, passing a comprehensive examination, and agreeing to follow the appraisal standards and other rules. No groups would be "grandfathered."

C. Certification Program

The Appraisal Institute recommends that a Real Estate Appraisal Board be established in each state to adminster a program for the certification and recertification of qualified appraisers based upon the minimum qualification criteria established from time to time by the Real Estate Appraiser Qualification Board.

Persons who are not "certified" would not be prohibited from stating that they are appraisers, nor would they be prohibited from accepting appraisal assignments except in those instances where a regulatory agency has decided that the use of a "certified" appraiser is required.

D. Enforcement of Rules and Standards

The Appraisal Institute has developed a Model Bill that gives each state the primary responsibility for enforcing the appraisal standards that certified appraisers must follow. This means that an appraiser's "certification" could be removed or suspended if the person did not follow the standards. Since the state has subpoena powers and immunity privileges, enforcement by the states will be more effective than enforcement by a private professional organization.

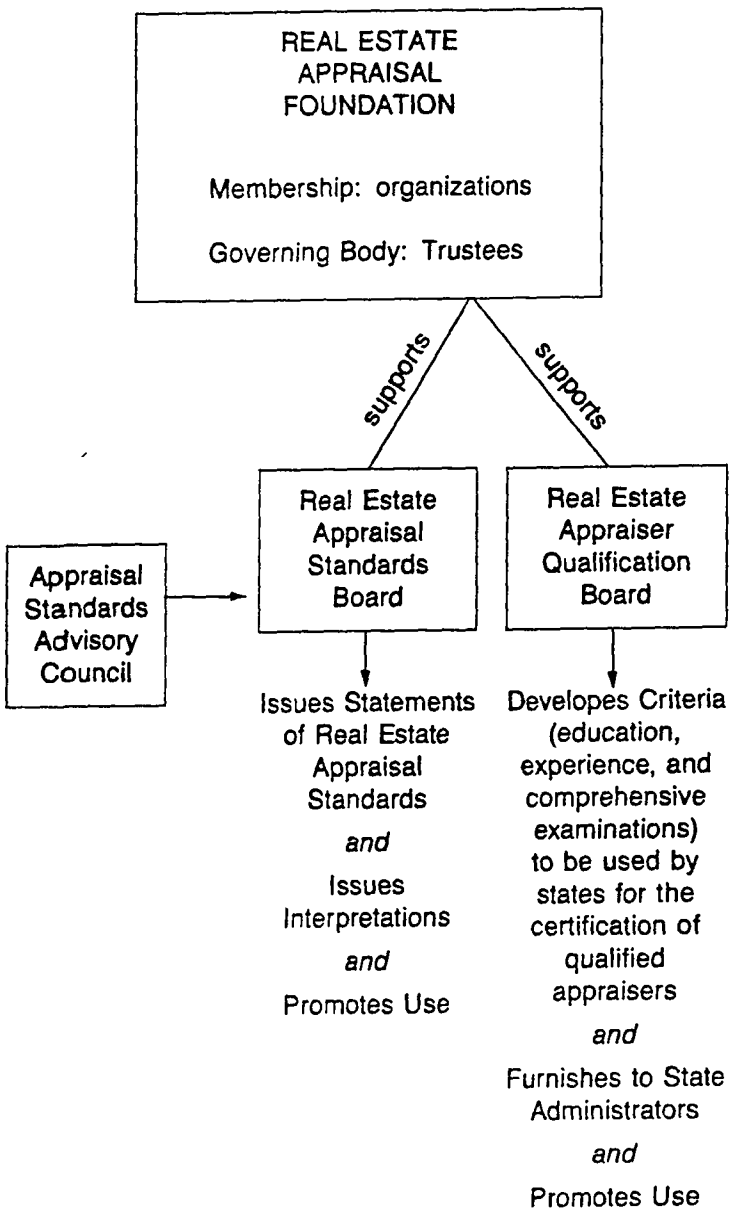
The Model Bill provides that the appraisal community will be represented on the state Real Estate Appraisal Board and participate in its work. Maintaining a certifying board and accepting responsibility for enforcement would not be a financial burden on the state because the fees to become certified and to renew one's certification could be high enough to cover the cost of administering the program. The Certified Public Accountant program is not a financial burden on states.

E. Utilization by Federal and State Regulatory Agencies

With the self-regulatory system described above in place, federal and state regulatory agencies would be in a position to adopt meaningful and effective regulatory requirements, relating to both the qualifications of appraisers and to appraisal standards. Regulatory agencies could require that certain types of appraisal services be performed only by persons who are certified. For example, the Securities and Exchange Commission could adopt a rule that (i) only appraisals prepared by state certified appraisers (from states which observe the minimum criteria set

by the Real Estate Appraiser Qualification Board) would be acceptable for use in connection with the issuance of securities, and (ii) all such appraisals must meet the standards promulgated by the Real Estate Appraisal Standards Board.

CHART A



State Administrators

Use Criteria Developed by the Real Estate Appraiser Qualification Board to:

1. Check education and experience and administer examination (before issuing certificates for state certified real estate appraisers)

2. Supervise continuing education program for renewal of certificates

and

Enforce the Standards developed by the Real Estate Appraisal Standards Board (with penalties for violation)

State and Federal Regulators

Adopt (when appropriate) the Standards Developed by the Real Estate Appraisal Standards Board

and

Restrict Certain Types of Appraisal Services to State Certified Real Estate Appraisers (certified by states that use the criteria developed by the Real Estate Appraiser Qualification Board)

4/15/87 Draft

POSITION PAPER

SELF-REGULATORY STRUCTURES FOR THE REAL ESTATE APPRAISAL PROFESSION PROPOSED BY THE AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS OF THE NATIONAL ASSOCIATION OF REALTORS

This Position Paper describes the self-regulatory structures proposed by the Appraisal Institute for the real estate appraisal industry. Part I addresses the Real Estate Appraisal Foundation, the Real Estate Appraisal Standards Board and the Real Estate Appraiser Qualification Board. Part II addresses the State Certification Legislation that will enable a State to administer a certification and recertification system for qualified appraisers and to enforce the appraisal standards adopted by the Standards Board. Part III describes the manner in which this self-regulatory system can be utilized by the various regulatory agencies at the State and federal level that now indirectly regulate appraisal activity.

I. Real Estate Appraisal Foundation and its Boards

The Real Estate Appraisal Foundation, an Illinois not for profit corporation, will create and support both the Real Estate Appraisal Standards Board and the Real Estate Appraiser Qualification Board. Various organizations will be the members of the Foundation. The governing body of the Foundation will be a Board of Trustees composed of twenty Trustees, chosen by various organizations.

The Trustees of the Real Estate Appraisal Foundation will select and appoint the members of the Real Estate Appraisal Standards Board and the members of the Real Estate Appraiser Qualification Board. The Trustees will also arrange funding and approve the budgets for both Boards.

The Trustees will also establish and maintain an Appraisal Standards Advisory Council to advise the Standards Board. This Advisory Council will be composed of a minimum of 20 real estate related organizations who will work closely with the Standards Board in an advisory capacity in much the same way that the Financial Accounting Standards Advisory Council assists the work of FASB.

The Trustees of the Foundation will not be allowed to serve on the Real Estate Appraisal Standards Board, the Real Estate Appraiser Qualification Board, or the Appraisal Standards Advisory Council.

A. Real Estate Appraisal Standards Board

The Real Estate Appraisal Standards Board ("Standards Board") will issue formal Statements of real estate appraisal standards and Interpretations of the Statements. It will also promote their use. The Standards Board will consist of five members who have extensive knowledge of the real estate business and a concern for the public interest in matters concerning real estate appraisals. The members will serve three year terms on a full time basis and would be salaried. The members cannot have financial or other obligations to previous employers or clients that might actually impair, or create the impression of impairing, objectivity.

An Appraisal Standards Advisory Council ("Advisory Council") will be established by the Board of Trustees to work closely with the Standards Board in an advisory capacity. This Advisory Council will consist of at least twenty organizations or entities that are either knowledgeable with respect to the use of real estate appraisals in the marketplace and the problems relating to such use, or have demonstrated a concern related to the implementation of sound real estate appraisal practices and procedures.

The Advisory Council will represent varied professions and occupations as a means of involving the public in the work of the Foundation and would include, if possible, organizations representing homebuilders, real estate brokers, investors, financial institutions, the securities industry, consumers, regulators and the general public. Each organization or entity serving on the Advisory Council will designate an individual to be its representative at meetings of the Advisory Council.

B. Real Estate Appraiser Qualification Board

The Real Estate Appraiser Qualification Board ("Qualification Board") will develop minimum requirements for the certification and recertification of qualified real estate appraisers, furnish the qualification criteria to each State, and assist each State in estaolishing and maintaining an appropriate system for the certification and recertification of qualified real estate appraisers.

The qualification criteria for certification is expected to include defined amounts of education and experience and passage of a comprehensive examination. The Qualification Board will develop the comprehensive examination to be used by each State, and will assist in the administration and grading of the examination. The requirements for recertification would include continuing education.

II. State Certification Legislation

The Appraisal Institute's Model State Certification Bill currently contains appraisal standards and minimum certification requirements. We will continue to use this Model Bill until the Standards Board and the Qualification Board have become active. When the Standards Board and Qualification Board are in operation, the Model State Certification Bill will be modified to refer to the standards developed by the Standards Board and to the minimum certification requirements established by the Qualification Board.

The Model Bill gives the States the primary responsibility for the enforcement of appraisal standards and provides that the certification of a real estate appraiser certified by a State can be removed or suspended if such appraiser fails to follow the standards. The enforcement procedures contemplate that panels of other State certified real estate appraisers would act in an investigatory or review capacity on grievance committees, hearing committees, or review and counseling committees. Since the State has subpoena powers and immunity privileges, disciplinary proceeding by a State should be more effective than if such proceedings were conducted by a private professional organization. A private organization, such as the Appraisal Institute, operates with caution because a high percentage of its disciplinary actions are challenged in court and a failure to observe due process could threaten the survival of the organization. In addition, a private organization can sanction only its own members and candidates and cannot deal with other appraisers.

III. Utilization By Federal and State Regulatory Agencies

As detailed in the Barnard Report, the appraisal profession is indirectly regulated by a variety of agencies that regulate other industries and this indirect regulation has not been effective. The solution to this problem is not to create a new agency with direct authority and responsibility for the regulation of appraisers. Further, the licensing of appraisers is not a solution because it will reduce regulation to the lowest common denominator and fail to solve the problems detailed in the Barnard Report. The only solution that makes sense and will be effective is to establish a self-regulatory system similar to the self-regulatory system that governs the accounting industry.

When the self-regulatory system proposed by the Appraisal Institute is put in place, federal and State regulatory agencies will have the tools that they need to adopt meaningful and effective regulatory requirements relating to both the qualifications of appraisers and to appraisal standards. Until now, the attempts to solve the problem have related solely to standards, and standards alone will not work.

When our self-regulatory structures are functioning, the exisiting regulatory agencies can do a better job. When appropriate, these regulatory agencies will require adherence to the appraisal standards by the institutions and industries that they regulate. When appropriate, the regulatory agencies will also require the use of State certified appraisers for certain types of appraisal assignments. For example, the Securities and Exchange Commission could adopt a rule that only appraisals prepared by State certified appraisers would be acceptable for use in connection with the issuance of securities and all such

appraisals must meet the standards promulgated by the Real Estate Appraisal Standards Board.

To insure proper utilization of the system, Congress could provide that each federal agency with a role in evaluating appraisals be required review the uniform appraisal standards issued by the Real Estate Appraisal Standards Board and determine to what extent these standards should apply to the institutions or industry subject to such agency's jurisdiction. The effect of this legislation would be to require the use of the uniform appraisal standards unless the agency determined that a certain standard was in appropriate. For example, the Federal Home Loan Bank Board might not require that all aspects of the uniform reporting rules be followed in appraisals of single family residences when the value was less than $100,000. In time, however, we hope that the Standards Board will be able to develop specific standards for each type of appraisal situation so that regulatory agencies will not be forced to utilize exceptions.

Congress could also provide that each federal agency be required to consider whether or not a State certified appraiser must be used for specific appraisal assignments under each such agency's jurisdiction. In this connection, State certified real estate appraisers would be defined to include only those appraisers who had been certified by a State that met the minimum requirements established by the Real Estate Appraiser Qualification Board.

Conclusion

The self-regulatory structures proposed by the Appraisal Institute not only provide a solution to many of the problems detailed in the Barnard Report but also provide effective self-regulation of the real estate appraisal industry in a manner that will be of great benefit to the entire real estate industry. The vitality of the real estate industry depends to a great extent upon the availability of credit at affordable rates. This proposal will strengthen financial insitutions and give great stability to the process of making mortgage loans. The self-regulatory proposal of the Appraisal Institute is a great step forward towards professionalism, and it will contribute mightily to public confidence in investing in real estate.

Without centralizing control in a bureaucratic agency, both federal and State agencies will have an important role in assisting the appraisal profession in this effort. The users of appraisal services, the real estate industry, and the public will be the primary beneficiaries of this joint effort.

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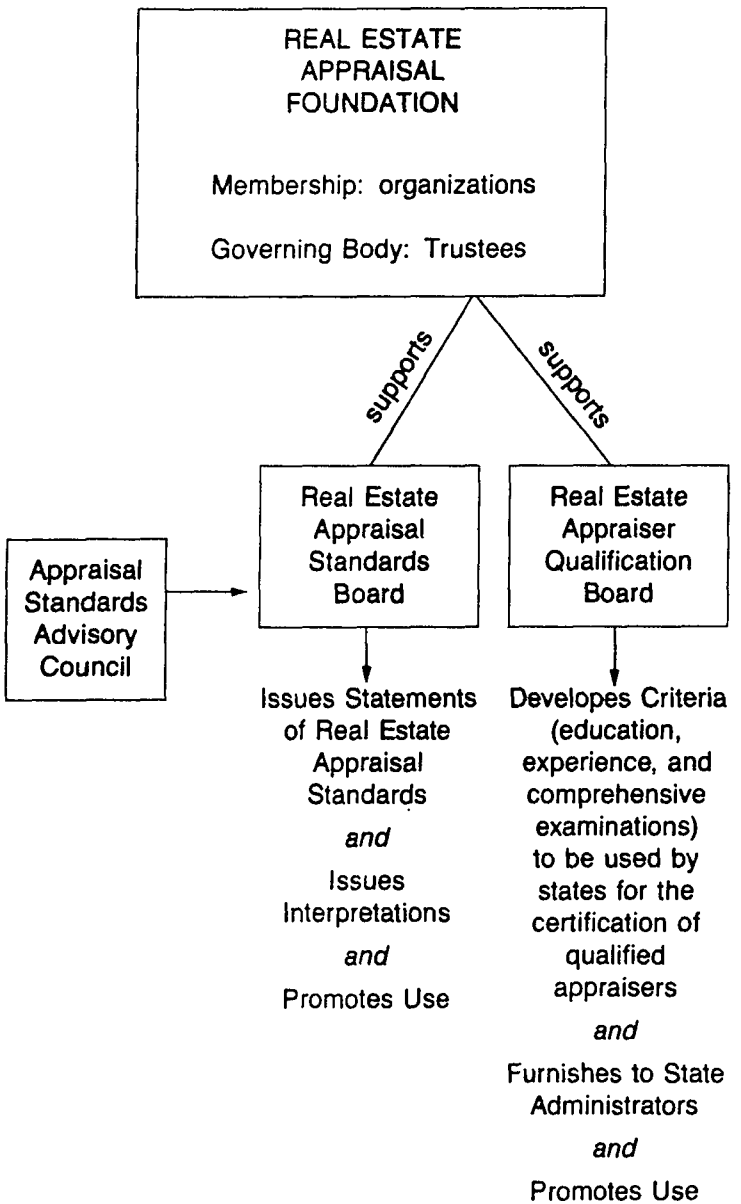
CHART A



State Administrators

Use Criteria Developed by the Real Estate Appraiser Qualification Board to:

1. Check education and experience and administer examination (before issuing certificates for state certified real estate appraisers)

2. Supervise continuing education program for renewal of certificates

and

Enforce the Standards developed by the Real Estate Appraisal Standards Board (with penalties for violation)

State and Federal Regulators

Adopt (when appropriate) the Standards Developed by the Real Estate Appraisal Standards Board

and

Restrict Certain Types of Appraisal Services to State Certified Real Estate Appraisers (certified by states that use the criteria developed by the Real Estate Appraiser Qualification Board)

MODEL CERTIFICATION LEGISLATION
Proposed by the American Institute of Real Estate Appraisers

CERTIFICATION OF REAL ESTATE APPRAISERS

Article 1. Scope of Regulation

Section 1. This Act may be cited as the State Certified Real Estate Appraisers Law.

Section 2. If any provision of this Act or its application to any person or in any circumstance is declared by a court of competent jurisdiction to be invalid or unenforceable, provisions constituting the remainder of the Act and the application of those provisions to other persons and in other circumstances shall not be affected.

Section 3. The following terms as used in this Act have the following meaning:

(a) The terms "real estate appraisal" or "appraisal" mean an analysis, opinion or conclusion relating to the nature, quality, value, or utility of specified interests in, or aspects of, identified real estate, for or in expectation of compensation.

(b) A "state certified real estate appraiser" means a person who holds a current, valid certificate issued to him or her under the provisions of this Act. A state certified real estate appraiser may designate or identify appraisals rendered by him or her as "certified appraisals."

(c) "Department" means the Department of _____.

(d) "Director" means the Director of the Department of _____.

(e) "Board" means the Real Estate Appraisal Board established pursuant to the provisions of this Act.

(f) "Real Estate" means an identified parcel or tract of land, including improvements, if any.

(g) "Real Property" means one or more defined interests in a parcel of real estate, whether an unencumbered fee or a lesser estate.

(h) "Appraisal assignment" means, an engagement for which an appraiser is employed or retained to act, or would be perceived by third parties or the public as acting, as a disinterested third party in rendering an unbiased analysis, opinion, or conclusion relating to the nature, quality, value, or utility of specified interests in, or aspects of, identified real estate.

(i) "Directed Appraisal Assignment" means appraisal services which do not fall within the meaning of "appraisal assignment" in subdivision (h), which services relate to the employer's or client's individual needs or investment objectives and include specialized marketing, financing, and feasibility studies as well as analyses, opinions and conclusions given in connection with activities such as real estate brokerage, mortgage banking, real estate counseling, and real estate tax counseling. A state certified real estate appraiser who enters into an agreement to perform these legitimate business activities may be paid a fixed fee or, subject to compliance with conditions prescribed by the Board, a fee that is contingent on the results achieved by the appraisal service.

(j) "Appraisal Report" means any communication, written or oral, of an analysis, opinion, or conclusion relating to the nature, quality, value, or utility of specified interests in, or aspects of, identified real estate. Under this definition the purpose of an appraisal is immaterial; therefore valuation reports, real estate counseling reports, real estate tax counseling reports, real estate offering memoranda, mortgage banking offers, highest and best use studies, market demand and economic feasibility studies, and all other reports communicating an appraisal analysis, opinion, or conclusion are appraisal reports, regardless of title.

Section 4. A state certified real estate appraiser must comply with the standards provided in this Act for the development and communication of real estate appraisals for any appraisals of real estate located in this state.

