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## **Real Estate/ Appraising The Value Added by Appraisers**

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Today's challenging business environment requires a continuous push toward higher levels of operating efficiency. Such efforts are designed to enhance "bottom-line" profitability through a careful examination of the policies and practices that comprise the delivery of products and service to the customer. An integral part of this process is to examine established procedures to independently evaluate their contribution to organizational goals and objectives. Those that add value are retained, those that do not are eliminated or reengineered. Also important to this process is the assessment of emerging technologies as businesses seek innovative ways to integrate these advancements into their business plan. When approached objectively, this process can provide valuable insight into enhancing operating efficiency. At the same time, however, it is wise to approach this process cautiously in order to ensure thoughtful consideration of the complex issues that accompany change.

The relocation industry has been faced with the same challenges that affect the general business community. In response to this challenge, the traditional relocation appraisal process has received increased attention as employers seek a better understanding of its components. This attention has led to significant enhancements to the appraisal process, along with proposals and experiments with alternative valuation methods. The quest to create a more efficient relocation process has been fueled by the issuance of the Internal Revenue Service's (IRS) Private Letter Ruling No. 9552040, dated December 29, 1995. This ruling implies that a Broker's Market Analysis (BMA) can be used in place of independent appraisals. In considering this option, employers should endeavor to gain a better understanding of appraisals and BMAs to facilitate informed policy decisions.

The valuation process for a relocated employee's home has long been a source of concern and controversy for employers and employees alike. This is not unexpected, given the intensely personal nature of homeownership. The unique characteristics that comprise our individual personalities lead us to create home environments in our own image. It is, therefore, natural that we, as individual, sense intrinsic value in our homes that will not always be fully recognized by others. It also seems reasonable to expect that outsiders' failure to validate or agree with that perceived value during the relocation process will be a perpetual source of conflict.

At the same time, however, the employee relocation process demands an independent "outsider" to provide an objective estimate of value. This estimate must reflect the price that a typical purchaser would be willing to pay for the home, without regard for the transferee's perception of the home's value. Blaming appraisers and the appraisal process for the dissatisfaction of transferees is like shooting the messenger who brings bad news. Transferees are predisposed to reject any estimate of value that does not validate their own expectations, primarily because they believe it to be in their own best interests to do so. For this reason, using BMAs instead of appraisals will not help alleviate employee frustration. Transferee disapproval of the home valuation process will apply to any method of valuation the employer chooses to use. In light of this predisposition for individuals to hold an inflated opinion of their home's value, the significant structural differences between appraisals and BMAs take on added significance.

Appraisals have a wide variety of potential uses. Some of the more common uses of residential appraisals include mortgage financing, insurance replacement cost calculation, estate valuation, equitable distribution in connection with marital divorce actions and partnership dissolutions, and corporate relocation, to name a few. Since these varied uses of residential appraisals have different objectives, distinct methodology and guidelines have evolved for each. A specialized methodology has evolved to facilitate the employee relocation process. This methodology is embodied in the ERC Residential Appraisal Report and is structured specifically to meet the needs of employers and their employees. Substantial improvements have occurred in this methodology since its introduction in 1984, the most recent of which are embodied in the 1994 revision of the report form.

These improvements have been accomplished through the cooperative efforts of the corporate, governmental, relocation management company, and appraiser members of ERC. Together, these partners have worked to develop comprehensive standards and guidelines for the completion of relocation appraisals.

The resulting body of knowledge is highly regarded throughout the appraisal and general real estate communities, and is widely held to represent the state of the art for residential property appraisals. Additionally, these appraisal reports contain specific internal calculation and justification that detail and document the derivation of the home value estimate. These calculations result in "dollar adjustments" that clearly demonstrate the valuation procedures and the means by which conclusions were reached to readers of the written report. In this way, a transferee's home that is appraised for less than the selling price of a neighboring home will contain specific dollar adjustments and supporting explanatory comments that demonstrate the calculation of the lower value estimate.

While the ERC's Broker Market Analysis and Strategy Report (BMA) has enjoyed similar cooperative efforts in its development, its format is far more general and lacks the specific dollar adjustments and calculations present in appraisals. The resulting lack of detail creates noticeable gaps in the valuation methodology and yields a more general subjective analysis of marketing issues. Although the selling prices of similar neighborhood homes are recited in the body of the BMA report, dollar adjustments to these selling prices are absent. As a result, there is no discernible thread that translates the comparable's selling price into a value estimate of the employee's home. To be fair, this detail is absent by design, since using BMAs in lieu of appraisals was not anticipated when this reporting format originally was developed. Evidence of this can be found in both the current and pending revised BMA forms, which begin with the disclaimer, "This report is not an appraisal..." Given the skepticism and resulting scrutiny that employees hold for the valuation process, the absence of a clear and explicit valuation procedure in a BMA report is likely to cause increased concern and frustration among transferees.

