2024, Volume 8, Issue 2

ARM E-Journal™

ASA Providing Value Worldwide®

OFFICIAL PUBLICATION

ASA Appraisal Review & Management Discipline

FEATURED ARTICLES

Lack of a Qualified Appraisal in Hoensheid v. Comm (TCM 2023-34)

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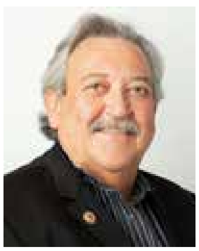

We continue to welcome new members to the growing Appraisal Review and Management (ARM) discipline. It is both fun and frustrating to be on the ground floor of an evolving practice. We both have seen ARM evolve through generations of development and we are both enthusiastic about the future.

To support the discipline academically, this Journal publishes thought provoking articles designed to prompt development among our practitioners. Looking over the past eight years of this Journal while preparing an outline for the upcoming ARM Resource Manual, we found ourselves questioning our own appraisal methodology. We are all so busy getting the work done we seldom sit back and re-think what we are doing.

Scope of work is so critical that it really needs a fresh approach in every new engagement letter, not boilerplate. Logic is complicated and it takes frequent review for us to get it right. Reconciliations take a different approach in every report we write. We find the past articles in this Journal on those subjects helpful and hope you do too. It is interesting how the concepts written from one discipline are applicable in another.

Additionally, new cases involving Appraisal Review are decided several times every year and we can see that Appraisal Review is a new concept for Boards and Courts. Often these cases do not get it quite right (in our eyes) as they deal with unfamiliar concepts. For example, USPAP, now 40+ years old, is still not necessarily the driving force in many appraisal decisions even though we may wish it were so. Some spectacular court cases that disregard USPAP as well as accepted methodology and standard of care for appraisal review are making headlines and we hope to bring some of these to you in future issues. As professional practitioners, we need to continue to educate our clients and the public as to the importance of adhering to guidelines and ethics.

You can play a role in this. When you are either involved in a case that involves Appraisal Review or hear of one, let us know! We will pursue it and make a strong effort to include them in these issues. We will present them as abstracts with links for you to read the back story and will have ARM members comment on the merits and their opinions of the facts. Should be interesting reading!

Charles Dixon

Charles Dixon, ASA, ARM
ARM E-Journal™ Co-Editor

Richard Conti

Richard Conti, ASA, ARM
ARM E-Journal™ Co-Editor

ARM E-Journal™

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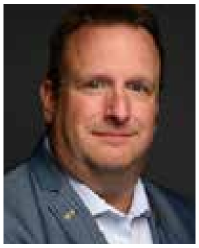
Letter from ARM Chair



Happy Spring!

I expect you are all enjoying the developing spring. I am writing this on a plane that is held up due to thunderstorms. This will be my last ARM Chair posting, as Terri Lastovka will be moving into the position of ARM Chair. I can't thank her enough for her support as the Vice Chair and all the hard work, she continues to do for the Conference.

It's been my pleasure to serve as Chair and I couldn't have done this without Terri's support and all the support from the other members on the committee. I also appreciate the contributions of all the ARM members and especially the authors and editors of the ARM journal. It's impressive how this discipline group works together to help each other and continue to develop the ARM discipline.

Educational Offerings

I want to invite you to look at several educational offerings coming up. One or more may be a good fit for your schedule and interests.

Appraisal Review Report Writing Tutorial Workshop, May 30, 2024
Those of you who haven't earned your ARM designation because of the intimidation of writing the report, this is your opportunity to get it done.

ASAI Symposium, June 27, 2024
This is a great offering for those who are interested in Artificial Intelligence and what it means to our industry. You may have been involved in some of the many discussions around the use of AI in appraisal writing. This symposium will offer guidance and some language for appraisers and appraiser reviewers to use in stating if AI was or not used in their reports.

ARM for BOE

The ARM Committee has been discussing free and discounted courses for the BOE. Expect changes to be made, including the possibility of mandates that BOE members join the ARM discipline.

International Reviews

We are going to have a fantastic series coming up for anyone performing work internationally regarding reviews and IVS. Special thanks to Faisel Hoodbhoy and Melanie Modica for their work on this.

Outgoing ARM Chair

As Past Chair, I will continue to be involved in the Committee and look forward to hearing from you real soon.