Section 5. This Act does not preclude a person who is not certified as a state certified real estate appraiser from appraising real estate for compensation. No person, other than a state certified real estate appraiser, shall assume or use that title or any title, designation, or abbreviation likely to create the impression of certification as a real estate appraiser by this state. A person who is not certified pursuant to this Act shall not describe or refer to any appraisal or other evaluation of real estate located in this state by the term "certified".

Article 2. Real Estate Appraisal Board

Section 1. There is hereby created within the Department of _____ the Real Estate Appraisal Board which shall consist of seven members, two of whom shall be public members and five of whom shall be real estate appraisers.

The Governor shall appoint three members who are real estate appraisers. The Senate Rules Committee and the Speaker of the House shall each appoint one public member and one real estate appraiser member.

Section 2. The term of each member shall be three years; except that, of the members first appointed, those appointed by the Senate Rules Committee shall serve two years and the members appointed by the Speaker of the House shall serve for one year.

Section 3. Upon expiration of their terms, members of the Board shall continue to hold office until the appointment and qualification of their successors. No person shall serve as a member of the Board for more than two consecutive terms. The appointing authority may remove a member for cause.

Section 4. The real estate appraiser members of the Board shall be members in good standing of a nationally recognized appraisal organization that requires appraisal experience, education and testing, as well as adherence to standards of professional practice to qualify for and retain membership in good standing.

The public members of the Board shall not be licentiates of the Department nor real estate appraisers.

Section 5. The real estate appraiser members appointed after January 1, 19__, shall be state certified real estate appraisers actively engaged in the practice of real estate appraising.

Section 6. The Board shall appoint a person exempt from civil service who shall act as Executive Officer to the Board and who shall exercise the powers and perform the duties delegated by the Board.

Section 7. The Board shall meet not less frequently than once each calendar quarter to conduct its business. Places of future meetings shall be decided by the vote of members at meetings. The Executive Officer shall give written notice to each member of the time and place of each meeting of the Board at least 10 days before the scheduled date of the meetings.

Section 8. The members of the Board shall elect a chairperson from among the members to preside at Board meetings.

Section 9. A quorum of the Board shall be four members. At least three of these four members shall be appraiser members.

Section 10. Each member of the Board shall be entitled to a per diem allowance of _____ for each meeting of the Board at which the member is present and, for each day or substantial part thereof actually spent in the conduct of the business of the Board. Each member of the Board shall be entitled to reimbursement of travel expenses necessarily incurred in attending meetings of the Board and in conducting the business of the Board other than at meetings of the Board.

Section 11. The Board shall adopt rules and regulations in aid or in furtherance of this Act.

Section 12. The Board shall have the following powers and duties:

(a) to establish educational programs and research projects related to the appraisal of real estate;

(b) to establish the administrative procedures for processing applications and issuing certificates to state certified real estate appraisers and for disciplinary proceedings pursuant to the provisions of this Act;

(c) to receive and review applications and to establish the examination specifications for each category of state certified real estate appraisers, write examination questions and answers, and grade examinations;

(d) to further define by regulation and with respect to each category of state certified real estate appraisers the type of educational experience, appraisal experience, and equivalent experience that will meet the statutory requirements of this Act;

(e) to further define by regulation and with respect to each category of state certified real estate appraisers, the continuing education requirements for the renewal of certification that will meet the statutory requirements provided in this Act;

(f) to review the standards for the development and communication of real estate appraisals provided in this Act from time to time and to adopt regulations explaining and interpreting the standards;

(g) to perform such other functions and duties as may be necessary in carrying out the provisions of this Act.

Section 13. The Board shall maintain a registry of the names and addresses of people certified under this Act. The Board shall retain these records and all application materials submitted to it.

Section 14. The Board shall file with the Department an annual report of its activities, including a complete statement of the receipts and disbursements of the Board.

Article 3. Revenue

Section 1. The amount of the fees required by this Act is that amount fixed by the following schedule:

(a) The application fee for certification shall not exceed $_____.

(b) The examination fee shall not exceed $_____.

(c) The fee for renewal of certification shall not exceed $_____.

Section 2. (a) The Board shall report each month to the Controller the amount and source of all revenue received pursuant to this Act and shall pay the entire amount thereof into the State Treasury for credit to the State Certified Real Estate Appraisers Fund which is hereby established and from which fund all expenses of carrying out the provisions of this Act shall be defrayed.

(b) All monies paid into the Certified Real Estate Appraisers Fund pursuant to subdivision (a) are hereby continuously appropriated to the Board for the purposes of this Act.

Article 4. Certification Process

Section 1. (a) Applications for examinations, original certification, and renewal certification made pursuant to this Act shall be made in writing to the Board on forms provided by the Board.

(b) Appropriate fees, as fixed by the Board pursuant to Article 3, must accompany all applications for examination, original certification and renewal certification.

(c) At the time of filing an application for certification, each applicant shall sign a pledge to comply with the standards set forth in this Act and state that he or she understands the types of misconduct for which disciplinary proceedings may be initiated against a state certified real estate appraiser, as set forth in this Act.

Section 2. There shall be two classes of certification for certified real estate appraisers. One class shall consist of those persons applying for certification relating solely to the appraisal of residential real property of one to four units. The other class of certfication shall consist of those persons applying for a general certification relating to the appraisal of real property. The application for examination, original certification and renewal certification shall specify the classification of certification being applied for.

Section 3. An original certification as a state certified real estate appraiser shall not be issued to any person who has not demonstrated through a written examination process that he or she possesses the following:

(a) Appropriate knowledge of technical terms commonly used in or related to real estate appraising, appraisal report writing, and economic concepts applicable to real estate.

(b) Basic understanding of real estate law.

(c) Adequate knowledge of theories of depreciation, cost estimating, methods of capitalization, and the mathematics of real estate appraisal.

(d) Understanding of the principles of land economics, real estate appraisal processes, and of problems likely to be encountered in the gathering, interpreting, and processing of data in carrying out appraisal disciplines.

(e) Understanding of the standards for the development and communication of real estate appraisals as provided in this Act.

(f) Understanding of the types of misconduct for which disciplinary proceedings may be initiated against a state certified real estate appraiser, as set forth in this Act.

Section 4. An applicant who has failed an examination for state certified real estate appraiser may apply for reexamination by submitting an application with the appropriate examination fee within 90 days after the date of having last taken and failed the examination. The reexamination must be taken by the applicant within one year after submitting the application and fee for reexamination.

Section 5. (a) As a prerequisite to taking the examination for the general certification relating to the appraisal of real property, an applicant shall present evidence satisfactory to the Board that he or she possesses the equivalent of three years of full time experience in real property appraisal, acquired within a period of five years immediately preceding the filing of the application for certification, or the equivalent thereof; and either

(i) has a college degree; or

(ii) has successfully completed not less then 120 semester hours of academic experience in subjects related to real estate appraisal.

(b) As a prerequisite to taking the examination for certification relating solely to the appraisal of residential real property of one to four units, an applicant shall present evidence satisfactory to the Board that he or she possesses the equivalent of two years of full time experience in real property appraisal, acquired within a period of five years immediately preceding the filing of the application for certification, or the equivalent thereof; and either

(i) has a college degree; or

(ii) has successfully completed not less then 60 semester hours of academic experience in subjects related to real estate appraisal.

(c) The Real Estate Appraisal Board shall prescribe and define the "subjects related to real property appraisal," and the "full time experience in real property appraisal" which will satisfy the requirements of subdivisions (a) and (b).

(d) Each applicant for certification shall furnish under oath a detailed statement of the real estate appraisal assignments for each year for which experience is claimed by the applicant. Upon request, the applicant shall furnish to the Board for examination, copies of appraisal reports which the applicant has prepared in the course of his or her appraisal practice.

Section 6. It is unlawful for any person to practice any deception or fraud with respect to his or her identity in connection with an application for examination or in the taking of an examination for certification as a state certified real estate appraiser.

Section 7. (a) The Board may, in accordance with the provisions of this Act relating to hearings, deny the issuance of a certificate as a state certified real estate appraiser to an applicant on any of the grounds enumerated in Article 6.

(b) To assist in determining whether grounds exist to deny the issuance of certification to an applicant, the Board may require the fingerprinting of every applicant for an original certificate.

Section 8. The term of a certificate issued under the authority of this Act shall be two years from the date of issuance. The expiration date of the certificate shall appear on the certificate and no other notice of its expiration need be given to its holder.

Section 9. (a) Every applicant for certification under this Act who is not a resident of this state shall submit, with the application for certification, an irrevocable consent that service of process upon him or her may be made by delivery of the process to the Secretary of State if the plaintiff in an action against the applicant in a court of this state, arising out of the applicant's activities as a state certified real estate appraiser, cannot, in the exercise of due diligence, effect personal service upon the applicant.

(b) A nonresident of this state who has complied with the provisions of subdivision (a) may obtain a certificate as a state certified real estate appraiser by conforming to all of the provisions of this Act relating to state certified real estate appraisers.

Section 10. The Board shall issue a certificate as a state certified real estate appraiser to a holder of a certificate issued by another state, upon a showing that:

(a) The applicant passed the examination required for issuance of his or her certificate with grades that would have been passing grades at the time in this state; and

(b) If the applicant is applying for the general certification he or she meets the requirements of Section 5, Part (a) or if the applicant is applying for certification relating solely to the appraisal of residential real property of one to four units he or she meets the requirements of Section 5, Part (b).

Section 11. To obtain a renewal certificate as a state certified real estate appraiser, the holder of a current, valid certificate shall make application and pay the prescribed fee to the Board not earlier than 120 days nor later than 30 days prior to the expiration date of the certificate then held. With the application for renewal, the state certified real estate appraiser shall present evidence in the form prescribed by the Board of having completed the continuing education requirements for renewal specified in Article 5.

If the Board determines that an applicant has failed to meet the requirements for renewal of certification through mistake, misunderstanding, or circumstances beyond the control of the applicant, the Board may extend the term of the certificate for a period not to exceed six months, upon payment by the applicant of a prescribed fee for the extension.

If the applicant satisfies the requirements for renewal during the extended term of certification, the beginning date of the new renewal certificate shall be the day following the expiration of the certificate previously held by the applicant.

Section 12. If a person fails to renew a certificate as a state certified real estate appraiser prior to its expiration or within a period of extension granted by the Board pursuant to Section 10 above, the person may obtain a renewal certificate by satisfying all of the requirements for renewal and by the payment of a late renewal fee in an amount equal to 1-1/3 times the renewal fee in effect at the time the application is made for late renewal of the certificate.

Section 13. No certificate shall be issued under the provisions of this Act to a corporation, partnership, firm or group.

Nothing herein shall preclude a state certified real estate appraiser from rendering appraisals for or on behalf of a corporation, partnership or group practice, provided that the appraisal report is prepared by, or under the immediate direction of, the state certified real estate appraiser and is signed by such state certified real estate appraiser.

Section 14. Each state certified real estate appraiser shall advise the Board of the address of his or her principal place of business and all other addresses at which he or she is currently engaged in the business of preparing real property appraisal reports.

Whenever a state certified real estate appraiser changes a place of business, he or she shall amend the certificate issued by the Board to reflect the change and shall immediately give written notification of the change to the Board.

Every state certified real estate appraiser shall notify the Board of his or her current residence address. Residence addresses on file with the Board are exempt from disclosure as public records.

Section 15. If the Board is satisfied that the public interest is not likely to be harmed, the Board may issue a restricted certification as a state certified real estate appraiser to an applicant for certification who has otherwise satisfied the requirements for certification, but against whom (a) grounds exist to deny certification under Section 7 above, or (b) whose certification has been revoked pursuant to Article 6.

Section 16. The Board may restrict the certification of a state certified real estate appraiser that is issued pursuant to Section 15 above in any of the following respects:

(a) The length of term of certification.

(b) The type of appraisals for which the person may hold himself or herself out to be a state certified real estate appraiser.

(c) The conditions to be met as prerequisites to the issuance of a restricted certification include but are not limited to the following:

(i) Passing of the examination for certification.

(ii) Completion of prescribed continuing education courses for ·tate certified real estate appraisers.

(iii) The posting and maintaining in effect of a surety bond in such form and condition as the Board may require for the protection of persons for whom the restricted certificate holder may perform acts for which certification as a state certified real estate appraiser is required.

(d) Persons or classes of persons with whom the certificate holder may not associate under the name and style of a state certified real estate appraiser.

(e) Other conditions to be observed by the restricted certificate holder in engaging in business under authority of the certificate.

Section 17. A restricted certificate issued pursuant to Section 14 above does not include a right of renewal of the certificate nor does it confer any property right in the privileges which it authorizes the holder to exercise.

The Board may suspend without holding a hearing, any or all of the privileges exercisable by the holder of a restricted certificate.

Section 18. A certificate issued under authority of this Act shall bear the signatures or facsimile signatures of the members of the Board and a certificate number assigned by the Board.

Each state certified real estate appraiser shall place the certificate number adjacent to or immediately below the designation "State Certified Real Estate Appraiser" when used in an appraisal report or in a contract or other instrument used by the certificate holder in conducting real property appraisal activities.

Section 19. The term "state certified real estate appraiser" may only be used to refer to individuals who hold the certificate and may not be used following or immediately in connection with the name or signature of a firm, partnership, corporation, or group; or in such manner that it might be interpreted as referring to a firm, partnership, corporation, group, or anyone other than an individual holder of the certificate.

Section 20. The Board may require as a prerequisite to the granting of an application for reinstatement of a revoked certificate that the applicant successfully complete the written examination process referred to in Section 3 of this Article.

Article 5. Continuing Education

Section 1. (a) As a prerequisite to renewal of certification, a state certified real estate appraiser shall present evidence satisfactory to the Board of having met the continuing education requirements of this Article.

(b) The basic continuing education requirement for renewal of certification shall be the completion by the applicant, during the immediately preceding term of certification, of not less than 30 semester hours of instruction in courses which have received the approval of the Board.

(c) In lieu of meeting the requirements of subdivision (b), an applicant for re-certification may satisfy all or part of the requirements of this Article by presenting evidence of the following:

(i) Completion of courses of study determined by the Board to be equivalent, for continuing education purposes, to courses approved by the Board pursuant to subdivision (b).

(ii) Participation other than as a student in educational processes and programs in real property appraisal theory, practices or techniques, including, but not necessarily limited to, teaching, program development and preparation of textbooks, monographs, articles, and other instructional materials.

Section 2. (a) The Board shall adopt regulations for implementation of the provisions of this Article to the end of assuring that persons renewing their certifications as state certified real estate appraisers have current knowledge of real property appraisal theories, practices, and techniques which will provide a high degree of service and protection to those members of the public with whom they deal in a professional relationship under authority of the certification. The regulation shall prescribe the following:

(i) Policies and procedures for obtaining Board approval of courses of instruction pursuant to subdivision (b) of Section 1 above.

(ii) Standards, policies, and procedures to be applied by the Board in evaluating applicant's claims of equivalency in accordance with subdivision (c) of Section 1 above.

(iii) Standards, monitoring methods, and systems for recording attendance to be employed by course sponsors as a prerequisite to Board approval of courses for credit.

(b) In adopting regulations pursuant to subpart (i) of subsection (a) above, the Board shall give favorable consideration to courses of instruction, seminars, and other real property appraisal education courses or programs previously or hereafter developed by or under the auspices of professional appraisal organizations and utilized by those associations for purposes of designation, certification or re-certification of the members of the association.

(c) No amendment or repeal of a regulation adopted by the Board pursuant to this section shall operate to deprive a state certified real estate appraiser of credit toward renewal of certification for any course of instruction completed by the applicant prior to the amendment

or repeal of the regulation which would have qualified for continuing education credit under the regulation as it existed prior to the repeal or amendment.

Section 3. On and after January 1, 19__, a certification as a state certified real estate appraiser that has been revoked as a result of disciplinary action by the Board shall not be reinstated, nor shall a restricted certificate be issued to an applicant in connection with a petition for reinstatement, unless the applicant presents evidence of completion of the continuing education required by this Article. This requirement of evidence of continuing education shall not be imposed upon an applicant for reinstatement who has been required to successfully complete the examination for state certified real estate appraiser as a condition to reinstatement of certification.

Article 6. Disciplinary Proceedings

Section 1. The rights of any holder under a certificate as a state certified real estate appraiser may be revoked or suspended, or the holder of the certificate may be otherwise disciplined in accordance with the provisions of this Article relating to hearings, upon any of the grounds set forth in this Article.

Section 2. (a) The Board may investigate the actions of a state certified real estate appraiser, and may revoke or suspend the rights of a certificate holder or otherwise discipline a state certified real estate appraiser for any of the following acts:

(i) Procuring or attempting to procure a certificate pursuant to this Act by knowingly making a false statement, submitting false information, refusing to provide complete information in response to a question in an application for certification or through any form of fraud or misrepresentation.

(ii) Failing to meet the minimum qualifications established by this Act.

(iii) Paying money other than provided for by this Act to any member or employee of the Board to procure a certificate under this Act.

(iv) A conviction, including a conviction based upon a plea of guilty or nolo contendre, of a crime which is substantially related to the qualifications, functions, and duties of a person developing real estate appraisals and communicating real estate appraisals to others.

(v) An act or omission involving dishonesty, fraud, or misrepresentation with the intent to substantially benefit the certificate holder or another person or with the intent to substantially injure another person.

(vi) Violation of any of the standards for the development or communication of real estate appraisals as provided in this Act.

(vii) Failure or refusal without good cause to exercise reasonable diligence in developing an appraisal, preparing an appraisal report or communicating an appraisal.

(viii) Negligence or incompetence in developing an appraisal, in preparing an appraisal report, or in communicating an appraisal.

(ix) Willfully disregarding or violating any of the provisions of this Act or the regulations of the Board for the administration and enforcement of the provision of this Act.

(x) Accepting an appraisal assignment when the employment itself is contingent upon the appraiser reporting a predetermined analysis or opinion, or where the fee to be paid for the performance of the appraisal assignment is contingent upon the opinion, conclusion, or valuation reached, or upon the consequences resulting from the appraisal assignment.

(xi) Violating the confidential nature of governmental records to which he or she gained access through employment or engagement as an appraiser by a governmental agency.

(xii) Violating any term or condition of a restricted certificate issued by the Board under authority of this Act.

(b) An act, omission or crime that is a ground for disciplinary action under this section shall constitute a basis for disciplinary action against another license of the state certified real estate appraiser if the act or omission involved is substantially related to the qualification, functions or duties required of a person acting under authority of the other license.

Section 3. The Board may suspend or revoke the certificate of a state certified real estate appraiser based upon a final civil judgment against the person on grounds of fraud, misrepresentation or deceit in the making of an appraisal of real property. In a disciplinary proceeding based upon the judgment, the state certified real estate appraiser shall be afforded notice and the opportunity to present matters in mitigation and extenuation, but may not collaterally attack the civil judgment.

Section 4. (a) On the receipt of evidence that a person has procured the issuance of a certificate as a state certified real estate appraiser by making a material misstatement of fact or by willfully failing to disclose information requested in the application for certification, the Board may suspend the certificate issued to the person without first conducting a hearing.

