APPRAISING THE APPRAISAL

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GENERAL PRINCIPALS

- **Basic Principal.** ***An appraisal is not value. It is someone's best guess at value. It can be a good guess or a bad guess, but it is never "correct."***

  Thus presentation and documentation must be thorough and well executed. This indicates that the appraiser understands the problem and has researched thoroughly, giving the reviewer confidence that the estimate is a valid indication of true market value. Wherever possible, an appraisal should be characterized as a range of value.

- **Market Lag**. To the extent that appraisals rely on market evidence, by definition they lag the market. When a market is rising, they will tend to undervalue. In a falling market, they will overvalue.

- **An Appraisal Should be Professionally Written**

  - **Rationale**. Because appraisal involves judgment and interpretation, the appraiser should provide thorough rationale, not simply conclusion.

  - **Reasonableness**. Rationale and conclusions should be reasonable based on the data available.

  - **Documentation**. Research, data, and conclusions should be well documented. Certain factual information may be retained in the appraiser's files, but enough should be contained in the appraisal that a reviewer may follow the appraiser's rationale. Reference to undocumented prior appraisals lacks credibility. Personal interviews or otherwise proprietary information need not be revealed, but it should be accessible by the appraiser.

  - **Vernacular**. Casual vernacular should be avoided.

  - **Grammatical Person**. In the writing of the appraisal, use of the first person should be avoided unless it involves quoted opinion.

ORGANIZATION

- **Ease of Review**. Material should be discussed as fully as necessary, but it should also be sectionalized, tabularized, and summarized.

- **Definition of terms**. Terms and usage differ by region and individual convention. Every appraisal should have a glossary that defines basic terms.

METHODS OF APPRAISAL

Assets Appraised

The appropriate appraisal technology is in part determined by what is being appraised.

- **Highest and Best Use.** Appraisal is an estimate of the value of a property in its highest and best economic use. Forestry is usually the lowest economic use and has difficulty in competing with higher "developed" uses. Developed uses are frequently referred to as "Higher and Better Uses" or "HBU." HBU may be irrigated pasture, ranching, rural home sites, recreational development, or housing.

- **Compatible Use.** Some properties lend themselves well to both forestry and compatible uses and thus it may be valid to appraise properties for both. Some higher uses, such as Christmas trees, hunting leases, and pine needle gathering, are wholly compatible. Others, such as rural home sites, are less so and generally require some level of subdivision and fragmentation, removing some land from forest production.

The nature of the appraised assets must be defined.

Approaches to Appraisal

There are three approaches to appraisal:

- **The Market Approach.** The Market Approach relies on finding recent comparable sales similar in use to the subject property. No two properties are alike and thus this method relies heavily on reconciliation of differences between "comps" and the subject. The process of reconciliation is both quantitative and qualitative and requires meticulous rationale. In general, appraisal relies most on the Market Approach, at times too heavily.

- **The Income Approach.** The Income Approach relies on estimation of future revenues from the property in its prospective uses and on estimation of anticipated costs of generating those revenues. The difference between revenue and cost is an annual income stream that an investor can expect from the property over time.

  - **Price and Revenue**. Timber revenues result from a combination of volume and prices. Therefore a timber appraisal must include a credible discussion of growing stock (inventory of standing volume), growth, and projected harvest volume over time and the factors that influence them. A discussion of anticipated prices must include an analysis of market supply and demand, local mills and their capacities, hauling distances from the subject property, global economics and how the market views price behavior over time.

  - **Discount Rate**. Another important element in the Income Approach is the rate at which the income stream is discounted. Seen differently, the discount rate is the rate of return that an investor (or in the case of an appraisal, the market of investors) will expect. In large part, its magnitude reflects the risk that the market perceives for an asset in a given situation. The higher the discount rate, the higher the perceived risk, and the less an investor is willing to pay for a given income stream.

- **The Cost Approach.** Relies on assessment of replacement costs, such as how much it might cost to build an office or apartment building. Because forests are indiscrete assets with respect to location and time, the Cost Approach does not lend itself well to forest appraisal and is rarely used.

In theory, all three approaches will yield the same value if all facts are known. In fact they never do. Depending on the information available, the number, similarity, and quality of comparative sales, revenue and cost, and the assessment of perceived market risk, an appraiser will give more or less weight to a given approach. It is the appraiser's job to reconcile the differences between the results from each method used and to provide a rationale for that rationalization.

COMMON APPRAISAL WEAKNESSES

The application of appraisal technology never yields a perfect appraisal. All are subject to scarcity of information and reliance on qualitative judgment that may lead to results that do not adequately reflect the true market value of a particular asset. Keeping in mind the fact that the only precise reflection of true market value is the price for which a property actually sells, it is the appraiser's role to assess what is available and provide an estimate of value that is unbiased and credible under existing conditions.

The following are several ways in which appraisals commonly fall short

General

- Poor documentation, incomplete information.
- Failure to provide complete rationale.
- Over-reliance on one method or another, especially over-reliance on the Market approach.
- Simple averaging of Market and Income approaches.
- Double accounting. Summation of values from incompatible uses.
- Overuse of local vernacular.
- Poor organization. Arguments difficult to follow, information difficult to locate.
- Failure to define terms.
- Failure to characterize appraisal results as a range of value.
- Citing of undocumented prior appraisals.

Common Short-comings of the Market Approach.

- Too few comparables.
- Comparables too old.
- Comparables too dissimilar.
- Lack of discussion of the nature of buyers and sellers. Public, private, NGOs. Over-reliance on conservation acquisitions.
- Failure to describe sources of funding and nature of financing.
- Incomplete reconciliation of comparables.
- Reconciliation of comparables yields too broad a value range.

Common Shortcomings of the Income Approach

- Failure to provide complete analysis of regional supply/demand.
- Lack of local mill analysis and their proximity to the subject property.
- Lack of adequate analysis of past and expected price trend.
- Failure to adequately define and discuss market discount rate.
- Incomplete discussion of market risk and the various risk factors.
- Where easements encumber property, failure to discuss easement risk.