Best regards,

Matthew Kaufman

Matthew Kaufman, ASA, ARM
ARM Chair

Meet Your ARM Committee

1. Matthew Kaufman, ASA, ARM
Chair

2. Terri Lastovka, ASA, ARM
Vice Chair
ARM Publication Reviewer

3. Melanie Modica, ASA, ARM
Secretary/Treasurer
ARM Marketing Subcommittee Chair
ARM Board of Examiners Reviewer
ARM Publication Reviewer
2020 ASA Woman Appraiser of the Year

4. J. Mark Penny, FASA, IA, ARM
Past Chair

5. Barry Shea, ASA, ARM, IFA
Member At-Large
Deputy Chair, IES Coalition
ARM Publication Reviewer

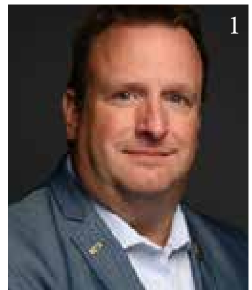
6. Charles Dixon, ASA, ARM
Member At-Large
ARM E-Journal™ Co-Editor

7. Faisel Hoodbhoy, ASA, ARM
Member At-Large

8. Raymond Rath, FASA, CEIV, IA, ARM
Member At-Large
ARM Publication Reviewer

9. Richard Conti, ASA, ARM
Member At-Large
ARM E-Journal™ Co-Editor

10. Ronald Prat, ASA, ARM, IFAS
ARM Education Subcommittee Chair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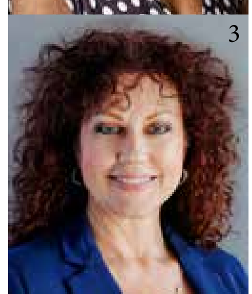
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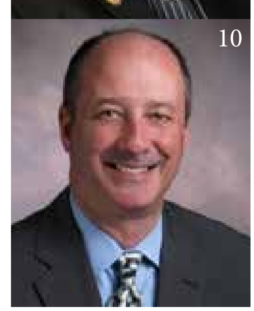
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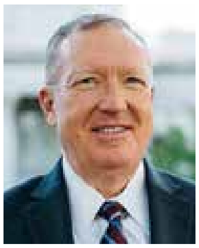
ARM GOVERNOR NOTES

New CEO Selection Tops BoG Agenda



As you are probably aware, the current primary focus of the Board of Governors (BoG) is the selection of a new CEO. Vice President G. Adrian Gonzalez Jr., is leading the selection committee, which includes other respected ASA appraisers including several past presidents.

Selection committee members developed a comprehensive set of criteria for the role and we're pleased to report that there has been significant interest in the position. By mid-May, the search firm expects to have chosen two or three top candidates from the pool of applicants. In May, the BoG will participate in interviewing these select applicants in Herndon, VA.

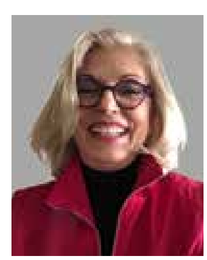
Additionally, the BoG is actively addressing other important issues, including redefining the role of members of the Board and updating the ASA governance policy manual (GPM). The GPM is the crucial document that outlines what the Board expects of the CEO and of itself and this update will ensure that the GPM adequately addresses the challenges our new CEO will face, particularly regarding declining membership and retention.

We appreciate your ongoing support and engagement as we navigate through these matters. If you have questions or comments regarding the Board of Governors and how its actions influence the ARM discipline and appraisal review profession, please e-mail jack@norcalvaluation.com.

Jack Young

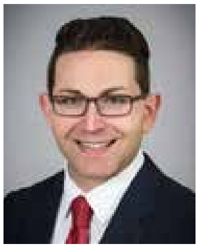
Jack Young, ASA, ARM
ARM Discipline Governor

Breaking News: ASA Names Lana Vukovljak as New CEO



ASA announced on May 24, 2024 that Lana Vukovljak will join as CEO & Executive Vice President on July 1, 2024. In her new role, Vukovljak will lead the Society's efforts to advance and serve its nearly 5,000 members and the broader valuation profession. Her responsibilities will include overseeing operations, ethical and professional standards, supporting the Society's six disciplines and its network of fifty chapters worldwide, and consumer outreach to enhance public awareness and trust in ASA members. She will also manage partnerships with the ASA Educational Foundation, the NAIFA Education & Research Trust, and a network of organizations around the world. Read the complete announcement online.