(b) The authority of the Board pursuant to this section, to order the suspension of a certificate shall expire 120 days after the date of issuance of the certificate, and the suspension itself shall remain in effect only until the effective date of a decision rendered by the Board after a hearing conducted pursuant to this section and the provisions of this Act, relating to hearings.

(c) A statement of issues shall be filed and served upon the respondent with the suspension order. Service may be effected by certified or registered mail directed to the respondent's current address of record on file with the Board.

(d) The respondent shall have 30 days after service of the suspension order and statement of issues in which to file with the Board a written request for hearing on the statement of issues. The Board shall hold a hearing within 30 days of receiving the request and issue a decision within 10 days thereafter.

(e) A respondent against whom a suspension has been ordered under authority of this section shall have no property rights in the certificate suspended by order of the Board unless the decision of the Board after hearing is that the respondent is entitled to an unrestricted certificate as a state certified real estate appraiser.

Article 7.
Standards for the Development and Communication of Real Estate Appraisals

Section 1. Except as otherwise provided in this Article, the standards set forth in this Article apply to the performance of real estate appraisal services that result from an appraisal assignment and to the performance of real estate appraisal services that result from a directed appraisal assignment.

Section 2. A state certified real estate appraiser must comply with the following standards in the development of appraisals of real estate located in this State:

(a) In developing real estate appraisal analyses, opinions, and conclusions, an appraiser must

(i) be aware of, understand, and correctly employ those recognized appraisal methods and techniques that are necessary to produce a credible analysis, opinion or conclusion; and

(ii) not commit a substantial error of omission or commission that significantly affects an analysis, opinion or conclusion.

(b) In developing a real estate appraisal analysis, opinion or conclusion, an appraiser must observe the following specific real estate appraisal guidelines:

(i) identify the real estate and real property interest under consideration, define the opinion that is the purpose of the appraisal, consider the scope of the appraisal service, and identify the effective date of the opinion;

(ii) identify and consider the appropriate procedures and market data required to perform the appraisal service;

(iii) consider the effect on use and value of the following factors: existing land use regulations, reasonably probable modifications of such land use regulations, economic demand, the physical adaptability of the estate, neighborhood trends, and the highest and best use of the property;

(iv) consider the effect on the property being appraised of anticipated public or private improvements, located on or off the site, to the extent that market actions reflect such anticipated improvements as of the effective appraisal date;

(v) recognize that land is generally appraised as though vacant and available for development to its highest and best use and that the appraisal of improvements is based on their actual contribution to the site;

(vi) appraise proposed improvements only after examining and having available for future examination (i) plans, specifications, or other documentation sufficient to identify the scope and character of the proposed improvements, (ii) evidence indicating the probable time of completion of the proposed improvements, and (iii) reasonably clear and appropriate evidence supporting development costs, anticipated earnings, occupancy projections, and the anticipated competition at the time of completion; and

(vii) base estimates of anticipated future rent and expenses for the property being appraised on reasonably clear and appropriate evidence.

(c) In developing a real estate appraisal analysis, opinion or conclusion that contains an estimate of value, an appraiser must define the value being considered. If the value estimate is a statement or estimate of market value, the appraiser must clearly indicate whether the statement or estimate is the most probable price in terms of (i) cash or (ii) financial arrangements equivalent to cash, or (iii) such other terms as may be precisely defined.

If an estimate of value is based on submarket financing or financing with unusual conditions or incentives, the terms of such atypical financing must be clearly set forth, the contribution to, or

negative influence on value must be described and estimated, and the market data supporting the valuation estimate must be described and explained.

(d) For each real estate appraisal analysis, opinion or conclusion that contains an estimate of value, an appraiser must observe the following specific real estate appraisal guidelines. An appraiser must

(i) consider whether an appraised fractional interest, physical segment, or partial holding contributes pro rata to the value of the whole;

(ii) identify any personal property or other items that are not real property but are included with or considered in connection with the real estate being appraised and contribute to the total value estimate or conclusion;

(iii) consider and analyze any current Agreement of Sale, option or listing of the property being appraised, if such information is available to the appraiser in the normal course of business;

(iv) consider and analyze any prior sales of the property being appraised that occurred within the following time periods: (1) one year for one- to four-family residential property, and (2) three years for all other property types;

(v) when estimating the value of a leased fee estate or a leasehold estate, analyze and consider the effect on value, if any, of the terms and conditions of the lease; and

(vi) give careful consideration to the effect on value, if any, of the assemblage of the various estates or component parts of a property and refrain from estimating the value of the whole solely by adding together the individual values of its various estates or component parts.

(e) In developing a review appraisal analysis, opinion, or conclusion, an appraiser must observe the following specific appraisal guidelines. A review appraiser must

(i) identify the report being reviewed, the real estate being appraised, the real property interest being appraised, the effective date of the opinion in the original report, the date of the original report, and the date of the review;

(ii) identify the scope of the review process to be conducted, including a determination of whether or not it is appropriate or essential to inspect the appraised property and the data presented;

(iii) form an opinion as to the adequacy and relevance of the data used and the propriety of any adjustments made;

(iv) form an opinion as to whether or not the appraisal methods and techniques used were appropriate and, if not, the reasons for the reviewer's disagreement with the original appraiser; and

(v) form an opinion as to whether or not the analyses, opinions or conclusions in the report being reviewed are correct or appropriate and, if not, state his or her analyses, opinions or conclusions and his or her reasons for disagreement with the original appraiser.

(f) In developing a real estate appraisal analysis, opinion, or conclusion for an employer or a client, an appraiser must carefully consider and determine whether the appraisal service to be performed is intended to result in an analysis, opinion or conclusion of a disinterested third party and therefore would be classified as an appraisal assignment as defined in this Act. If the appraisal service to be performed is not intended to result in an analysis, opinion or conclusion of a disinterested third party, the appraiser must then carefully consider whether or not he or she would be perceived by third parties or the public as acting as a disinterested third party.

(g) Prior to entering into an agreement to perform a real estate appraisal service, an appraiser must carefully consider the knowledge and experience that will be required to complete the appraisal service competently and either:

(i) have the knowledge and experience necessary to complete the appraisal service competently; or

(ii) immediately disclose the lack of knowledge or experience to the client, and take all steps necessary to complete the appraisal service competently.

(h) An appraiser may enter into an agreement to perform a real estate appraisal service that calls for something less than, or different from, the work that would otherwise be required by the specific appraisal guidelines, provided that prior to entering into such agreement,

(i) the appraiser has determined that the appraisal service to be performed is not so limited in scope that the resulting analysis, opinion or conclusion concerning real estate would tend to mislead or confuse the client, the users of the appraisal report, or the public; and

(ii) the appraiser has advised the client that the appraisal service calls for something less than, or different from, the work required by the specific appraisal guidelines, and therefore the appraisal report will include a qualification that reflects the limited or differing scope of the appraisal service.

Section 3. A state certified real estate appraiser must comply with the following standards in the communication of appraisals of real estate located in this State:

(a) Each written or oral report or communication concerning the results of an appraisal must contain sufficient information to enable the persons who receive or rely on the report or communication to understand it correctly.

(b) Each written or oral report or communication concerning the results of an appraisal must clearly and accurately set forth each appraisal analysis, opinion, or conclusion in a manner that will not be misleading in the marketplace.

(c) Each written or oral report or communication concerning the results of an appraisal must clearly and accurately disclose any extraordinary assumption or limiting condition that directly affects an appraisal analysis, opinion, or conclusion.

(d) Each written report or communication concerning the results of an appraisal must comply with the following specific reporting guidelines. The written report or communication must

(i) identify and describe the real estate being appraised;

(ii) identify the real property interest being appraised;

(iii) define the opinion that is the purpose of the appraisal and describe the scope of the appraisal;

(iv) set forth the effective date of the opinion and the date of the report;

(v) set forth the appraiser's opinion of the highest and best use of the real estate being appraised when such an opinion is necessary and appropriate;

(vi) set forth the appraisal procedure followed, the data considered, and the reasoning that supports the analyses, opinions, and conclusions;

(vii) set forth all assumptions and limiting conditions that affect the analyses, opinions, and conclusions in the report;

(viii) set forth any additional information that may be appropriate to show compliance with, and to identify permitted departures from, the requirements for the development of appraisals as provided in Section 2 of this Article; and

(ix) include a signed certification in accordance with the requirements of Standard (e) of this section.

(e) Each written report or communication of the results of an appraisal signed by a state certified real estate appraiser must contain a certification that is similar in content to the most appropriate of the following two suggested forms:

(i) Certification to be Used in Written Reports Resulting from Appraisal Assignments

I certify that, to the best of my knowledge and belief,...

-- the statements of fact contained in this report are true and correct.

-- the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.

-- I have no (or the specified) present or prospective interest in the property that is the subject of this report, and I have no (or the specified) personal interest or bias with respect to the parties involved.

-- my compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report.

-- my analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the requirements of the State of _____ for state certified real estate appraisers.

-- the use of this report is subject to the requirements of the State of _____ relating to review by the Real Estate Appraisal Board.

-- I have (or have not) made a personal inspection of the property that is the subject of this report. (If more than one person signs the report, this certification must clearly specify which individuals did and which individuals did not make a personal inspection of the appraised property.)

-- no one provided significant professional assistance to the person signing this report. (If there are exceptions, the name of each individual providing significant professional assistance must be stated.)

(ii) Certification To Be Used in Written Reports Resulting From Appraisal Services That Are Directed Appraisal Assignments

I certify that, to the best of my knowledge and belief,...

-- the statements of fact contained in this report are true and correct.

-- the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, professional analyses, opinions, and conclusions.

-- I have no (or the specified) present or prospective interest in the property that is the subject of this report.

-- my compensation is (or is not) contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report. (If the compensation is contingent, the basis of such contingency must be explained.)

-- my analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the requirements of the State of _____ for state certified real estate appraisers.

-- the use of this report is subject to the requirements of the State of _____ relating to the review by the Real Estate Appraisal Board.

-- I have (or have not) made a personal inspection of the property that is the subject of this report. (If more than one person signs the report, this certification must clearly specify which individuals did and which individuals did not make a personal inspection of the property.)

-- no one provided significant professional assistance to the person signing this report. (If there are exceptions, the name of each individual providing significant professional assistance must be stated.)

(f) To the extent that it is both possible and appropriate, each oral report or communication concerning the results of an appraisal must address the substantive matters set forth in Standard (d) of this section.

(g) An appraiser may enter into an agreement calling for an appraisal report that is something less than, or different from, the complete appraisal report that would otherwise be required by the specific reporting standards set forth in this section, provided that prior to entering into such an agreement,

(i) the appraiser has determined that the resulting appraisal report would not be so limited in scope that it would tend to mislead or confuse the client, the users of the appraisal report, or the public; and

(ii) the appraiser has advised the client that the report to be prepared is something less than, or different from, the report

required by the specific reporting standards and therefore the appraisal report for the service will include a qualification that reflects this fact.

In this context, exceptions to Standards (a), (b) and (c) of this section are not permitted under any circumstances. Exceptions to Standard (e) of this section are not permitted in a written report.

Section 4. If a question arises as to the applicability or interpretation of the standards or definitions in this Article, the Real Estate Appraisal Board may consider other reference materials, including materials published by national appraisal organizations interpreting similar standards adopted by such national appraisal organizations.

Article 8. Miscellaneous

Section 1. A state certified real estate appraiser shall retain for two years, originals or true copies of contracts engaging the person's services for real property appraisal work, appraisal reports, and supporting data assembled and formulated by the appraiser in preparing the appraisal reports. The period for retention of the records applicable to each engagement of the services of the appraiser shall run from the date of the submittal of the appraisal report to the client. These records shall be made available by the state certified real estate appraiser for inspection and copying by the Board on reasonable notice to the appraiser.

Section 2. (a) Any person who willfully violates or knowingly participates in the violation of Section 6 of Article 4 of this Act is guilty of a misdemeanor.

(b) This section shall not be construed to preclude the applicability of any other provision of the criminal law of this state which is otherwise applicable to an act or omission which violates a provision of this Act.

_____ BILL _____

38TH LEGISLATURE - STATE OF NEW MEXICO - FIRST SESSION, 1987

INTRODUCED BY

AN ACT

RELATING TO REAL ESTATE; AMENDING AND ENACTING CERTAIN SECTIONS OF THE NMSA 1978; ENACTING THE STATE CERTIFIED REAL ESTATE APPRAISERS ACT; CREATING THE CERTIFIED APPRAISER FUND.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF NEW MEXICO:

Section 1. [NEW MATERIAL] SHORT TITLE.--Sections 1 through 20 of this act may be cited as the "State Certified Real Estate Appraisers Act".

Section 2. [NEW MATERIAL] DEFINITIONS.--As used in the State Certified Real Estate Appraisers Act:

A. "appraisal" or "real estate appraisal" means an analysis, opinion or conclusion relating to the nature, quality, value, or utility of specified interests in, or aspects of, identified real estate, for or in expectation of compensation;

B. "appraisal assignment" means an engagement for which an appraiser is employed or retained to act, or would be perceived by third

underscored material = new
[~~bracketed material~~] = deletion

parties or the public as acting, as a disinterested third party in rendering an unbiased analysis, opinion, or conclusion relating to the nature, quality, value, or utility of specified interests in, or aspects of, identified real estate;

C. "appraisal report" means any communication, written or oral, of an analysis, opinion or conclusion relating to the nature, quality, value, or utility of specified interests in, or aspects of, identified real estate regardless of title or designation, and all other reports communicating an appraisal analysis, opinion or conclusion;

D. "board" means the real estate appraisers board created under the State Certified Real Estate Appraisers Act;

E. "commission" means the New Mexico Real Estate Commission created by Chapter 61, Article 29 NMSA, 1978;

F. "general certificate" or "general certification" means a certificate or certification issued pursuant to the provisions of the State Certified Real Estate Appraisers Act for appraisals of all types of real estate;

G. "real estate" or "real property" means any leasehold or other estate or interest in, over or under land, including structures, fixtures and other improvements and interests which by custom, usage or law pass with a conveyance of land though not described in a contract of sale or instrument of conveyance, and includes parcels with or without upper and lower boundaries and spaces that may be filled with air;

H. "residential certificate" or "residential certification" means a certificate or certification issued pursuant to the provisions of the

State Certified Real Estate Appraisers Act limited to appraisals of residential real estate or residential real property; and

I. "residential real estate" or "residential real property" means real estate designed for occupancy by one to four families and includes manufactured housing.

J. "state certified appraisal" means any appraisal which is identified as a state certified appraisal report or is in any way described as being prepared by a state certified real estate appraiser;

K. "state certified real estate appraiser" means a person who holds a current, valid general certificate or a current, valid residential certificate issued pursuant to the provisions of the State Certified Real Estate Appraisers Act;

Section 3. [NEW MATERIAL] ADMINISTRATION--ENFORCEMENT.--The administration and enforcement of the State Certified Real Estate Appraisers Act is vested in the commission.

Section 4. [NEW MATERIAL] REAL ESTATE APPRAISERS BOARD CREATED.--

A. There is created a "real estate appraisers board" consisting of five members, three of whom shall be certified real estate appraisers with at least three years of real estate appraisal experience in New Mexico; one of whom shall represent lenders, or assignees thereof, engaged in the business of lending funds secured by mortgages; and one of whom shall represent the public and shall not have ever been a real estate appraiser or engaged in the business of real estate appraisals. Upon enactment of the State Certified Real Estate Appraisers Act, the board shall advise and make recommendations to the commission on matters to which the State Certified

Real Estate Appraisers Act applies, including without limitation, regulations necessary to effectuate the provisions of the State Certified Real Estate Appraisers Act.

B. The state certified appraiser members shall be appointed by the governor with initial appointments for two members for terms of three years and one member for a term of five years. Not more than two state certified appraiser members shall be from any one county within New Mexico. The lender member and public member shall each be appointed for a term of five years. Thereafter, the additional members shall be appointed by the governor for staggered terms of five years each. The state certified real estate appraiser members of the board shall be appointed from lists submitted to the governor by any generally recognized organization of real estate appraisers in New Mexico. The governor may remove any member for cause. Vacancies shall be filled by appointment by the governor for the unexpired term within sixty days of the vacancy.

Section 5. [NEW MATERIAL] BOARD--POWERS--DUTIES.--The board shall advise and recommend to the commission for adoption and promulgation such rules, regulations and certification standards as may be necessary to effectuate the provisions of the State Certified Real Estate Appraisers Act.

Section 6. [NEW MATERIAL] COMMISSION--POWERS--DUTIES.--The commission, upon the advice and recommendations of the board, shall:

A. establish educational programs and research projects related to the appraisal of real estate;

B. establish the administrative procedures for processing

applications and issuing certificates to certified real estate appraisers and for conducting disciplinary proceedings pursuant to the provisions of the State Certified Real Estate Appraisers Act;

C. receive and review applications, establish the examination specifications for each category of state certified real estate appraisers, prepare or supervise the preparation of examination questions and answers, and supervise grading of examinations;

D. adopt regulations defining the extent and type of educational experience, appraisal experience, and equivalent experience that will meet the requirements of the State Certified Real Estate Appraisers Act after considering generally recognized appraisal practices;

E. adopt regulations providing for continuing education programs for the renewal of certification that will meet the requirements provided in the State Certified Real Estate Appraisers Act;

F. adopt standards for the development and communication of real estate appraisals provided in the State Certified Real Estate Appraisers Act and adopt regulations explaining and interpreting the standards after considering generally recognized appraisal practices; and

G. perform such other functions and duties as may be necessary to carry out the provisions of the State Certified Real Estate Appraisers Act.

Section 7. [NEW MATERIAL] ORGANIZATION OF BOARD--MEETING OF THE BOARD.--

A. The board shall organize by electing a chairman, vice chairman and secretary from its members. A majority of the board shall constitute a quorum and may exercise all powers and duties established by the provisions

of the State Certified Real Estate Appraisers Act. The secretary of the board shall keep a record of its proceedings, a register of persons certified as state certified real estate appraisers, showing the name and places of business of each and retain all records and applications submitted to the commission pursuant to the State Certified Real Estate Appraisers Act.

B. The board shall meet not less frequently than once each calendar quarter at such place as may be designated by the commission and special meetings may be held on five days' written notice to each of the members by the commission or chairman.

Section 8. [NEW MATERIAL] REIMBURSEMENT AND EXPENSES.--Each member of the board shall receive per diem and mileage as provided in the Per Diem and Mileage Act, and shall receive no other perquisite, compensation or allowance. The commission may employ persons to assist the board and commission as may be necessary. Compensation for employees and any necessary supplies and equipment shall be paid from the certified appraiser fund.

Section 9. [NEW MATERIAL] CERTIFICATION--EXCEPTIONS.--

A. It is unlawful, unless certified by the commission as a state certified real estate appraiser under a general certification or residential certification, for any person to:

1. assume or use any title, designation, or abbreviation likely to create the impression of certification as a state certified real estate appraiser; or

2. describe or refer to any appraisal or evaluation of real

estate by the term "state certified"; or

3. assume or use any title, designation, or abbreviation likely to create the impression of certification as a state certified real estate appraiser firm, partnership, corporation or group; or

4. assume or use any title, designation, or abbreviation likely to create the impression of certification under a general certificate, or describe or refer to any appraisal or evaluation of non-residential real estate by the term "state certified", if certification is limited to residential real estate.