Early reports from real estate agents who have performed BMAs in connection with an employer's guaranteed home purchase offer confirm this frustration. These reports indicate that some employees have been requesting additional information to include the specific dollar adjustments that are absent in the BMA report. In the absence of such supporting data, a vacuum is created that denies the employee critical information. Given this scenario, it appears that the continued use of BMAs in this manner may lead to their being expanded in the future to include the information sought by employees. Should this happen, the BMA report could evolve to become the very appraisal report it is intended to replace.

Another critical aspect of this issue concerns transferee perception as it relates to the independent nature of the home valuation process. Appraisals hold the advantage of being an independent process absent of any future interest or bias with respect to the employee's home. The procedural guidelines on page one of the ERC Residential Appraisal Report state, "The appraiser is not to solicit a listing or generate a referral as a result of an appraisal assignment." This condition is intended to ensure the independence of the valuation process in order to encourage a perception of fairness to the employee.

These conditions are not practical in the case of a real estate agent performing a BMA report, however. Presumably, one of the primary attractions of using a BMA for this purpose is to avoid paying a fee to the appraiser. It would be unreasonable to expect the real estate agent to provide his free service without the ability to solicit a listing of the property at a later time. Given the suspicion that employees hold toward the home valuation process, it seems reasonable to expect that this will prove to be a continuing source of concern for employees. While I do not intend to malign the integrity of real estate agents or suggest that they will behave other than professionally, the inherent potential for employee perception of a conflict of interest is apparent. If this conflict remains unresolved, it likely will be a continuing concern raised by the employee that will far exceed the limited controversy surrounding the present appraisal process. If the real estate agents in the future are required to exclude themselves from soliciting the listing for the property in order to quell this controversy, it then seems likely, too, that those agents will expect to be compensated for their efforts in preparing the BMA report. Once again, this will lead us to a point where BMAs could evolve into the appraisals they are intended to replace.

Related to this issue of playing real estate agents for BMA reports are recent legislative developments whereby a growing number of states have enacted mandatory licensing laws. These laws generally hold that individuals who are paid a fee to provide a written estimate of value must hold an appraisal license. Presently, there are 25 states that have enacted some form of this legislation, which applies to all valuation including those that are conducted for relocation purposes. Of these, 16 state laws contain some provisions that render them less stringent and may permit these activities by licensed real estate agents. The remaining nine states, however, require that all valuations be performed by licensed appraisers with no exceptions. It appears unlikely, therefore, that a consistent national policy that implements paid BMAs in lieu of appraisals could be implemented.

Another aspect of this topic that is far more difficult to assess is the relative accuracy of appraisals and BMAs. The previously discussed IRS private letter ruling implies a similar accuracy level for each. Inadequate detail in the text, however, does not explain the methodology used to reach this conclusion. In order to perform such an analysis accurately, both valuations must have been performed simultaneously on the identical home. Those familiar with corporate relocation practices will recognize that BMAs often are performed at multiple points in time ranging from home marketing analyses to inventory updates. What is not known about the IRS analysis is which of these BMA scenarios was used for comparison to appraisal accuracy. In the case of inventory BMA updates, accuracy is enhanced significantly by knowledge of market conditions that may have changed considerably since the appraisal was completed. Also significant is the marketing history of the subject property that occurs after the appraisal has been completed. Clearly, a comparison formulated under these conditions would be invalid.

Based on the uncertainty surrounding the accuracy issue, a definitive answer to this question cannot be determined. What is clear, however, is that such analyses must be performed carefully to maintain the integrity of the data and ensure meaningful conclusions.

Both appraisers and real estate agents bring valuable skills to bear in assisting employers and their employees to accomplish a successful relocation process. At the same time, however, appraisals and BMAs have distinct differences that lend themselves to different purposes.

Clearly, appraisal reports are much more comprehensive in their reporting detail and analysis, while BMAs provide a more subjective evaluation of general market issues. In this regard, appraisals continue to play a valuable role in estimating and communicating the value of a transferring employee's home.

In their quest to improve efficiency and profitability, relocation policymakers examining the value of the traditional appraisal process would be wise to conduct a thorough analysis. Formulating effective

relocation policies demands a comprehensive understanding of these issues in order to optimize the success of the relocation process.

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