Looking Ahead to Portland for the Profession's Main Event



The countdown to the 2024 ASA International Conference (ASAIC24) is swiftly approaching its conclusion. ASAIC24 stands out by offering relevant insights tailored to all appraisal professionals across Business Valuation, Personal Property, Machinery & Equipment, Real Property, Gems & Jewelry, and Appraisal Review & Management. Attendees will experience state-of-the-art education and gain fresh perspectives that broaden their horizons.

ASAIC24's hybrid format accommodates various preferences, offering both in-person and virtual sessions. Whether you choose to join us in Portland, Oregon, or participate from your home or office, you'll enjoy the flexibility to engage in the way that suits you best. Both formats provide opportunities to explore the latest trends, exchange ideas, and connect with peers. Don't miss this exceptional chance to enhance your knowledge and network with leaders in the appraisal industry.

With over 65 educational sessions spanning six discipline tracks, ASAIC24 offers unparalleled learning opportunities. Whether attending in person in Portland or via live stream, participants will access a wealth of information and expertise. Additionally, all attendees can revisit sessions OnDemand for up to 90 days after the conference ends.

View the ARM Session Schedule or the full event Schedule At A Glance.

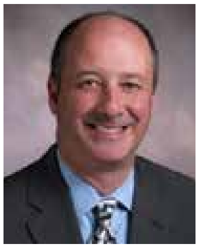
Take advantage of early registration savings available through July 26, and secure hotel room discounts available through August 21.

If you've never attended this event before, make Portland your new annual professional development tradition.

John D. Russell

John D. Russell, JD
Strategic Partnership Officer

Update from the Education Chair



ASA's Appraisal Review & Management (ARM) educational offerings cover topics from foundation-building Principles of Valuation (POV) courses to advanced curriculums on specialized topics. Courses are offered in multiple formats to meet the needs of busy and discerning students: choose from self-study, live virtual, traditional in-person, or a blended learning experience.

As always, you can log onto [www.appraisers.org]() to visit the ARM Course Library for a complete list of course offerings. Once on the home page, click DISCIPLINES, select Appraisal Review and Management, and then select Education on the left. Or follow this link.
are welcome!

Ronald Prat

Ronald Prat, ASA, ARM, IFAS
ARM Education Subcommittee Chair

Upcoming Classes & Events

AR209 Appraisal Review Report Writing Tutorial Workshop

May 30 | Virtual

Enroll in our tailor-made course for candidates pursuing an ARM designation, seasoned ARM members who need a refresher, and professionals seeking to stay up-to-date with the latest methodologies.

REGISTER

ASAI Symposium

Jun. 27 | Virtual

Wondering how AI might affect your professional life? This event, designed for all valuation professionals, will provide a better understanding of AI's tools, implications in valuation, ethical obligations, and best practices.

REGISTER

2024 ASA International Conference

Sep. 15-17 | Portland, OR & Virtual

Experience cutting-edge education and unlock fresh perspectives that will expand your horizons. Don't miss out on this exceptional opportunity to elevate your knowledge and network with appraisal industry leaders.

REGISTER

REGISTER

OnDemand Bundle Option

ASA is thrilled to introduce access to an exclusive bundle of OnDemand, online content specific to Appraisal Review & Management valuation. Explore an array of webinars and recorded conference sessions tailored to your interests and professional development goals. Access to this content is for a limited time. Sign up now and enjoy full access to the online content library from purchase date through **September 30, 2024**. With this bundle, you'll have the freedom to embark on a learning journey at your own pace. After signing up, dive into Appraisal Review & Management's OnDemand Library and handpick the offerings that align with your educational needs. Earn ASA continuing education (CE) credit as you go to ensure your learning not only enhances your expertise, but also contributes to your professional growth.

OnDemand/Self-Study

OnDemand/Self-Study offerings include recorded webinars as well as conference session recordings.