B. The requirement of certification as a state certified real estate appraiser shall not prohibit a person who is not certified from preparing appraisals, provided such appraisals are not described or referred to as "state certified" and provided further, such person does not assume or use any title, designation, or abbreviation likely to create the impression of certification as a state certified real estate appraiser. A holder of a residential certificate may prepare appraisals of non-residential real estate, provided such appraisals are not described or referred to as "state certified" and provided further, the holder of the certificate does not assume or use any title, designation or abbreviation likely to create the impression of general certification.

Section 10. [NEW MATERIAL] QUALIFICATIONS FOR CERTIFICATE.--

A. Certificates shall be granted only to persons who are deemed by the commission to be of good repute and competent to render appraisals.

B. Each applicant for a certificate shall be a legal resident of the United States, an actual bona fide resident of New Mexico, and have

reached the age of majority.

C. Each applicant for a general certificate as a state certified real estate appraiser shall have performed actively as a real estate appraiser and have the equivalent of:

1. three years of experience in real property appraisal, acquired within a period of five years immediately preceding the filing of the application; and

2. successfully completed one hundred and twenty classroom hours of instruction in appraisal of real estate approved by the board; or

3. such equivalent experience in an activity closely related to or associated with real estate appraisal as determined by regulation.

D. Each applicant for a residential certificate as a state certified real estate appraiser shall have performed actively as a real estate appraiser and have the equivalent of:

1. one year of experience in real property appraisal, acquired within a period of three years immediately preceding the filing of the application; and

2. successfully completed sixty classroom hours of instruction in appraisal of real estate approved by the board; or

3. such equivalent experience in an activity closely related to or associated with real estate appraisal as determined by regulation.

E. The commission shall require such information as it deems necessary from every applicant to determine the applicant's honesty, trustworthiness and competency.

Section 11. [NEW MATERIAL] APPLICATION FOR CERTIFICATE AND

EXAMINATION.--

A. All applications for certificates shall be made in writing, specify the classification of the certificate being applied for by the applicant, and shall contain such data and information as may be required by the commission.

B. Each applicant shall demonstrate, by successfully passing a written examination, prepared by or under the supervision of the commission, upon the advice and recommendations of the board, that the applicant possesses, consistent with the certification sought, the following:

1. an appropriate knowledge of technical terms commonly used in or related to real estate appraising, appraisal report writing, and economic concepts applicable to real estate;

2. a basic understanding of real estate law;

3. an adequate knowledge of theory and techniques of real estate appraisal;

4. an understanding of the principles of land economics, real estate appraisal processes, and problems likely to be encountered in the gathering, interpreting, and processing of data in carrying out appraisal disciplines;

5. an understanding of the standards for the development and communication of real estate appraisals as provided in the State Certified Real Estate Appraisers Act;

6. an understanding of the types of misconduct for which disciplinary proceedings may be initiated against a state certified real estate appraiser, as set forth in the State Certified Real Estate Appraisers

Act.

C. The examination shall be given at such time and places within the state as the commission shall prescribe; provided however, the examination shall not be given less than four times during each calendar year. Notice of passing or failing the examination shall be given by the commission to each applicant not later than thirty days following the date of the examination.

D. An applicant who fails to successfully complete the written examination may apply for reexamination ninety days after the date the examination was taken upon compliance with such conditions as set forth in the rules and regulations adopted by the commission pursuant to the provisions of the State Certified Real Estate Appraisers Act.

Section 12. [NEW MATERIAL] TEMPORARY CERTIFICATION.-- Prior to the promulgation of rules and regulations, for a period not to exceed two years from the effective date of the State Certified Real Estate Appraisers Act, the commission shall issue temporary certificates to practice as a state certified real estate appraiser.

A. Each applicant for a temporary general certificate shall submit verifiable documentation that the applicant has performed actively as a real estate appraiser and has the equivalent of:

1. three years of experience in real property appraisal, acquired within a period of five years immediately preceding the filing of the application; and

2. successfully completed one hundred and twenty classroom hours of instruction in appraisal of real estate approved by the board; or

3. such equivalent experience in an activity closely related to or associated with real estate appraisal.

B. Each applicant for a temporary residential certificate shall submit verifiable documentation that the applicant has performed actively as a real estate appraiser and has the equivalent of:

1. one year of experience in real property appraisal, acquired within a period of three years immediately preceding the filing of the application; and

2. successfully completed sixty classroom hours of instruction in appraisal of real estate approved by the board; or

3. such equivalent experience in an activity closely related to or associated with real estate appraisal.

C. Any person issued a temporary certificate pursuant to this section shall take an examination at such place and time the commission may require. If the holder of a temporary certificate fails to take such examination, or fails to pass such examination, the temporary certificate shall be automatically revoked and be of no further force or effect. All temporary certificates shall expire not later than two years from the effective date of the State Certified Real Estate Appraisers Act.

Section 13. [NEW MATERIAL] ISSUANCE, RENEWAL AND SURRENDER OF CERTIFICATES.--

A. The commission shall issue to each qualified applicant a certificate in such form and size as shall be prescribed by the commission.

B. Every certificate shall be subject to annual renewal on the last day of the certificate holder's month of birth of each year. The

commission shall certify renewal of each certificate annually, in the absence of any reason or condition which might warrant the refusal of the renewal of a certificate. Each certificate holder shall submit proof of compliance with continuing education requirements and the annual renewal fee. In the event any certificate holder fails to properly apply for renewal of the certificate within thirty days of his certificate renewal date of any given year, the certificate shall expire. In that event the commission may, upon the advice and recommendation of the board, in its discretion, treat the former certificate holder as a new applicant and further may require reexamination as a condition to reissuance of a certificate or may accept the renewal upon payment of the current annual renewal fee. Additionally, the commission shall require the former certificate holder to pay a reinstatement fee in an amount not to exceed one hundred dollars in addition to any other fee permitted under the State Certified Real Estate Appraisers Act. If, during a period of one year from the date the certificate expires, the certificate holder is either absent from this state on active duty military service or is suffering from an illness or injury of such severity that the person is physically or mentally incapable of renewal of the certificate, payment of the late fee and reexamination shall not be required by the commission if, within three months of the person's permanent return to this state or sufficient recovery from illness or injury to allow the person to make an application, the person makes application to the commission for renewal. A copy of the person's military orders or a certificate of the applicant's physician shall accompany the application. Any person excused by reason of active duty

military service, illness or injury as provided for in this subsection may renew the certificate without imposition of the late fee.

Section 14. [NEW MATERIAL] REFUSAL, SUSPENSION OR REVOCATION OF CERTIFICATE.--

A. The commission, upon the advice and recommendations of the board, shall have the power to refuse issuance or renewal of a certificate for cause or suspend or revoke a certificate at any time, when the applicant or certificate holder, in performing or attempting to perform any of the actions set forth herein, is deemed guilty of:

1. procuring or attempting to procure a certificate by knowingly making a false statement or submitting false information, or through any form of fraud or misrepresentation;

2. refusing to provide complete information in response to a question in an application for certification or failing to meet the minimum qualifications established by the State Certified Real Estate Appraisers Act;

3. paying money (other than provided for by the State Certified Real Estate Appraisers Act) to any member or employee of the commission or board to procure a certificate;

4. being convicted of a crime which is substantially related to the qualifications, functions, and duties of a person developing real estate appraisals and communicating real estate appraisals to others;

5. committing or omitting an act involving dishonesty, fraud, or misrepresentation with the intent to substantially benefit the certificate holder or another person or with the intent to substantially

injure another person;

6. willfully disregarding or violating any of the provisions of the State Certified Real Estate Appraisers Act or the regulations of the commission;

7. accepting an appraisal assignment when the employment itself is contingent upon the appraiser reporting a predetermined analysis or opinion, or where the fee to be paid for the performance of the appraisal assignment is contingent upon the opinion, conclusion, or valuation reached, or upon the consequences resulting from the appraisal assignment;

8. violating the confidential nature of records to which the appraiser gained access through employment or engagement as an appraiser; or

9. committing any other conduct which is related to dealings as a state certified real estate appraiser and which constitutes or demonstrates bad faith, untrustworthiness, impropriety, fraud, dishonesty, or any unlawful act.

B. The commission, upon the advice and recommendations of the board, shall have the power to refuse issuance or renewal of a certificate for cause and to suspend or revoke a certificate at any time, when the applicant or certificate holder, in the performance of real estate appraisal work, is found guilty of:

1. repeatedly failing to observe one or more of the standards for the development or communication of real estate appraisals set forth in the regulations adopted pursuant to the State Certified Real Estate Appraisers Act;

2. repeatedly failing or refusing, without good cause, to

exercise reasonable diligence in developing an appraisal, preparing an appraisal report or communicating an appraisal; or

3. repeatedly being negligent or incompetent in developing an appraisal, in preparing an appraisal report, or in communicating an appraisal.

C. The action of the commission, upon the advice and recommendations of the board, relating to the issuance, suspension or revocation of any certificate shall be governed by the provisions of the Uniform Licensing Act.

D. The provisions of the Criminal Offender Employment Act shall govern any consideration of criminal records required or permitted under the State Certified Real Estate Appraisers Act.

E. Nothing in the State Certified Real Estate Appraisers Act shall be construed to preclude any other remedies otherwise available under common law or statutes of this state.

Section 15. [NEW MATERIAL] FEES.--The commission shall charge and collect the following fees:

A. an initial application fee for temporary general certification in an amount not to exceed three hundred dollars ($300);

B. an initial application fee for general certification in an amount not to exceed three hundred dollars ($300);

C. an initial application fee for temporary residential certification in an amount not to exceed two hundred dollars ($200);

D. an initial application fee for residential certification in an amount not to exceed two hundred dollars ($200);

E. an examination fee for general certification in an amount not to exceed two hundred dollars ($200);

F. an examination fee for residential certification in an amount not to exceed one hundred and fifty dollars ($150);

G. an annual certificate renewal fee for general certification in an amount not to exceed one hundred fifty dollars ($150);

H. an annual certificate renewal fee for residential certification in an amount not to exceed one hundred dollars ($100); and

I. for each duplicate certificate, where the certificate is lost or destroyed and an affidavit is made thereof, a fee in an amount not to exceed twenty-five dollars ($25).

Any person who allows his certificate to lapse by failure to renew as provided in the State Certified Real Estate Appraisers Act, and the commission, upon the advice and recommendations of the board, in its discretion, permits the reinstatement without reexamination, shall be reinstated by the commission on payment of the fee for the current annual fee plus a reinstatement fee in an amount not to exceed one hundred dollars ($100), as determined by the commission. This provision shall not apply to anyone whose certificate has been revoked or suspended.

Section 16. [NEW MATERIAL] FUND ESTABLISHED--DISPOSITION--METHOD OF PAYMENT.--

A. There is created in the state treasury the "certified appraiser fund".

B. All fees received by the commission pursuant to the State Certified Real Estate Appraisers Act shall be deposited with the state

treasurer. The state treasurer shall place the funds to the credit of the certified appraiser fund.

C. Payments out of the certified appraiser fund shall be on vouchers issued and signed by the person designated by the commission upon warrants drawn by the department of finance and administration and shall be used by the commission for the purpose of meeting necessary expenses incurred in the enforcement of the provisions of the State Certified Real Estate Appraisers Act, the duties imposed by the State Certified Real Estate Appraisers Act and the promotion of education and standards for real estate appraisers in this state. All money unexpended or unencumbered at the end of the fiscal year shall remain in the certified appraiser fund for use in accordance with the provisions of the State Certified Real Estate Appraisers Act. Any income earned on investment of the fund shall be credited to the fund for use as provided in the State Certified Real Estate Appraisers Act.

Section 17. [NEW MATERIAL] CONTINUING EDUCATION.--The commission, upon the advice and recommendations of the board, shall adopt regulations providing for continuing education programs that offer courses in real property appraisal and practices and techniques, including basic real estate law and practice. The regulations shall require that every state certified real estate appraiser, except certificate holders who are sixty-five years of age or older and who have a minimum of twenty years continuous experience in appraising real property, as a condition to renewal, shall successfully complete thirty classroom hours of instruction every three years in courses approved by the commission. The regulations shall prescribe areas of specialty or expertise relating to the type of certificate held and may

require that a certain part of the thirty classroom instruction be devoted to courses in the area of the certificate holder's specialty or expertise. The regulations shall also permit certificate holders to meet the continuing education requirements by participation other than as a student in educational processes and programs in real property appraisal theory, practices and techniques by instructing or preparing educational materials.

Section 18. [NEW MATERIAL] NONRESIDENT APPLICANTS.--

A. Application for issuance of a general or residential certificate shall be accepted only from a nonresident applicant who is a certified or licensed in another state which other state extends the privilege of certification or licensure to a state certified real estate appraiser certified in New Mexico. A qualifying nonresident applicant may become a state certified real estate appraiser by conforming to all conditions of the State Certified Real Estate Appraisers Act, but shall not be required to take a written examination if such examination is not required to be taken by New Mexico state certified real estate appraiser to be licensed or certified in the state of the nonresident.

B. The commission may recognize, upon the advice and recommendations of the board, in lieu of the matters required to be submitted with an application for certification, the certificate or license issued to a nonresident in another state, provided the other states extends the privilege of licensure or certification to New Mexico state certified real estate appraisers upon the same or lesser conditions as set forth in this section. The license shall be issued upon payment of the application fee, verification that the applicant has complied with his resident state's

current education requirements, and the filing with the commission of a certified copy of the applicant's license or certificate issued by the other state.

C. The applicant shall file an irrevocable consent that suits and actions may be commenced against him in the proper court of any county of this state in which a cause of action may arise from their actions as a state certified real estate appraiser or in which the plaintiff may reside, by the service of any process or pleadings authorized by the laws of this state on the commission, the consent stipulating and agreeing that such service of process or pleadings on the commission shall be taken and held in all courts to be as valid and binding as if personal service has been made upon the applicant in New Mexico. In case any process or pleading mentioned in the case is served upon the commission, it shall be by duplicate copies, one of which shall be filed in the office of the commission and the other immediately forwarded by registered mail to the applicant against which the process or pleadings are directed.

Section 19. [NEW MATERIAL] PENALTY; INJUNCTIVE RELIEF.--

A. Any person who violates any provision of the State Certified Real Estate Appraisers Act is guilty of a misdemeanor and shall by punished by a fine of not more that five hundred dollars ($500), or by imprisonment for not more than six months, or both.

B: In the event any person has engages, or proposes to engage, in any act or practice violative of a provision of the State Certified Real Estate Appraisers Act, the attorney general or the district attorney of the judicial district in which the person resides or the judicial district in

which the violation has occurred or will occur shall, upon application of the commission, upon the recommendations and advice of the board, maintain an action in the name of the state to prosecute the violation or to enjoin the proposed act or practice.

Section 20. [NEW MATERIAL] SEVERABILITY.--If any part or application of the State Certified Real Estate Appraisers Act is held invalid, the remainder of its application to other situations or persons shall not be affected.

Section 21. Section 61-29-4 NMSA 1978 (being Laws 1959, Chapter 226, as amended) is amended to read:

"61-29-4. CREATION OF COMMISSION; POWERS AND DUTIES.--There is created the New Mexico real estate commission, called "the commission" in Chapter 61, Article 29 NMSA 1978. The commission shall be appointed by the governor and shall consist of five members who shall have been residents of the state for three consecutive years immediately prior to their appointment, four of whom shall have been real estate brokers licensed in New Mexico and one of whom shall be a member of the public who has never been licensed as a real estate broker or salesperson; provided not more than one member shall be from any one county within the state. The members of the commission shall serve for a period of five years or until their successors are appointed and qualified. Members to fill vacancies shall be appointed for any unexpired term. The governor may remove any member for cause. The commission shall possess all the powers and perform all the duties prescribed by Chapter 61, Article 29 NMSA 1978 [~~,~~] and the State Certified Real Estate Appraisers Act, and it is expressly vested with power and authority to make and enforce any

rules and regulations to carry out the provisions of that article [~] and the State Certified Real Estate Appraisers Act. Prior to any final action on any proposed changes or amendments to the rules and regulations of the commission, the commission shall publish notice of the proposed action in its official publication, distribute the publication to each licensee or certificate holder and give the time and place for a public hearing on the proposed changes. The hearing shall be held at least thirty days prior to any proposed final action. Any changes or amendments to the rules and regulations shall be filed in accordance with the procedures of the State Rules Act and shall become effective thirty days after notification to all licensees and certificate holders of the filing of the changes or amendments. The commission may employ any staff it deems necessary to assist in carrying out its duties and in keeping its records."

Position Statement on Appraiser Regulation Adopted by the Governing Council of the Appraisal Institute on November 2, 1986

RESOLUTION

WHEREAS, the Resolution adopted by the Governing Council on November 4, 1985, that reads as follows:

> "That the Appraisal Institute support legislation and regulations adopting the Institute's Standards of Professional Practice and/or programs for the certification of appraisers when the legislation or regulations lead to and support a national program for the appraisal profession, similar to the Certified Public Accountant program for the accounting profession, that is based upon a certifying board for appraisers and an appraisal standards board to set standards for the profession."

is still a current and appropriate statement of the Appraisal Institute's position on the issue of the regulation of appraisers; and

WHEREAS, subsequent to the adoption of the Resolution, the Report of the Congressional Subcommittee on Commerce, Consumer, and Monetary Affairs recommended the implementation of a regulatory plan similar to the plan suggested by the Appraisal Institute;

NOW THEREFORE BE IT RESOLVED, that the "Conceptual Draft of Self-Regulatory Structures for the Real Estate Appraisal Profession" presented to the Governing Council on November 2, 1986, is consistent with the Resolution of November 4, 1985, and the recommendation of the Congressional Subcommittee on Commerce, Consumer, and Monetary Affairs; and

BE IT FURTHER RESOLVED, that the plan suggested in the Conceptual Draft be adopted as the regulatory plan recommended and endorsed by the Appraisal Institute; and

IT IS FURTHER RESOLVED that the President of the Appraisal Institute and his designees be, and they hereby are, authorized to monitor and support proposals and legislation that would lead to the implementation of the plan proposed in the Conceptual Draft, including the introduction of legislation if and when necessary to the goals of the Appraisal Institute.

SOCIETY OF REAL ESTATE APPRAISERS

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DONALD E. KELLY

Legislative Counsel

Society of Real Estate Appraisers

Mr. Kelly joined the Society of Real Estate Appraisers as Legislative Counsel in 1986 after serving as staff counsel on the U.S. House of Representatives' Banking, Finance and Urban Affairs Committee. As Legislative Counsel he is responsible for liaison with both houses of Congress in matters affecting the real estate appraisal profession. He works with the various federal agencies on issues involving the profession. Mr. Kelly monitors federal and state legislation, and works with elected officials and congressional staff in preparing language for legislative proposals and reports.

Mr. Kelly holds a BA Degree from the University of Florida in Political Science, is a graduate of the University of Florida College of Law, and is a member of the Florida Bar.

BACKGROUND ON THE SELF-REGULATION ISSUE

The issue of appraisal industry practices most recently came to the attention of the U.S. Congress in 1984, as a result of investigations of bank and thrift institution failures conducted by the Government Affairs Subcommittee of the House Commerce, Consumer and Monetary Affairs Committee.