Webinar Recordings

- ASA Virtual Town Hall April 2023
- AR122-WEB Appraisal Review: Applying the Standards
- AR118-WEB Introduction to Cost Segregation
- AR119-WEB Social Media for Expert Witness Appraisers
- AR115-WEB Getting More Business: Expert Placement Firms—the Good, the Bad, and the Manageable

LEARN MORE

Conference Session Recordings

- AIC23-ARM Federally Regulated Transactions and USPAP
- AIC23-ARM $80 Billion and 87,000 Additional IRS Employees and Valuation
- AIC23-ARM Standards of Value: It Impacts All of Us
- AIC23-ARM The Perfect Storm: Convergence of Inflation, Climate Risk, and Social Inflation
- AIC23-ARM Determination of Value in Bankruptcy Proceedings
- AIC23-ARM Post-Pandemic Reality: Working in Remote Teams
- AIC23-ARM Building Trust in the Appraisal Profession
- AIC23-ARM Necessary Preparation for Depositions and Key Distinctions Between Deposition and Trial Testimony
- AIC23-ARM The Daubert Standard: An In-Depth Review of the Admissibility of Expert Witness Testimony
- AIC23-ARM Understanding The Ad Valorem Market
- AIC23-ARM Succession Planning for Appraisers
- AIC23-ARM/RP Mistakes to Avoid in Litigation Appraisals

Welcome Our Latest ASA ARM Member

Mark Cartwright, ASA, ARM, MGA

Mark is a partner with the love of his life, Mary Reich, (GG GIA, FGA, ASA, MGA, ARM) in their company Gemologically Speaking, LLC, an independent firm in Albuquerque, New Mexico, specializing in the identification and valuation of gems and jewelry.

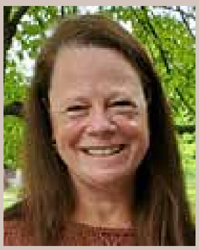
Mark began appraising jewelry in 1982 as the owner/gemologist of a jewelry store and has at various times over the course of a 40+ year career in the jewelry industry earned the highest appraisal designations conferred by ASA, ISA, NAJA and AGS. He is also an AQB Certified USPAP Instructor.

Mark has designed and created jewelry for over 50 years and won a Spectrum Award for fine jewelry designs featuring colored gemstones and has a second business where he continues to create fine jewelry for clients.

His son and daughter are in their 30s and living their own wonderful lives which Mark remains a significant part of whenever they'll let him.

Connect with Mark today!

Carol Busch, ASA, ARM



Carol became a member of ASA in 2013 and earned her ASA designation in Machinery & Technical Specialties three years later, in 2016. Subsequently, she added the ARM designation to her credentials in 2018.

Currently, Carol serves as a Staff Appraiser at HeliValue$, specializing in conducting Fair Market Value appraisals for individual aircraft and fleets. She continues to expand her expertise by undergoing training for various appraisal types.

Her tenure at HeliValue$ spans over three decades, during which she has held numerous roles, such as editor of The Official Helicopter Blue Book, website manager, public relations manager, events manager, and client services representative. She has been a constant presence at industry events like HeliExpo, NBAA, IAC, and Helitech conventions.

Carol earned her Bachelor of Science degree from the University of Wisconsin-Stout, where she was an active member of the Women's Volleyball team for four years.

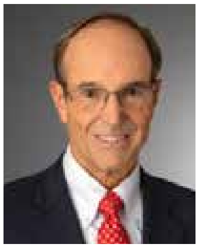
In addition to her professional endeavors, Carol actively volunteers for ASA, notably serving as President of the Society's Wisconsin Chapter. Presently, she plays a vital role in the ARM discipline as an editorial assistant for the ARM E-Journal™.

Connect with Carol today!

Lack of a Qualified Appraisal in Hoensheid v. Comm (TCM 2023-34)

By Curtis R. Kimball, ASA, ARM

Abstract: In the Hoensheid v. Comm case decision filed March 15, 2023, the Court decided that the taxpayers' appraisal work was "deficient with respect to several key substantive requirements" for both the appraisal report and the appraiser's qualifications. This article discusses specific points of that decision as it relates to appraisal practice and summarizes the ruling of the US Tax Court. A transcript of the Findings is provided.



Case Summary

In a memorandum case decision filed March 15, 2023,[2] the US Tax Court found that the taxpayers failed to properly and timely set up and document a charitable donation of closely held business stock shortly before the sale of the company in 2015.