THE BARNARD REPORT

Rep. Doug Barnard (D-Ga.), the Subcommittee's Chairman, became aware of flaws in the workings of the appraisal system that needed correcting. He issued a report in September 1986 detailing appraisal problems and made recommendations for solving them. It is advisable for all members involved in this effort--particularly Chapter Legislative Chairmen -- to read the Barnard Report, which was printed in the Fall 1986 issue of TREA&A.

THE NECESSITY FOR ACTION

Because the appraisal industry problems identified by Congressman Barnard affect federally-insured institutions and the banking industry as a whole, it has been clear for some time that Congress will take direct action by way of federal regulation to correct these problems unless the profession acts to regulate itself and to support state-level certification of appraisers who do work for federal programs.

In addition to the problems that have been experienced by financial institutions and others, public confidence in the appraisal process has eroded, and meaningful changes are necessary at this time to protect our profession's public image.

SELF-REGULATION AS A SOLUTION

Representatives of the Society and other major appraisal organizations are working to found an industry Self-Regulatory Organization (SRO) called the "Appraisal Foundation." Simply stated, the role of the SRO will be to establish and review standards of appraisal practice, and to establish qualifications for certification of appraisers that can be used by the states in their certification programs.

In February 1987, the Society became the first organization to adopt the Uniform Standards of Professional Appraisal Practice developed by an ad hoc committee of appraisal organizations. Another committee from that same group is working to form and

implement the SRO. All of the provisions of the new uniform standards had been included in the existing Society standards. These new uniform standards go beyond real estate standards to include provisions dealing with personal property, business valuation, etc. They became effective for Society members July 1, 1987.

ENFORCEMENT MECHANISM KEY CHANGE

While the standards themselves may change little, the enforcement mechanism will be strengthened significantly under the new self-regulatory system. Under the proposed system, appraisers who violate professional standards can lose their state certification, which would prohibit them from performing appraisals for "federally covered interests. Under the existing system, violators lose professional designations but can continue to appraise.

BARNARD LEGISLATION

The Society and other groups have been working closely with Congressman Barnard to develop a statutory framework that will allow the SRO to function. Congressman Barnard held hearings in June 1987 in California to further explore the role of appraisers and other professionals in the failure of California thrift institutions. The testimony further documents appraisal industry problems. It is expected that legislation will be introduced this Fall to establish a federal role in a self-regulatory system. The federal legislation, which recognizes the role of the Appraisal Foundation, and requires state-certification for certain federally-covered interests, will provide the needed impetus for an effective self-regulatory organization.

NEWS

SOCIETY OF REAL ESTATE APPRAISERS ®
645 North Michigan Avenue, Chicago, Illinois 60611, 312-346-7422

FOR IMMEDIATE RELEASE
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SOCIETY OF REAL ESTATE APPRAISERS ENDORSES GOVERNMENT ROLE IN INDUSTRY SELF-REGULATION EFFORTS

CHICAGO (June 18, 1987) -- The Society of Real Estate Appraisers announces its endorsement of limited government involvement in enforcement of the profession's uniform standards and appraiser qualification requirements.

The Society favors a limited government role in enforcing the industry's self-regulatory efforts. The current approach proposed by Rep. Doug Barnard (D-Ga.), involving state-level enforcement of the industry-promulgated standards and qualification requirements, would be acceptable.

"A system without government involvement is limited in its effectiveness," said Society president David N. Peterson, SREA. "Governmental involvement at various levels is necessary to assure that the standards are enforceable."

The Society is one of eight major appraisal organizations that have been working to establish an appraisal foundation, which will promote and disseminate the uniform standards of professional appraisal practice the industry groups have developed, and establish qualification requirements.

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for immediate release

Barnard chaired House Subcommittee hearings June 13 in Los Angeles focused on insider abuses at California thrift institutions, part of an apparent pattern of corruption in thrifts across the country made possible by loosening of thrift industry regulations. The Commerce, Consumer, and Monetary Affairs Subcommittee heard testimony implicating bank officials and directors, as well as professionals who work closely with them, including appraisers, attorneys, accountants, and other consultants.

"Frankly, there is serious concern in Washington that if government and the private sector fail to take speedy and dramatic action against unscrupulous operators in the vulnerable thrift industry, an undercapitalized FSLIC fund may give way to a non-existent thrift industry itself," Barnard said in Los Angeles.

Barnard is expected to introduce legislation later this summer that would establish a federal oversight mechanism for the appraisal industry self-regulatory structure. The federal council would intervene only where the industry's appraisal foundation or the state-level appraisal qualification agencies abused their powers or failed to meet their responsibilities.

With 18,000 members, the Society of Real Estate Appraisers is the largest independent association of professional real estate appraisers in North America. Members of the 52-year old organization have always been required to adhere to strict Standards of Professional Practice and Professional Conduct. All of the provisions of the industry's new uniform standards were included in Society standards that have been in effect for more than 20 years.

At present, however, enforcement of the Standards of Professional Practice and Conduct must be accomplished through a tort law system that does not allow plaintiffs subpoena power and can take two or three years.

"We share the widespread concern about thrift industry problems and are anxious to establish an enforceable self-regulatory system that can assure continued high standards of behavior in our profession," Peterson said. "The actions of a few threaten to damage the reputations of many thousands of honest practitioners."

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NEWS
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APPRAISERS UNITE TO FORM NEW STANDARDS-SETTING FOUNDATION

CHICAGO (July 24, 1987) -- "We are very pleased and encouraged with the actions taken by the Society of Real Estate Appraisers and the seven other appraisal organizations to form a broad based Appraisal Foundation. The Foundation will be dedicated to the promotion of the Uniform Standards of Professional Appraisal Practice and establishment of uniform qualification criteria for professional appraisers," said David N. Peterson, SREA, president of the Society, after the meeting in Denver to draft bylaws and articles of incorporation for the new Appraisal Foundation July 19.

"Formation of the Appraisal Foundation will prove to be a milestone in the maturing of the appraisal profession," Peterson said. "We are proud to have contributed to this effort and to unite with the professional organizations to promote high standards of professional practice, qualification, and conduct."

The Appraisal Foundation will be the parent entity for an Appraisal Standards Board and an Appraiser Qualification Board. The Standards Board will develop and promote Uniform Standards of Professional Appraisal Practice. The Qualification Board will establish criteria for certification of qualified appraisers, and

-more-

for immediate release

promote and disseminate the criteria to the states and other governmental agencies for adoption as uniform certification requirements.

Funding for the new non-profit organization initially will be provided by the appraisal organization members. In addition to the Society of Real Estate Appraisers, member groups include: American Institute of Real Estate Appraisers, American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, International Association of Assessing Officers, International Right of Way Association, National Association of Independent Fee Appraisers, and the National Society of Real Estate Appraisers. Five additional special members representing related industry interests are also members of the Foundation.

While there are at present few government licensing and certification requirements for appraisers, the Society and other professional organizations have consistently required their members to adhere to standards of professional practice and ethics. In response to recent concerns about professional conduct in the appraisal profession raised in congressional investigations, the appraisal organizations have reached consensus on Uniform Standards of Professional Appraisal Practice.

Impetus for establishment of state-level appraiser certification boards is expected to be provided by federal legislation. Rep. Doug Barnard (D-GA), whose subcommittee has looked into some of the problems, is expected to introduce legislation in September which will require appraisers performing certain "Federally covered interests"

to be state-certified. Given the pervasive involvement of the federal government in the mortgage finance industry, the Barnard proposal could effectively require state certification of appraisers. Under Barnard's proposal, state certification requirements would have to meet or exceed the requirements established by the Appraisal Foundation. A Federal Interagency Council would provide oversight to protect against abuse of power or dereliction of duty by the Foundation or the state agencies.

"We look forward to the official ceremonies in September to celebrate formation of the Appraisal Foundation," Peterson said. "It will be an historic occasion for appraisers and for the banking and thrift industries."

With more than 17,000 members and 52 years of experience, the Society of Real Estate Appraisers is the largest independent organization of professional appraisers in North America. It awards the professional designations: SRA (Senior Residential Appraiser), SRPA (Senior Real Property Appraiser), and SREA (Senior Real Estate Analyst).

TESTIMONY SYNOPSIS

SUBCOMMITTEE ON COMMERCE, CONSUMER, AND MONETARY AFFAIRS
COMMITTEE ON GOVERNMENT OPERATIONS
U.S. HOUSE OF REPRESENTATIVES
SATURDAY, JUNE 13, 1987

PROBLEMS IN THE CALIFORNIA THRIFT INDUSTRY

LOS ANGELES CITY HALL

Opening Remarks--Subcommittee Chairman
U.S. Rep. Doug Barnard, Jr. (D-GA)

"The hearing will be seeking detailed information on (1) the nature and extent of misconduct by California thrift industry insiders (officers, directors, and principal stockholders) and by certain affiliated outsiders (major borrowers and appraisers); (2) the role of abusive appraisal practices in such misconduct; (3) the relationship between misconduct and the insolvencies or problem status of California savings institutions, including the costs to the Federal savings and loan insurance fund; (4) the effectiveness of the Federal Home Loan Bank Board's policies for detecting criminality and making referrals on such misconduct to Federal law inforcement agencies -- the FBI, U.S. Attorney's offices and Justice Department's Fraud Division -- in investigating and prosecuting insider, borrower and appraiser misconduct; and (6) specific recommendations for solving the financial fraud problem....

"Under the rules of the House of Representatives, this subcommittee is charged with responsibility for overseeing the operations of the financial institutions and the federal bank regulatory agencies; and for advising Congress on whether the industry and those agencies are performing responsibly.... In October 1985 the subcommittee issued a report entitled 'Federal Response to Criminal Misconduct and Insider Abuse in the Nation's Financial Institutions.' That report was based on a comprehensive investigation of the role of misconduct in 150 financial institution failures. The report concluded that:

> 'Misconduct was a principal factor in 50 percent of the commercial bank failures studied and 25 to 30 percent of thrift insolvencies; that bank regulatory agencies were lax in searching for criminal misconduct and slow to make criminal referrals; and that the criminal justice agencies frequently lacked the commitment, resources and occasionally expertise, to prosecute complex financial institution fraud cases.'

"In September 1986, the subcommittee issued another report relevant to this hearing entitled, 'Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in the Secondary Market.' That report found that:

> 'Faulty and fraudulent real estate appraisals have become an increasingly serious financial problem; that their harmful effects are widespread, pervasive, and costly; that they have contributed directly to the insolvency or problem status of hundreds of the nation's financial institutions and are at least partially responsible for billions of dollars in losses to federally insured lenders, private mortgage insurers, investors in mortgage-backed securities and federal mortgage guarantee funds.'

"Today's hearing and hearings planned for later this summer in Washington are a logical -- and I would argue -- a necessary follow-up to the 'criminal misconduct' and 'appraisal abuse' reports.

"The hearing is being held in Los Angeles, not because financial institution misconduct and appraisal abuse are unique to California, but rather, because California's thrift industry problems are representative of what seems to be happening across the country -- although on a scale sufficiently large and dramatic to focus needed public attention.

"Nor are insider abuse and appraisal misconduct unique to the thrift industry. Last weekend, the FDIC, which insures deposits in commercial banks, announced that it was closing its 85th bank barely five months into the year. The Chairman of the FDIC has readily acknowledged that insider abuse is as frequently to blame for commercial bank failures as economic conditions in the oil patch, trouble in the farm belt, or loan defaults by Third World countries....

"Frankly, there is serious concern in Washington that if government and the private sector fail to take speedy and dramatic action against unscrupulous operators in the vulnerable thrift industry, an undercapitalized FSLIC fund may give way to a nonexistant thrift industry itself....

"The subcommittee's investigation of your thrift industry's problems strongly suggests that misconduct by S&L insiders, by major borrowers, and by appraisers has become the leading cause of thrift insolvencies here and has reached epidemic proportions. There is evidence to show that serious insider misconduct is implicated in <u>most</u> of California's 31 thrift failures over the last three years, that appraisals were used to facilitate much of this misconduct and that fraud is responsible for a large percentage of the $3.7 billion in accompanying losses to the FSLIC. Two extremely disturbing patterns appear to exist in

California in connection with the misconduct issue:

"First, it appears that many individuals who are engaged in financial institution misconduct have been able to move from financial institution to financial institution with virtual impunity -- to the detriment of all the institutions they touch. We need to get a handle on this issue and quickly.

"Second, the common practice of institutions participating in each other's loans, wtih little or no independent underwriting, is fraught with great risk. When loands are fraudulently made or involve unsafe and unsound ventures, defaults have a rippling effect on all participating institutions...."

* * * * * * * * * * *

William J. Crawford, [California] Savings and Loan Commissioner
California Savings and Loan Department

"Approximately 24 percent of the state savings and loan associations in California have significant problems.

"...As an overview of the 29 institutions on which we tendered conservatorship or receivership to the Federal Savings and Loan Insurance Corporation for California state-licensed associations, most of them included self-dealing, dealing with affiliates, dealing with friends, either as borrowers or as joint ventures. Appraisal abuse was present in most cases, as you need an inflated appraisal to validate the amount of money loaned or invested.

"...Our system of justice works slowly in prosecuting offenders, and has failed to transmit a strong message that integrity pays. In fact, the real public message is that white collar crime has high rewards and little risk.

"...There is not in place an effective means of censuring and disciplining officers, directors and appraisers if they are not convicted of wrongdoing.

"...it is no wonder that insurance companies do not want to write directors' and officers' liability insurance, that bonding companies do not want to write bond coverage, with appraisers providing accommodating appraisals to officers who must loan money that they have paid too much for.

"...we must require professional organizations to establish norms of behavior and standards of performance for their members and to discipline or remove the incompetent and unethical members who misuse the professional designations they hold. You must modify the tort system to improve professionalism. The Society of

Residential Appraisers [ed. note--this was meant to be a reference to the Society of Real Estate Appraisers] has 203 complaints awaiting action of their Ethics Committee, a tremendous increase of 200 in number over the last three years. Money will buy you almost any appraisal you want to validate a transaction so long as the unethical can keep their professional designations and licenses. Because of our tort system, the professional appraisal societies cannot effectively police their members. Therefore, I believe we must look to establishing government qualifications and testing of their ability and review of their work product. Disciplinary or removal action must be taken against the incompetent and fraudulent-prone appraisers."

* * * * * * *

Charles A. Deardorff, Deputy Director, Agency Group
Federal Home Loan Bank Board of San Francisco

"The nature, extent, and consequences of misconduct by insiders, borrowers, and appraisers in the thrift industry in California over the past several years has been extensive, costing the shareholders, FSLIC (principally), and other creditors hundreds of millions of dollars. In a review of 35 failed or failing institutions since year end 1985, insider misconduct was noted to some extent in 27 institutions, or in 77 percent of the sample. Unfortunately, this percentage is only marginally above the national average... this misconduct is not limited to insiders, borrowers, and appraisers, but also encompasses lawyers, accountants, consultants, and other persons involved in the affairs or FSLIC-insured institutions.

"...Appraisal abuse is typified in the example where an appraiser valued 123 acres of land in California at $69.4 million, ignoring three sales of the subject property that occurred 10 days prior. The first sale of the property was for about $30 million less than the appraised value. The insured institution that purchased the property in early 1984 was placed in conservatorship within days after the purchase. After three years, FSLIC was able to sell this property for $37 million, with the probable loss to FSLIC in excess of #30 million.

"... Many institutions having a superficially healthy appearance, upon examination, reveal insider transactions, often masked by poor documentation, and inaccurate appraisals. ...Institutions engaged in the worst insider abuse often cause catastrophic failures to the FSLIC by growing extremely rapidly and investing in highly risky assets, particularly acquisition, development, and construction (ADC) loans and direct investments. Such investments have proved a far more fertile area for fraud than mortgage loans."

[Description of procedures for deterring the movement of dishonest insiders and outsiders from institution to institution.] "...While the above-mentioned procedures assist in preventing the movement of certain individuals subject to criminal or administrative sanctions from one institution to another, the procedures do not address the broader spectrum of persons in the affairs of an insured institution, such as appraisers, consultants, accountants and borrowers.

[Examples of misconduct by such individuals]

"...Another individual, an appraiser, while not an insider, is worthy of mention. This appraiser has appeared in three failed California institutions. Within a two-year period of time, the individual performed three faulty and highly optimistic appraisals, each of which facilitated an unsafe and unsound investment, which contributed to the failure of each of the three California institutions. This individual remains an active appraiser with his professional designation as MAI (Member of the American Institute), despite three referrals (two from the Agency Group) to the American Institute of Real Estate Appraisers. To date, and to our knowledge, there have been no published actions regarding these referrals.

"In order to deter the movement of dishonest insiders and outsiders from institution to institution, certain reforms are necessary, including: (1) a dramatic increase in criminal investigations, prosecutions, convictions, and jail sentences; (2) improved communication between financial regulatory agencies and other federal agencies such as the FBI and Internal Revenue Service (IRS); (3) increased penalties and de-licensing for dishonest appraisers, accountants, consultants and other professionals; (4) broadened definitions of who can be removed and prohibited from participating in the industry; (5) improved means of limiting control of an institution by more than just one or a few dominant shareholders; (6) means of insuring the appointment of independent and competent directors, and (7) ability to seek civil money penalties for violations of law and regulation, similar to the powers of other financial institution regulators.

[Explanation of activities of a Criminal Referral Task Force established to detect, monitor, and report criminal activity.]

"...The criminal referral unit will consult with experts such as accountants and appraisers so that special attention can be brought to bear on those individuals, employed by, or contracting with, the institutions, who, at times, give fraudulent transactions the appearance of legitimacy. Concurrent with our criminal referrals, we will also expend every effort to ensure timely and effective referrals to ethics committees and other professional disciplinary bodies."

* * * * * * *

William K. Black
Deputy Director, FSLIC
and soon to be
General Counsel to the
Federal Home Loan Bank of San Francisco

"...Generally, misconduct by insiders has been a significant problem with the thrifts you have asked us to review. Of the institutions we reviewed approximately three-quarters had problems with insider misconduct.

"...Appraisal abuse has also been a problem at these institutions. In the institutions on your list, at least 10 had appraisal problems. We have brought suit naming eight appraisers, and others are being investigated. Nationally, too, we are looking seriously at the appraisal problems at failed institutions, and FSLIC has brought numerous compalints against appraisers. Copies of complaints filed against appraisers, involving institutions inside and outside of California, have been supplied to the subcommitee staff. As you know, the use of inflated appraisals aids insiders in completing transactions that might otherwise be prevented. These actions by unscrupulous appraisers have been, and continue to be, a serious problem in the thrift industry.

"An example of the appraisal abuse problem arose in Butterfield Savings and Loan Association. When the net worth of that institution began to fall dramatically, the management at Butterfield devised a scheme whereby its parent holding company issued new stock and contributed the stock to Butterfield, which in turn used this newly issued stock along with some cash to purchase 40 different parcels of real property at a cost in excess of $80 million. The scheme was structured so that the higher the purchase price, the better for management, since the purpose was to increase the book net worth figure as much as possible to relieve the pressure from regulators. Many of the appraisals obtained on these properties stated grossly inflated values and did not comply with industry standards and the Board's Memorandum R-41b. For example, one of the parcels purchased for development turned out to be largely a swamp and another was mostly a forest preserve. A suit has been filed seeking in excess of $20 million from appraisers and realtors involved in this case. Additional examples of appraisal abuses were found at Sun, Bell, United, Equitable, San Marino, and Consolidated, among others.

"...In addition, the misconduct of certain borrowers has been a problem in at least nine of the institutions you listed. A prime example of borrower misconduct was discovered at Consolidated, where the former management made a loan and participated in advances in the amount of $9 million into a corporation owned by a convicted felon by the name of Charles Bazarian. These advances

were made without any loan application and financial information, and they were made with only cursory, one-page letter opinions from the appraisers as to the value of the secured property. Not one payment was made on these loans and they appear to be substantial -- if not total -- losses."

"In summary, the record reflects that the misconduct of insiders, appraisers, and borrowers has played an important part in the failure of many California thrifts. I would also note that other professionals, particularly accountants and attorneys, have played an integral role in facilitating insider abuse and fraud.

"...The professional appraisal societies are making efforts to come to greater consistency in their standards. The Bank Board has sought public comment on improving its appraisal standards. We understand that you [addressing Congressman Barnard] intend to make legislative proposals to improve further the quality of the appraisal profession...."

THE FUNCTIONS AND ORGANIZATIONAL STRUCTURE OF THE SELF-REGULATORY ORGANIZATION (SRO)

WHY DO WE NEED A SELF-REGULATORY ORGANIZATION?

Uniform and enforceable professional standards for appraisers are necessary to restore public confidence in the appraisal process and in the appraisal profession.

The Appraisal Foundation, or self-regulatory organization (SRO), is designed to maximize the input of professional appraisal organizations in the establishment of professional standards and certification requirements. The SRO gives appraisers a mechanism for establishing an industry consensus on appropriate professional standards and certification requirements; we can expect that state and/or federal regulatory agencies will move forward with regulatory requirements with or without input from the appraisal industry, so it is clearly in the appraisal profession's interest to take the initiative to establish a uniform, industry-wide self-regulatory system.

WHY IS STATE-LEVEL LEGISLATION NECESSARY?

The existence of an effective state-level certification program would provide the necessary enforcement mechanism for our self-regulatory professional standards, and can forestall establishment of federal regulations. State certification programs will have standards and ethical enforcement jurisdiction over all those appraisers engaged in valuations of "federally-covered interests." In addition to any state action, the Society will continue to discipline its own members concerning allegations of unethical conduct, or violations of standards of practice.

WHY IS FEDERAL LEGISLATION NECESSARY?

Federal legislation is necessary to ensure that appraisal services provided for certain "federal interests" are performed by competent appraisers. The legislation will require appraisers to be certified by a state in accordance with qualifications established by the Appraisal Foundation. The legislation will also provide for a federal oversight mechanism to allow affected federal agencies to ensure that the state certification programs are sufficient and adequately reflect the appraisal profession's standards and other requirements as promulgated by the Appraisal Foundation.

The Society leadership believes that a requirement for an appraiser to have state certification in order to perform appraisals on certain federal appraisal assignments will ensure

that the states will adopt consistent certification programs.

HOW IS THE SRO ORGANIZED?

The major appraisal organizations are the founding members of the SRO, which will be called the "Appraisal Foundation." The Appraisal Foundation will appoint a Board of Trustees, which will in turn appoint an Appraisal Standards Board and an Appraiser Qualification Board. Five additional independent members of the Appraisal Foundation represent related industry interests. Initial funding for the non-profit Appraisal Foundation is provided by the appraisal organization members on a pro rata basis.

The Appraisal Standards Board will promulgate and maintain the Uniform Standards of Professional Appraisal Practice. The Appraiser Qualification Board will establish criteria for the certification of qualified appraisers, and disseminate those criteria to the states and other governmental entities for adoption in uniform certification programs administered by the states.

Over the last year, the major appraisal groups organized as an Ad Hoc Committee on Uniform Standards of Professional Appraisal Practice and developed consensus standards. Subsequently, the Select Committee on Implementation began work on developing recommendations for the structure of the SRO. The work of these industry coalitions will be transferred to the Appraisal Foundation.

HOW WOULD THE FEDERAL OVERSIGHT WORK?

Congressman Barnard has proposed oversight by a Federal Interagency Appraisal Council, which would interact with the Foundation and review the enforcement of state certification programs. The Council would take action only if the Foundation and the states failed to exercise these responsibilities adequately.

States would have a specified period of time (probably two years) to decide whether or not to establish state regulatory systems. Appraisers with offices in states without regulatory apparatus would be prohibited eventually from performing appraisals where there is a "covered federal interest." Given the extent of federal government involvement in the mortgage finance market, this requirement would provide a strong incentive for state-level legislative action.

KEY QUESTIONS ABOUT SELF-REGULATION OF APPRAISERS

Q. How many appraisers would be subject to certification under the self-regulatory plan?

A. Given the significant federal interests involved, it is anticipated that a large proportion of appraisers would have to be certified. Those who provide appraisal services to federally insured institutions and the secondary mortgage markets, among others, would be directly affected by the proposed federal legislation. Some states may require all appraisers practicing within their boundaries to be certified.

Q. Will the Appraisal Foundation issue certifications?

A. No. The Qualification Board of the Foundation will develop model criteria for certification to be adopted by the states and other government entitites. State Boards of Appraiser Qualification will issue the certifications.

Q. What if a state fails to act?

A. In that case some mechanism will have to be established -- possibly at the national level -- to certify appraisers for federally covered work.

Q. How long before appraisers will be required to be state certified?

A. Under the federal legislation expected to be introduced by Congressman Barnard, certification requirements would not go into effect until at least two years after passage of the legislation.

Q. Will there be a need for a Society designation after state certification is in place?

A. Yes. Your Society designation is expected to continue to be valuable because it will enable clients to identify Society members as the best qualififed professionals in the field of available certified appraisers.

Q. Will designated members of the Society be exempt from state certification requirements?

A. Not directly. It is expected that all appraisers who choose

to work where there is a covered federal interest will be required to meet the requirements for state certification. It should be noted that the Society's educational program and other requirements are expected to adequately prepare our members to meet state certification requirements.

Q. Just what are the certification requirements? Will I be required to take a test, or can I qualify based on education and/or experience?

A. The requirements will be developed by the Appraisal Foundation, and will be administered at the state level. A test will probably be required for state certification. The Foundation may develop specific education and experience requirements in addition to testing.

Q. Does our legal system favor a state certification program?

A. In many ways, yes. The states, through their governmental powers, are equipped to deal with certification and revocation of certification procedures. Private societies such as ours do not have governmental enforcement powers and have been unable, in the eyes of many, to adequately enforce our standards through disciplinary actions against our members.

ORGANIZING FOR STATE LEGISLATIVE ACTION

THE NEED FOR STATE-LEVEL ACTION

The self-regulation plan calls for establishment of Boards of Appraiser Qualification in each state. It is clearly in the interest of the appraisal profession to have substantial input in the process of defining the functions and authority of these state agencies. Make no mistake about it: if appraisers fail to represent their interests effectively in the state legislatures, other interests in the real estate industry will take advantage of the opportunity to encroach upon the interests of appraisers.

THE NEED FOR A UNIFIED POSITION

To be effective in a state-level lobbying effort, it is imperative that we develop and espouse a single, unified Society position within each state. The Chapters in each state must organize early this Fall and agree on a consensus position, and then develop a statement or handout that summarizes the Society's position, which can be used to "talk through the issues" and be left with legislators and their aides.

Useful in this regard is the Society's Model Certification Legislation, available from the Washington Office.

DEVELOPING A PUBLIC EDUCATION PLAN

Once the state-level Society position has been developed and Chapter legislative representatives are comfortable with their understanding of the issues, it will be time to move out and lobby -- that is, to educate legislators about the issue and the Society's position. Again it will be necessary to coordinate Chapter activities within each state, so that contacts with Members of Congress and state legislators are coordinated. You will also want to encourage members of other appraisal organizations to become involved. It is in everyone's interest for the appraisal profession to present a unified front; strive to project the image that "appraisers have their act together." The plan of attack should include face-to-face visits with legislators in local offices, as well as meetings with staff personnel who work in the legislators' local offices. You might consider inviting legislators to address your Chapter at a special luncheon or other event. Strive to establish a rapport with the legislator and his/her staff, so that they will perceive the Society as a source of reliable information about the appraisal regulation issue. Do not demand -- educate.

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QUALIFICATIONS OF
JARED SHLAES
SENIOR PRINCIPAL - REAL ESTATE ADVISORY SERVICES

Senior Principal, Pannell Kerr Forster, former owner and president, Shlaes & Co., real estate counselors and appraisers.

Member, past governor and 1978 first vice president, American Society of Real Estate Counselors (designation CRE). Chairman of education committee 1973-74, chairman of program committee 1976. Past editor, The Counselor; editor-in-chief, Real Estate Issues, 1977-1986.

Member, American Institute of Real Estate Appraisers (designation MAI); currently certified under the AIREA voluntary continuing education program; past director, Illinois Chapter.

Member and past director, Chicago Board of Realtors; past chairman, program committee, low-income and housing committee and education committee. Member, Illinois Association of Realtors and National Association of Realtors. Member, Omega Tau Rho. Member, Urban Land Institute, American Planning Association, and Realty Club of Chicago.

Member, Lambda Alpha. Cited "for his distinguished achievements and honors in various fields of real estate and for developing numerous middle-income projects which have received citations from national and regional associations."

Developer and co-developer of numerous award-winning townhouse and apartment complexes, ranging from luxury cluster homes to low- and moderate-income apartments in inner-city locations.

Nationally recognized authority on real estate counseling and appraising. Author of numerous articles on real estate and related subjects. Speaker, panelist, instructor and guest lecturer to numerous professional organizations, civic groups and universities.

Co-author of "Development Rights Transfers: A Solution to Chicago's Landmarks Dilemma." Louise and Y.T. Lum Award of the American Institute of Real Estate Appraisers for articles in the field of development rights transfers. Robert H. Armstrong Award of the American Institute of Real Estate Appraisers for his article "The Market In Market Value," cited as most significant contribution to the Appraisal Journal in 1984.

Former member, Board of Advisors, National Trust for Historic Preservation. Past director, Landmarks Preservation Council and Service; past advisor, Chicago Architecture Foundation.

Extensive experience in the management, leasing, sale, financing, development and appraisal of all types of real estate. Extensive experience in real estate counseling and economic studies throughout the United States.

BA (with honors) 1948; MBA 1950 - University of Chicago.

JARED SHLAES, MAI, CRE

Chicago-based real estate counselor with 42 years of local and national experience in real estate operation, brokerage, planning, development, appraising and counseling. President, Shlaes & Co. (1974-87, 1992-); former Chairman, Shlaes & Young Information Systems (1984-87). Former Principal and Director of Special Real Estate Services, Pannell Kerr Forster (1987) and Arthur Andersen & Co. (1988-92). Former Senior Vice President, Arthur Rubloff & Co. (1971-74); former Partner, George S. Lurie Co. (1957-67). Past First Vice President and Governor, American Society of Real Estate Counselors. Past Director of the Chicago Chapter of the Appraisal Institute, the Chicago Association of Realtors, The Cliff Dwellers, and the Landmarks Preservation Council of Illinois.

Counselor on valuation, marketing, zoning, planning, redevelopment, and tax policy to government bodies, civic and trade organizations, property owners, lenders, investors and tenants. Longtime economic, planning and real estate advisor to the Main Street Project of the National Trust for Historic Preservation, the State of Illinois Medical Center Commission and the Chicago Development Council. Member of the Advisory Boards of the Advanced Studies Institute of the Homer Hoyt Institute and of BOMA Chicago; former member of the Advisory Boards of IREM and the National Trust for Historic Preservation.

Developer of numerous award-winning Chicago townhouse and apartment projects. Appraiser of office, commercial, industrial and residential properties throughout the United States. Author or coordinator of numerous studies and articles on real estate valuation, zoning, planning, development, finance, renovation, landmark preservation, tax policy and related issues. Founding editor of Real Estate Issues, the journal of the American Society of Real Estate Counselors. Author, *Real Estate Counseling in a Plain Brown Wrapper* and numerous other publications. Frequent lecturer and speaker. MBA and BA with general honors, The University of Chicago..

Honors and awards:
James D. Landauer Award of the American Society of Real Estate Counselors for contributions to the industry and the counseling profession.

Louise Lee and Y. T. Lum Award of the Appraisal Institute for furthering the ideals of the real estate appraisal profession; Louise Lee and Y. T. Lum Award of the American Society of Real Estate Counselors for contributions to the counseling profession.

Robert H. Armstrong Award of the Appraisal Institute for the year's most outstanding article (1984) in the Appraisal Journal.

Silver Pen Award of the American Society of Real Estate Counselors for a decade of service as founding Editor-in-Chief of Real Estate Issues, the Society's journal.

Numerous awards from the American Institute of Architects, the City of Chicago, the Chicago Association of Commerce and Industry, and the United States Department of Housing and Urban Development for inner-city townhouse and apartment developments.

AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS
of the NATIONAL ASSOCIATION OF REALTORS®

RICHARD B. GASKINS
Executive Vice President

January 15, 1988

TO: ALL MEMBERS AND CANDIDATES OF THE AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS

FROM: RICHARD B. GASKINS

SUBJECT: REGULATION OF APPRAISERS

A great deal of concern has been expressed by our members (justified, I might add) about federal or state regulation of the appraisal profession. I receive an inordinate amount of calls asking what the Appraisal Institute's position is and whether we are monitoring the activity in this area. With topics as complex as this one, rumors frequently arise, and that's why I am writing to you.

The issue of the regulation of the appraisal profession is of deep concern to the Appraisal Institute and one with which it has been involved for quite some time. In November, 1985, the Governing Council passed a resolution confirming the Institute's support of legislation that would lead to or support a national program for the appraisal profession, similar to the Certified Public Accountant program for the accounting profession. In December of that same year, Congressman Doug Barnard, as Chairman of the Commerce, Consumer and Monetary Affairs Subcommittee, conducted hearings to examine the impact of faulty and fraudulent real estate appraisals on federally insured financial institutions and related agencies of the federal government.

The Appraisal Institute participated in those hearings. As part of its testimony, the Appraisal Institute recognized certain problems in the appraisal industry. Those problems include: (1) the large number of individuals acting as appraisers who have not participated in a broad qualification program that requires appraisal education, appraisal experience, and a clear understanding of ethical standards; (2) the majority of appraisers not being members of a professional appraisal organization that requires them to adhere to well defined standards for the development and communication of an appraisal; (3) the many users of appraisal services not having a basis for evaluating an appraiser's qualifications and work product; and (4) the considerable amount of press being generated about fraudulent appraisals and their effect on the faltering thrift industry.

The Appraisal Institute was faced with the fact that these problems were creating a ground swell of indignation and a backlash against the appraisal profession at both the federal and state levels. To

counter this negative reaction and to preclude a knee-jerk reaction from the federal or state governments, the Appraisal Institute proposed a self-regulatory structure for the appraisal profession modeled after the system used by the accounting profession. Essential components of the regulatory program are the establishment of a private, broad-based, national Appraisal Foundation and the passage of appropriate state legislation for the voluntary certification of qualified appraisers.

The Appraisal Foundation is now a reality, having been incorporated on November 30, 1987. (For clarity, I have attached Exhibit A, a chart which illustrates the Foundation.) The Trustees of the Foundation will appoint and fund an independent Appraisal Standards Board and an Appraiser Qualification Board. The Appraisal Standards Board will be responsible for promulgating appraisal industry standards and the Appraiser Qualification Board will develop minimum requirements for a voluntary state certification program. At a recent meeting, the Trustees elected officers of the Appraisal Foundation. They are: William Mount, President (Member, American Society of Farm Managers and Rural Appraisers); David W. Craig, Vice President (Member, American Institute of Real Estate Appraisers); James W. Klopfenstein, Secretary (Member, Society of Real Estate Appraisers); and Jeffrey D. Fisher, Treasurer (Member, American Real Estate and Urban Economics Association).

State certification legislation will enable a state to administer a certification and recertification system for qualified appraisers and to enforce appraisal standards adopted by the Standards Board of the Appraisal Foundation. To accomplish this, the Appraisal Institute, the Society of Real Estate Appraisers, and the American Society of Farm Managers and Rural Appraisers are promoting model certification legislation.

Under the model bill, the certification of appraisers is voluntary; persons not certified are not prohibited from stating that they are appraisers, or from accepting appraisal assignments. The Appraisal Institute believes that a voluntary certification program is far superior to mandatory licensing. Mandatory licensing would, by its very nature, require grandfathering, and the level of competency might not be sufficient to address the concerns that are causing the federal government to consider regulating the profession. A voluntary certification program enables those who have the qualifications to perform appraisal work that requires a higher level of knowledge, experience, and ethical conduct to demonstrate these qualifications. Voluntary certification also provides members of the public who use appraisers some assurance of professional competence.

The model legislation does not allow for grandfathering. Everyone must satisfy the requirements for certification, which include education, testing, and appraisal experience. The model legislation is predicated on the existence of the Appraisal Foundation and requires the standards developed by the Appraisal Standards Board and the minimum certification requirements established by the Appraiser Qualification Board. Certification thereby would be industry driven and not built around government bureaucracy.

As you may know, Congressman Doug Barnard has introduced a bill cited as "The Real Estate Appraisal Reform Act of 1987." The bill creates a new federal agency referred to as the Federal Interagency Appraisal Council. The proposed legislation vests authority for the establishment of appraisal standards and appraiser qualifications in the Council, with no assurance that it is qualified to properly discharge this duty. Furthermore, the influence of the appraisal profession on this program would be minimal. Rather than regulating appraisers through federal legislation, the Appraisal Institute firmly believes that the states are the appropriate partners of the appraisal profession for the adoption and enforcement of a program to identify qualified appraisers.

The decision to be pro-active with respect to the passage of state certification legislation resulted in the formation of a special committee known as the Legislation and State Certification Committee. Each committee member is a Regional Coordinator and has been assigned responsibility for monitoring activity in two or more states. In addition, a Coordinator has been appointed in each state. He or she will be responsible for organizing and monitoring activities in that particular state under the guidance of the Regional Coordinator.

The Institute held a legislative training session for the coordinators and staff support this month in Chicago. (Exhibit B lists the Regional and State Coordinators.) The purpose of this network is to provide an organized, efficient system to implement the Appraisal Institute's policy of promoting voluntary state certification legislation. The network also will provide an effective communication system to keep the Institute well informed about activities in each state.

The general consensus and position of the Institute is that the regulation of the profession ultimately will benefit everyone. The appraiser will benefit from the increased professionalism of the appraisal industry, the users of appraisal services will benefit from some assurance of professional competence, and the general public will benefit from the increased stability of lending institutions.

I will do my best to keep you apprised of this regulatory activity either through The Appraiser or letters such as these.

RBG:VAD

Rick

CC: Chapter Executive Secretaries

Encl.

The Appraiser

News, Views, and Developments
Published by the Appraisal Institute

Vol. 44 No. 1 January 1988

Asbestos Removal May Be Market's Choice, If Not EPA's

Silence from the Environmental Protection Agency on asbestos treatment for commercial buildings has left property owners in a dilemma. They must decide without federal guidance whether to undertake the expense of asbestos removal or to choose cheaper, less drastic abatement procedures. Increasing market demands for asbestos-free buildings may be making the decision for them in favor of removal.

Not one of the ten largest property owners, tenants or mortgage lenders would unreservedly buy, lease or lend on buildings with asbestos, according to a survey by Grubb & Ellis, the San Francisco-based real estate firm. Four of the top ten in each group would not buy, lend or lease on such buildings, and the others would do so only on a conditional basis.

Asbestos allowances have been built into sales prices of major properties, and discounts from five to twelve percent for buildings containing asbestos have figured in recent transactions, reports *Roulac's Strategic Real Estate.* "The prestigious buildings (with asbestos) sell no matter what, although at a discount, but asbestos kills the value of nonprestigious buildings," said John Allen, Grubb & Ellis Senior Vice President in Orange County, Calif.

Twenty percent of all commercial buildings in the U.S. were estimated to contain friable (crumbling) asbestos in a 1984 survey by the EPA. Evidence that linked airborne asbestos particles to cancer caused the EPA to ban the use of asbestos products in buildings in 1979. Building owners have since had several options in dealing with asbestos: inspection and monitoring, encapsulation or enclosure, or removal.

Removal is easily the most expensive option. Allen said that when lost rents, moving costs and other expenses are added to the base cost of removal, the bill can amount to $35 to $50 per square foot. In less prestigious buildings, the cost may run as high as 40 percent of the overall value of the building. Yet property owners are finding that they risk higher vacancy rates, decreased cash flow, lawsuits, and declining property value if they delay removal, which is likely to cost more the longer it is left in place. Market pressures are also forcing asbestos abatement companies to favor removal. Many firms will no longer perform lesser measures

Continued on p. 7

FNMA Rewrites Its Appraisal Underwriting Guidelines

Fannie Mae wants to make itself perfectly clear to appraisers and lenders. With the intention of clarifying and modifying its *Selling Guide,* the Federal National Mortgage Association has almost entirely rewritten its loan eligibility underwriting standards which pertain to property and appraisal analysis and special considerations. The effective date for the revisions is January 4, 1988.

The revisions are more clarifications of the extant FNMA guidelines than substantive changes. "The reason for the changes was to provide consistent interpretation of our policies," said Mark T. Simpson, Manager of Appraisal Standards at Fannie Mae. "The main idea was to take areas that we received inquiries on and try to clean them up."

For the convenience of lenders' underwriters and appraisers, Fannie Mae plans to reproduce the revised appraisal section in a new booklet form. The new guide will be available in February.

Some of the most significant changes in the new version of the appraisal section of the *Selling Guide* include:

- *Required exhibits to support each appraisal report.* A new requirement obliges appraisers to file a Certification and Statement of Limiting Conditions (Form 1004B) when one is not already on file with the lender. If changes are made to this certification, the appraiser must reference the change in the "reconciliation" section of the appraisal report in order for the mortgage to be eligible for consideration. Floor plan sketches are no longer required unless the floor plan is functionally obsolete.
- *Role of the review appraiser.* The section on appraiser qualifications recommends that lenders review the qualifications of both the appraiser and the review appraiser, and not solely rely on those of the latter. The appraiser is considered the individual who personally

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FNMA *Continued from p. 1*

inspected the subject property, inspected the exterior of the comparables, performed the analysis, and prepared, certified, and signed the report. Although review appraisers are not required to sign appraisal reports, when they do so they are indicating their concurrence with the contents. The review appraiser must indicate on the appraisal report form whether he or she personally inspected the subject property.

- *Professional affiliation of the appraiser.* The revised section recognizes the potential usefulness of professional designations, but cautions lenders to be familiar with the appraisal organization's specific requirements to assure that the designation is evaluated appropriately.
- *Lender supplied information.* The lender is obliged to inform the appraiser of all financing data and sales concessions for the property that will be or have been granted by anyone associated with the transaction. This usually can be accomplished by providing the appraiser with a copy of the complete, ratified sales contract for the property that is to be appraised.
- *Residential mortgages only.* The revisions make it clear that it is not Fannie Mae's function to purchase agricultural-type properties, undeveloped land, or land development-type properties. To be eligible for purchase by Fannie Mae, a mortgage must be secured by a property that is residential in nature, based on the description of the subject property, zoning, and the present land use.

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Editor: Grace Hayek

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Advertisements: Jobmart, DataSearch, and Firm for Sale are published to aid persons and firms in finding and filling positions and in exchanging information related to real estate appraisal. Listings are published without charge and must be submitted in writing, with a maximum of 50 words. Persons wishing to use a "blind ad" must furnish their own box number and address. Listings will be printed in one issue only unless otherwise requested. AIREA assumes no responsibility for the reliability of listings other than publishing them. Submission should be made by the 5th of the month prior to publication date. Send listings to: Editor; The Appraiser; 430 N. Michigan Ave.; Chicago, IL 60611-4088.

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- *Price range and predominant price.* Appraisers must indicate the price range and predominant price of properties in the subject neighborhood. The predominant price may be stated as a single figure or as a range, whichever is more appropriate. The revisions expand on the ratings system for various aspects of a given neighborhood.
- *Specific zoning classification.* According to the new guidelines, the appraiser is responsible for reporting the specific zoning classification for the subject property. A general statement describing what the zoning permits must be included, along with a specific statement if the improvements do not represent a legal and conforming use of the land. Fannie Mae will not purchase a mortgage on a property if the improvements do not constitute a legally permissible use of the land.
- *Remaining economic life.* A more realistic definition of the remaining economic life of a property was determined to be "the estimated period over which the improvements will continue to contribute to the value of the property, or the estimated period in which the improvements increase the value of the property above that for the vacant site." The remaining physical life of a property is considered the estimated period over which the improvements will physically last if they receive normal maintenance.
- *Sales comparison approach.* Much attention was paid to detailing what constitutes an acceptable comparable. A minimum of three comparable sales must be used in a report, generally sales that have been settled or closed within the last 12 months. The most comparable sales available for the subject property must be adjusted to reflect the market's reaction to the differences (except for sales and financing concessions) between the comparable sales and the subject property, without regard for the percentage or amount of the dollar adjustments. In most cases, the dollar amount of the net adustments for each comparable sale should not exceed 15 percent of the comparable's sales price. If the appraiser's adjustments do not fall within FNMA's net and gross percentage adjustment guidelines, the appraiser simply has to provide an appropriate explanation.
- *Sales or financing concessions.* Appraisers must provide the sales and financing concession information that was available (and verified) for the comparables. If such information is unavailable because of legal restrictions or other disclosure-related problems, the appraiser must explain why the information is not available. Fannie Mae will not accept explanations

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Correction

In the November 1987 issue of *The Appraiser*, the National Association of Independent Fee Appraisers was misidentified. In the same issue, NAIFA was unintentionally deleted from a list of Appraisal Foundation members. We sincerely regret these oversights.

THE INSIDE INSTITUTE

Barnard Bill on Appraisal Introduced to Congress

On November 20, Congressman Doug Barnard introduced a bill entitled the "Real Estate Appraisal Reform Act of 1987." The bill would create a new federal agency, to be known as the Federal Interagency Appraisal Council, which would establish appraisal standards and criteria for the certification of appraisers. The proposed Council would be authorized to monitor and oversee the activities of approved state appraiser certifying agencies. The bill would attempt to work through certification agencies in each state. However, it provides that the Council can certify appraisers in states that do not have an approved certification agency.

Terrell Oetzel, MAI, President of the Appraisal Institute, pointed out that positive aspects of the bill include recognition of certification of appraisers at the state level, that regulatory agencies may require the use of state certified appraisers, that the appraisal work of state certified appraisers must comply with standards, and state enforcement for the violation of standards.

Although there are several positive aspects to the bill, Oetzel said the Appraisal Institute is particularly concerned with that portion of the bill that vests final authority for the establishment of appraisal standards and appraiser qualifications in a federal agency. The input of the appraisal profession in the establishment of appraisal standards is minimal, according to Oetzel. He said that the Appraisal Institute would like to see Congressman Barnard's bill complement the industry's self-regulatory plan by recognizing the Appraisal Foundation, the Appraisal Standards Board and its responsibility for promulgating appraisal industry standards, the Appraiser Qualification Board, and the establishment by all states of programs for the voluntary certification of appraisers.

The appraisal industry is moving ahead with a plan that would make Congressman Barnard's legislation unnecessary, according to Oetzel. The Appraisal Foundation was incorporated November 30, 1987, and its first meeting was held on December 7. The Foundation will establish an Appraisal Standards Board to issue uniform appraisal standards. The structure of the Appraisal Standards Board will be modeled after the Financial Accounting Standards Board. The Foundation will also establish an Appraiser Qualification Board to develop criteria (education, experience, and examinations) for states to use in a voluntary certification program for appraisers.

On the state legislative front, the Appraisal Institute

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Institute's Peer Review Process Now Up to Speed

The National Professional Standards Committee reported to the Governing Council at its November meeting that there has been a large jump in the number of files reviewed and the number of educational and disciplinary measures taken this year. Statistics compiled as of October 14, 1987, show that the peer review program's figures exceed those of the previous year in almost every category.

Educational counseling by the Review and Counseling Division had the highest volume of activity. Of the total number of files processed by Review and Counseling, 259 resulted in remedial counseling, compared with 107 last year. There was also a substantial increase in the activity of the Ethics Administration Division. Twenty-five formal hearings have been held this year. This total exceeds by four the aggregate number of formal hearings held in the past five years. The six published disciplinary actions taken this year were greater than the number of published disciplinary actions in any single year since 1968.

The primary purpose of the peer review process is to encourage members and candidates to improve the quality of their work through educational counseling and to conduct disciplinary proceedings against members and candidates who are alleged to have violated the Code of Professional Ethics. Educational counseling is required when a member or candidate fails to observe the Standards of Professional Practice. Disciplinary action is required when it is determined that a member or candidate has violated the Code of Professional Ethics.

A new peer review system was established in 1982. This new system transferred primary responsibility for the peer review process from Chapter Ethics and Chapter Appraisal Review committees to a system of regional administration. At the national level, a National Professional Standards Committee was established with several Divisions and a Director of Screening to route referrals to the proper Division.

In the first few years after adoption of the new peer review program, much time was devoted to setting up the necessary administrative procedures and recruiting and training the Regional Panels that supply the manpower for Grievance Committees, Hearing Committees, and Review and Counseling Committees. A new screening system and new administrative procedures had to be developed, thousands of cases from the old Chapter Ethics and Chapter Appraisal Review system had to be assimilated, and training materials had to be developed.

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In Memoriam

The officers of the Appraisal Institute announce with sincere regret the deaths of these Members.

Paul W. Adams, MAI (355)
San Antonio, Tex.

William S. Becker, MAI (2223)
Wilmette, Ill.

I. R. Blandford, MAI (234)
Grand Rapids, Mich.

Stanley J. Boden, MAI (3055)
Ormond Beach, Fla.

Marguerite Brouilette, RM (823)
Houston, Tex.

Walter Buck, MAI (1030)
Pompano Beach, Fla.

Edward J. Eppstein, MAI (2718)
Toledo, Ohio

William A. Fowler, MAI (4919)
Ocala, Fla.

Wallace D. Gibbs, Jr., MAI (3117)
Charlotte, N. C.

R. Morey Hart, MAI (2108)
Pensacola, Fla.

Francis J. Klein, MAI (4688)
Arcadia, Calif.

Paul G. Kloster, MAI (4931)
Tustin, Calif.

Carl E. Koch, MAI (612)
Carnegie, Pa.

James J. O'Connell, MAI (3022)
Lincroft, N.J.

Frederick A. Osmers, MAI (1341)
Hartford, Conn.

Robert W. Plank, MAI (1660)
Philadelphia, Pa.

V. P. Ringer, MAI (2465)
Houston, Tex.

Alvin C. Smith, MAI (820)
Milford, Conn.

Ben Solari, MAI (3718)
Zephyr Cove, Nev.

Rolla E. Stephens, MAI (264)
Joplin, Mo.

Howard J. Stulgin, MAI (5277)
Downers Grove, Ill.

Clay H. Thomas, MAI (1460)
Omaha, Nebr.

James D. Wigley, MAI (4317)
Macon, Ga.

Asbestos *Continued from p. 1*

because of potential liability and trouble in obtaining insurance coverage.

"Encapsulating asbestos costs a third to half as much as removal, but it is only temporary and delays the inevitable," said Randy McCann, president of SOS International, a large hazardous substance abatement firm. "It not only drives up the cost of removal, but it increases our liability."

Property owners may find asbestos decisions made for them when the EPA finally releases its report on asbestos in commercial buildings. Some analysts anticipate a strong governmental stance, perhaps even recommending removal, and some believe that removal will be required within several years. At press time, a spokesman for the EPA indicated that the study is to be released in late January.

FNMA *Continued from p. 3*

to verify the information. Positive adjustments for sales or financing concessions are not acceptable.

- *Environmental hazards.* If the appraiser is aware of any hazardous conditions (whether on the subject or within the immediate vicinity) that affects the value of the subject property, he or she must comment on the hazard's influence on the property's value and marketability and make appropriate adjustments in the overall analysis of the property's value. Examples of hazardous conditions include the presence of hazardous wastes, toxic substances, asbestos-containing materials, urea-formaldehyde insulation, and radon air pollution. "If you have knowledge of it, you can't ignore it," said Simpson.

1988 Regional Conference Schedule

Printed below is the schedule of the Appraisal Institute's 1988 Regional Conferences. Members are strongly encouraged to attend the conferences in their regions to meet fellow appraisers, take advantage of the many educational sessions, and participate in shaping the future of the Institute.

NORTH CENTRAL REGION
March 23-26, Milwaukee, Wis. Chairman: Ohland W. Liessmann, MAI, Milwaukee, Wis.

NORTHEAST REGION
June 1-4, Ottawa, Canada. Chairman: Henry P. Wright, MAI, Ottawa, Canada.

CENTRAL ATLANTIC REGION
June 6-8, Hershey Convention Lodge, Hershey, Pa. Chairman: Charles G. Orberg, MAI, York, Pa.

SOUTHEAST REGION
July 6-10, Sandestin Beach Hilton, Destin, Fla. Chairman: Lonnie Tidwell, MAI, Birmingham, Ala.

SOUTH CENTRAL REGION
July 27-29, Keystone Resort, Keystone, Colo. Chairman: Richard C. Mosier, MAI, Denver, Colo.

NORTHWEST REGION
July 27-30, Embarcadero Resort Hotel & Marina, Newport, Oreg. Chairmen: Mark D. Barry, MAI, and David E. Pietka, MAI, Portland, Oreg.

GREAT LAKES REGION
August 17-21, Lincoln Hotel & University Conference Center, Indianapolis, Ind. Chairman: Donald H. Treadwell, Jr., MAI, Southgate, Mich.

SOUTHWEST REGION
October 5-9, Scottsdale Hilton, Scottsdale, Ariz. Chairman: Terry Smith, MAI, Scottsdale, Ariz.

1987 Appraisal Journal Manuscript Competition

James E. Gibbons, MAI, editor-in-chief and chairman of the Editorial Board of *The Appraisal Journal,* reminds aspiring authors that the 1987 Manuscript Competition deadline has been extended to February 1, 1988. The competition seeks articles based on the solution to an actual appraisal assignment.

- All entries will be considered for publication.
- Winning article will appear in *The Appraisal Journal.*
- Winning author will receive $500 in prize money and a commemorative plaque.
- Final deadline for submitting articles is February 1, 1988.

Authors should follow the format outlined in the Manuscript Guide printed in *The Appraisal Journal* and indicate in a covering letter that the manuscript is to be considered for the competition.

Member HAPPENINGS

Tom M. Ferstl, MAI, of Little Rock, Ark., was instrumental in the writing and passage of legislation which allows Arkansas appraisers to place a lien on real estate for unpaid appraisal fees. The law, known as Act 1035, is the first lien law in the U.S. that specifically recognizes the right of an appraiser to place a lien against real property.

Eugene C. Burleson, MAI, of Stockton, Calif., has been appointed chief of the Division of Right of Way for the California Department of Transportation. A 30 year veteran with the department, he will head 810 Right of Way agents, engineers and support staff.

R. A. Stuart Miller, MAI, of Ho-Ho-Kus, N.J., has been elected Chairman of the Board of Directors of Elysian Federal Savings Bank in Hoboken, N.J.

Gonzalo Ferrer, MAI, of Santurce, P.R., was recently named to the Cornell University Council. The Council assists the university in planning and development. He also spoke on recent developments in capitalization techniques at the IV Venezuelan Appraisal Congress, held in November.

David S. Mason, MAI, of Glendale, Calif., was the 1987 recipient of the Appraisal Institute's Southwest Regional Meritorious Service Award. He owns the firm of Mason & Mason and has long been active at the chapter, regional, and national levels.

J. Christopher Curth, MAI, of Atlanta, Ga., has been elected a Managing Director of the Atlanta office of Landauer Associates, Inc.

Alan L. Fenton, MAI, of London, England, was promoted to Director of Estates of Reed International PLC in London.

Author Sought for Book on Real Estate Market Analysis

The Appraisal Institute is interested in publishing a book on real estate market analysis. Topics to be covered include: how to define markets and their activity; forecasting demand; location, site, and property analysis; analysis of residential, office, and retail markets; and research techniques. Since the book will be primarily used by those actively involved in appraisal and by AIREA courses, it is necessary that the manuscript be replete with examples and practical information. Interested authors should direct proposals and queries to: Director of Publications; AIREA; 430 N. Michigan Ave.; Chicago, IL 60611-4088.

Appraisal Bill *Continued from p. 5*

and the Society of Real Estate Appraisers are formulating model certification legislation that will be jointly sponsored. The two groups have established a legislative network in each state to secure enactment of the model bill in all state legislatures.

1988 Directory of Members Now Available

The 1988 *Directory of Members* is now available from the Appraisal Institute. The *Directory* lists the business addresses of all active members of the Appraisal Institute in a convenient, pocket-sized format. Members and candidates will automatically be sent copies in the mail. Copies of the *Directory* are also available free of charge to any interested party. To receive a copy of this year's *Directory*, fill out the form below and send it to: Public Relations Dept.; AIREA, 430 N. Michigan Ave.; Chicago, IL 60611-4088.

1988 DIRECTORY OF MEMBERS

Please send me a copy of the latest Appraisal Institute *Directory*.

Name _____

Firm _____

Address _____

City _____ State _____ Zip _____

FIRM FOR SALE: Commercial and residential appraisal business one block from court house in Jacksonville, Fla. Twenty-five years of files, well equipped, top reputation. Owner will leave or stay. Negotiable. Two-story bldg. optional. Contact: Appraiser; 131 E. Bay St.; Jacksonville, FL 32202. (904) 355-7531.

FIRM FOR SALE: Asheville, N.C.: buyer wanted for appraisal business that is mostly from comm./indust. clients in western N.C. MAI with 27 years in Asheville is moving to farm. Growing resort community. Contact: Alan Butterworth; 603 Northwestern Plaza; Asheville, NC 28804. (704) 254-9697.

SOCIETY OF REAL ESTATE APPRAISERS NEWSLETTER

BRIEFS

March 2, 1988

Office Rents Down Slightly

The average rental rate for office buildings in the U.S. dropped slightly in 1987, according a survey of 34 major markets by The Office Network. It was $19.83 in 1987, compared to $19.95 in 1986 (see graph).

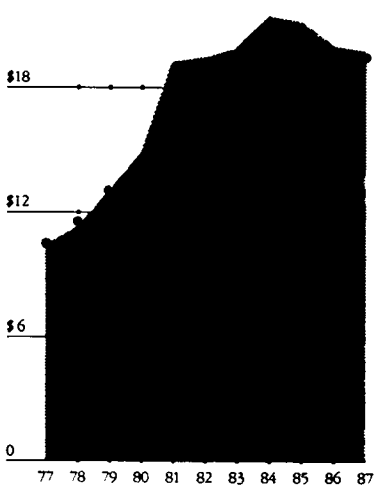
Midtown Manhattan averaged the highest rate, at $40.00 per square foot, and Denver and Houston the lowest, at $12.00. Despite the high rents, New York City has the lowest vacancy rate (9.3%).

In contrast to even New York's high rental rate is that of London, England, which has an average

(Continued on page 2)

U.S. AVERAGE RENTAL RATE 1977–1987

Annual rate – $ per square foot in existing buildings



● CPI Applied to 1977 Rental Rate

Source: The Office Network®, Houston

Sears Emphasizes Foundation, Uniform Standards in Congressional Testimony

Complimenting the efforts of Rep. Doug Barnard and others in investigating and helping to solve problems confronting the appraisal profession, Society president R. Howard Sears, SREA, proposed an amendment to The Real Estate Appraisal Reform Act of 1987 (H.R. 3675). Sears' amendment would strengthen the role of the Appraisal Foundation in the legislation at the same time phasing out the Federal Interagency Council's direct authority over appraisal standards. He presented these proposals during testimony before the House Commerce, Consumer and Monetary Affairs Subcommittee on February 17.

Sears proposed that the Appraisal Foundation be recognized as the undisputed voice of the appraisal profession and be provided the authority to act as the sole source of appraisal standards and appraiser qualification criteria. He also proposed that the Foundation "be accorded additional weight in the regulatory scheme . . . to ensure that the standards of the profession are prescribed to and adhered to by the various Federal agencies involved."

Rep. Barnard and other Congressional committee members expressed interest in and support for Sears' amendment. Barnard said that he looks forward to working with the Society in producing a bill suitable to the needs of the appraisal profession and the federal government. He also said that he does not want to create a massive federal bureaucracy to regulate appraisers.

Sears stressed reliance on the Uniform Standards of Professional Appraisal Practice: "They represent the consensus of the organized industry and go far in satisfying the concerns raised by members of this Subcommittee in the 1985-86 hearings. We urge their endorsement as the fundamental criteria for agencies and states to follow. An additional set of standards promulgated independently by the proposed [Federal Interagency] Council would result in added confusion in the marketplace."

In further testimony, Sears recommended that the bill include "all agencies which have significant responsibility over appraisal issues."

"Agencies involved in mortgage-related activities are covered in the bill, yet agencies involved in land acquisition, exchanges, condemnation, and others are not covered by this legislation," Sears testified.

He also urged a "stronger Fed-

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At a Glance

Reorganization underway for Asset Disposition Agency — *p. 3*

Society launches '88 advertising campaign — *p. 4*

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Jobsearch — *p. 9*

Asset Disposition Agency Undergoes Reorganization

In an effort to assuage Congressional concern about its operations, the Federal Asset Disposition Association (FADA) is being reorganized under its parent organizations, the Federal Savings & Loan Insurance Corporation (FSLIC) and the Federal Home Loan Bank Board. It was the Bank Board that chartered FADA a year and a half ago to facilitate the disposition of assets acquired by the FSLIC.

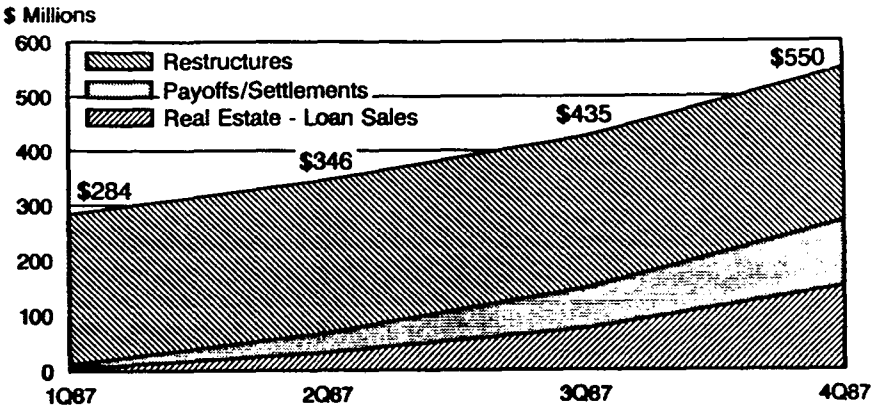
FADA has more than $4 billion worth of assets but has generated only $600 million for the FSLIC, reports *Business Week* (February 15). The agency suffered a $10 million loss, according to the same source. FADA claims developers often expected to acquire distressed properties at "fire-sale" prices.

A technical group is being created within FADA to coordinate the delivery of valuation services and the management of participation assets. It will have responsibility for identifying, engaging and monitoring appraisal work as well as reviewing appraisals.

This and other steps were outlined by Bank Board chairman M. Danny Wall in recent testimony before the House Subcommittee on General Oversight and Investigations.

A new national marketing and sales group within FADA will work to provide better information to prospective buyers and brokers.

FADA would also get a new boss. Gerald P. Carmen, a former GSA administrator and a current board member of the FHLB of Boston, has been offered the position. Replacing Roslyn Payne, whose $250,000 salary as FADA chief was cause for grumbling both in Congress and the FSLIC, Carmen would work out of Washington at a salary under $150,000, according to Wall.



FADA Activity to Date

Testimony *(from p. 1)*

eral mandate to states for consistent and equitable disclosure" of data relating to real estate transactions. "Without access to property sales and other data, appraisers cannot adequately and reliably fulfill their function," he stated.

In providing the Subcommittee with a brief review of events leading to the problems being addressed in the bill, Sears stressed that pressures from within the marketplace had been placed on appraisers to "come up with the 'right numbers.'"

"Appraisers must be relieved from direct pressures placed upon them by lenders and users of appraisal services," Sears emphasized. "They need protection when they resist these pressures in the marketplace. Sanctions on appraisers for violating appraisal standards may help, but regulatory relief must be forthcoming which will penalize those applying undue pressure. At a minimum, there should be protection for those appraisers who resist and report institutions that use such methods."

In speaking to the issue of Federal regulation itself, Sears commented that it can mean less regulation for appraisers. "Many differing notions exist as to the effects Federal legislation will have upon the appraisal community . . . . to some the prospect appears overwhelming. Yet when further analyzed, appraisers are already very much a regulated group. The Federal Home Loan Bank Board and other Federal banking agencies have varying requirements for appraisals. Secondary mortgage market clients such as Fannie Mae have extensive guidelines and the numerous Federal agencies involved in mortgage lending and land acquisition also have many differing requirements."

Sears also spoke to the Model Bill for State Certification, which the Society and other appraisal organizations have developed. "The Model Bill requires an *independent* appraisal board to be set up in each state. That Board will be required to look to the Appraisal Foundation for appropriate standards and qualifications . . . This Model Bill would prohibit grandfathering. All those performing appraisal assignments would have to satisfy continuing education requirements."

When asked how long it would take states to initiate certification programs, Sears responded that the Barnard bill is already acting as an incentive to the enactment of state certification legislation.

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May 14, 1987

Mr. Lester G. Thompson
Deputy Director for Operations
Virginia Department of Commerce
3600 West Broad Street
Richmond, Virginia 23230-4917

Dear Mr. Thompson,

In response to yours of the 12th, I can be available at almost any time to discuss details of your forthcoming public hearings. Please telephone me and advise me of the date, time and place.

I was very lucky during my trip to Los Angeles last week. I sat at dinner with Dexter MacBride (previously named) and Professor Gideon Kanner of the Loyola University School of Law. Our host was another practicioner I've known for almost as long as Kanner, or about 20 years. What Dexter and I failed to get into the discussion during dinner, we finished later in the evening in my hotel room in Glendale.

While I previously mentioned MacBride in my letter to you of May 3rd, I will now add that he grew up in Tidewater, Virginia and was later the chief right-of-way agent for California Department of Highways. He is a member of the Virginia and California bars, and was happy to learn that your department, rather than the Real Estate Commission, has undertaken the study. I have warned him that he will probably be asked to fly to Norfolk for your public hearing on June 29th. Now, see his letter to me of the 7th, Enclosure #1.

Gideon Kanner (listed also in MacBride's letter) and I have traded tidbits on defamation of lawyers and real estate appraisers almost since the era of the bankrupt REITs in 1974. Before he joined Loyola he practiced law in Calif., specialized in eminent domain, the co-authored a paper I have in the Pacific Law Journal, Vol. 8, no. 2, July 1977, titled, "Urban Renewal: Laissez-Faire For The Poor, Welfare For The Rich".

My second enclosure is a letter from Dr. James A. Graaskamp, holder of one of the most important chairs in land economics education in the nation. Please take special note of Jim's third and fourth paragraphs. He is as worried as I that the Appraisal Institute (AIREA), with its strong support by the National Association of Realtors, might persuade federal or state governments to adopt a "diluted enforcement program" -- and I am referring to the two documents of AIREA's mailed you before I went to California last week.

Enclosure #3 is an excerpt from Dexter MacBride's master's degree thesis in valuation sciences in 1979.

While we talked, Dexter said the subject just might be "too important to discuss. Everybody has a vested interest in an activity which can't stand regulation." He recalled that there are more single family residential appraisals than all others totalled, but the people who pay for those appraisals are denied the right to see them. "Appraisers don't need regulations because nothing really bad has ever resulted (until quite recently). . . Hardly any appraisers evaluating properties in California mention the future earthquake. But many other groups -- ham radio operators, the Red Cross, and the Pacific Bell and other telephone companies -- know there will be an earthquake and are prepared to react, but feel helpless by themselves. The public, therefore, is given no warning, no protection from the earthquake or the faulty or secret appraisal report. The public doesn't even know it needs help."

While in L.A. County I telephoned John H. Monroe, FASA, the outgoing president of ASA, to learn more about the inability of the seven to fifteen national appraisal societies to agree upon ethics and standards. As concerns your study, Monroe strongly recommended I try to get a copy of a speech in Baltimore, April 23rd, on appraiser oversight regulations, by U.S. Congressman Doug Barnard.

My purpose in sending all this extra information is to get you to tell me whether your study group would definitely be interested in hearing from <u>any</u> of the persons named in MacBride's May 7th letter, for then I would have to get on the telephone and invite them and, possibly also, solicit travelling expense contributions from friends in Virginia.

Sincerely,

M.B. Hodges, Jr.

Enclosures (3)

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Pension appeal

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July 7, 1987

Professor James A. Graaskamp, CRE
School Business
University of Wisconsin
1155 Observatory Drive
Madison, Wisconsin 53706

Dear Professor Graaskamp:

I read with interest the article headed "Appraisal Reform and Commercial Real Estate Investments for Pension Funds" as published by Salomon Brothers Inc., January 1987.

Back in 1970, we met at the convention in Las Vegas for the International Association of Assessing Officers when I was on a panel with you. At that time I was employed by the Ontario Department of Municipal Affairs. Since that time I have worked for private enterprises, including my own company, and for awhile with Royal LePage, Appraisal Division. I have recently joined Drivers Jonas who are an international company of Real Estate Consultants and Valuers having a long history in U.K., being established in 1725. The company has had a presence in Canada for some 15 years and more recently, over the past 5 years, has established an office in Toronto.

As a trained Chartered Surveyor in the U.K,. I was particularly interested in your article which points out some of the concerns that the North American real estate profession has with respect to the valuation of portfolio properties.

I certainly agree with the fact that as a profession we have been selling ourselves too cheap. Many institutions have caused appraisers to cut their fees substantially where in actual fact it should almost be the other way around, particularly with the advent of the information boom where so much more information or various specialities are required in order to completely understand the problem.

One of the advantages of the company I am now working for is that is it based on the U.K. Chartered Surveyor concept. We have a multi-disciplinary compliment in the company and can call on experts to assist us in our valuations. For example, we work very closely with our Property Management division who are adequately qualified to provide us with detailed information as to the status of a building, including its construction and systems and as well give valuable commentary on the leasing structure and how such leasing structures can be improved.

This brings me to one disagreement I have with your article under the heading "The Appraiser and Building Management". You suggest that in order to avoid a systematic upward bias of value that hinges on the successful completion of grand improvement plans, a property should be valued exactly as it exists on the day of valuation without taken into consideration any potential improvements of the property. Whereas I agree that unrealistic and grandiose plans of improvement estimated by people not qualified for such commentary is unrealistic, I believe it is important that, under the definition of highest and best use which takes into consideration the purchase by a prudent purchaser, that one cannot assume the continuation of poor management. Surely the Valuer must assume that the purchaser is prudent and will adopt realistic management practices.

We tend to adhere by the Royal Institution of Chartered Surveyors standards for reporting on the valuation of fixed assets, as implemented by the International Asset Valuation Standards Committee.

Another aspect of our work is that we provide the client not only with an estimate of the value of his property but give suggestions as to how this value can be improved by carrying out prudent management techniques. As a result, the Portfolio Manager has a report which provides him with ongoing useful information.

Once again I enjoyed reading your article and I hope that our paths will cross sometime in the future.

Yours sincerely,

Michael Cane

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Vice President, Valuations

MC/im

AIREA Research Series

Impacts of Regulation On the Appraisal Industry

Research Report 2

American Institute of Real Estate Appraisers

AIREA Research Series

Impacts of Regulation on the Appraisal Industry

Research Report No. 2

Proceedings of the May 16-17, 1987 Research Forum sponsored by the American Institute of Real Estate Appraisers, Chicago, Illinois

W. Lee Minnerly, Editor

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Part II -- REGULATORY INITIATIVES FOR INDUSTRY

Schultz: The next presenter is James A. Graaskamp speaking on "Can the Appraisal Industry Survive without Increased Regulation?"

Graaskamp: The question is, I think, a little ephemeral. I think most industries have found that once they get over the shock of what they perceive as government interference with their industry, government regulations adroitly exploited have been a great advantage to the industry. Either they establish a monopoly for them or they shield them from the consumer, or at least greatly narrow the parameters of the unknown as to where their responsibility in their process lies. So I think initially one does not have to regard regulation as a singularly negative concept.

Now I would like to divide the question of whether the appraisal industry can survive without it into essentially three areas, looking at regulation as protective rather than as pejorative. The first major factor that accounts for the appraisal profession being uncomfortably ill is its customer base. Historically, the appraisal industry has been unable to protect itself from its own customers. If R-41c has anything to say for itself, it is the fact that it makes the customer, as the fiduciary hiring the appraiser and applying the appraisal in his or her lending and realty process, equally culpable for an inappropriate or

incomplete piece of work. It is now in his or her vested interest that you should be allowed to operate as a professional.

That type of regulation is a very positive element, and to define it as part of the regulatory environment of appraisals certainly is to be encouraged. How do we protect ourselves from our best friends, namely, our customers, who have gone a long way toward destroying the credibility of the appraisal process? The American tradition of reciprocity, of advocacy and the team approach, is very hard to overcome whether you are in a law case or a loan case. The measure of success is, Did we get the loan? The fee system has traditionally enhanced it; more frequently one is hired by the applicant for the loan than by the lender, and then there is the matter of all parties working for community development. This very parochial type of relationship in many cases is virtually an implied conspiracy between the lender who wants to make a loan under any circumstances, and the developer who needs the loan under any circumstances, and the appraiser who wants to be part of the "good ole boy" network that carries this off.

So regulation protects us from our best friends, but I don't think we can survive without it. I think making the customer equally culpable with the appraiser for a poor piece of work, as evident in R-41c, is a very positive regulatory step.

The second area of increased regulation concerns what Mr. Harrington was talking about today. I think the appraisal is a critical social function for equity in our society. Whether we're talking about the protection of our financial institutions, about the relationships between two parties attempting to achieve a fair contract, or about eminent domain and public compensation, the appraisal product should be the pivotal issue rather than the appraisal process. The appraisal process too often is manipulated today against the advocacy positions of the usual vested interests. To the degree that increased regulation could better control the appraisal product so that it performed its critical function of social equity, then regulation advances the interest of professionalism in the appraisal process.

The third and perhaps most significant area in which regulation is a positive factor to the survival of the appraisal industry lies in the historical success of the appraisal process. There is a tremendous financial vested interest in the status quo, which is unfortunate in a society moving as quickly as Mr. Harrington has suggested this morning. We're moving toward a much higher level of social responsibility on the part of enterprise to society and to individual property owners. The social transaction is beginning to take precedence over the business transaction. The appraisal process has not kept up with that, and there are vested interests that do not wish to keep up with that. This renders the education of all of us in this room, let alone the entire professional cadre of appraisers, obsolete.

It obliterates a very significant investment of personal entities and money and time. Obviously, some would much prefer the status quo and a broader array of exemptions, disclaimers, shifts of liability to other professions, and so forth. The threat of new legislation and the related spin-offs of Congressional investigation of the collapse of the Sunrise Savings and Loan Association of Florida show the rate at which we've accelerated consideration of these issues.[23] Without that spur of regulation, there would not be a creative response to bridge the gap between social and business responsibilities.

Regulation is the only way in which we can break the inertia of the financial success of the appraisal process and force the responsible appraiser to come to grips with change in the business environment in which he or she works.

So for all these reasons, the appraisal industry not only cannot survive without regulation, but regulation provides the most accelerated means to move the industry into what essentially is the twenty-first century of professional response. Since we are a pivotal factor in a legitimate transaction and ours is a society in which the social transaction is now bearing equal weight with the business transaction, I don't see any way in

[23]For additional information see "Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in the Secondary Market," House Committee on Government Operations, 99th Cong., 2nd sess., H. Report 99-891, 1986, pp. 16-23.

which the appraisal industry can adapt without regulatory protection.

The final element is simply the cost of regulation itself. I think the appraisal industry has found it has not been able to afford self-regulation. It cannot afford it for several reasons. One obvious reason is the legal cost of due process associated with removing designations from those who have failed their responsibilities. Another is an internal cost in energy to the organization that has to spend so much of its resources disciplining its own members. This becomes very divisive and makes it difficult to go forward with the more positive aspects of this profession.

The punitive aspects of regulation within the profession should be divorced from its fraternal and educational functions so that the great majority can work together. Other industries have managed to insulate themselves from certain disagreeable functions, from inertia, and from their customers who otherwise would kill them with love and fees.

Schultz: Thank you, Dr. Graaskamp. Our next presenter this morning is William Pittenger of the Federal Home Loan Bank of Atlanta, speaking on "FHLBB Initiatives Affecting Appraisal."

Pittenger: Thank you, Carl. I've been asked to talk about the Board's perspective of regulation, including the history of