As part of the lack of proper documentation, the Court found that the taxpayer's valuation was not a qualified appraisal under Section 170 of the Internal Revenue Code (IRC). Furthermore, the investment banker leading the deal who prepared the report was deemed not to be a qualified appraiser, due to his lack of appraisal credentials and the occasional nature of his valuation practice.

Because of timing and documentation problems, the taxpayers were deemed to have created an anticipatory assignment of the sale income from the shares and no charitable gift deduction was allowed.

The Internal Revenue Service also alleged other deficiencies and proposed additional accuracy-related penalties. The Court ultimately decided not to apply penalties due to the taxpayer's good faith reliance on professional legal advice concerning these penalty issues.

Factual Background

The third generation of the Hoensheid family decided to explore the sale of their family business, Commercial Steel Treating Corp. (CSTC), toward the end of 2014. One family member, Scott, and his wife, Anne, (the Hoensheids, or taxpayers) decided to make a charitable contribution of some of their appreciated shares to a charitable donor advised fund (DAF) to be administered by a major national charitable financial advisory firm. CSTC and the Hoensheids engaged legal counsel and an investment banking firm to advise and assist on the deal and on the charitable gift transaction.

To qualify for a charitable gift of stock, a transfer must be completed before a definitive purchase agreement is executed. If not, then tax law deems that the taxpayer is instead making an *anticipatory assignment* of his capital gains income and thus incurs a capital gains tax. If not properly documented, the charitable gift deduction will be disallowed.

In the timeline running down to the sale date in 2015, a number of documents had to be created and signed to complete the transfer to the DAF. The attorneys and the charitable financial advisory firm were not helped by their client, Scott, who insisted he wanted to "wait as long as possible" to gift the stock until he was "99% sure" that the deal would

[1] Estate of Scott M. Hoensheid, Deceased, Anne M. Hoensheid, Personal Representative, and Anne M. Hoensheid, Petitioners v. Commissioner of Internal Revenue, Respondent (TCM 2023-34, dated March 15, 2023).

"...the Court found that the taxpayer's valuation was not a qualified appraisal under Section 170 of the Internal Revenue Code (IRC). Furthermore, the investment banker leading the deal who prepared the report was deemed not to be a qualified appraiser..."

go through. The court decision revealed that there were delays, misunderstandings, and documentation finalization issues on the transfer. These problems ultimately resulted in the charitable gift occurring on July 13, 2015, instead of the taxpayer's originally intended (and reported) transfer date of June 11, 2015. The sale of CSTC effectively closed on or about July 15, 2015.

The taxpayers and their legal counsel also realized that a qualified appraisal was necessary to follow charitable contribution reporting requirements. A Form 8283 must be filed by the taxpayer and signed by the charitable entity receiving the gift and signed by the appraiser opining on the fair market value of the gift. The investment banking firm leading the sale process agreed to provide the valuation report and sign the Form 8283, despite the fact that its engagement letter did not state that such appraisal services were part of its scope of work.

The Tax Court's Decision

On the first issue, the Court decided that the "realities and substance" of the evidence of the charitable transfer and the evidence of the sale process indicated that the sale of CSTC was "a virtual certainty" just prior to the completion of the transfer of the Hoensheids' stock to the DAF, which the Court determined to be as of July 13, 2015. Thus, the transfer occurred too late to be a gift of the closely held stock but was rather a gift of the anticipatory assignment of a fixed right to income.

The taxpayer can still receive a charitable deduction for the income anticipatorily assigned to the charity if proper documentation is in accordance with federal tax regulations under IRC Section 170. The Hoensheids argued that they were in substantial compliance with the IRC regulations.

In this case the Court decided that the taxpayers' appraisal work was "deficient with respect to several key substantive requirements" for both the appraisal report and the appraiser's (i.e., the investment banker who acted as the appraiser) qualifications.

The Court concluded that the investment banker was not a qualified appraiser under the regulations. He and his firm did not hold himself out as an appraiser to the general public and he did not possess any certifications from professional appraisal organizations. He conducted valuations on a limited basis only once or twice a year and the Court said that a number of his valuations were uncompensated work for companies for which his firm was acting, or hoped to act, as sales intermediary. While not having a professional certification is not an automatic disqualifier, the totality of the investment banker's background and work apparently influenced the Court's thinking in this case.

The Court also found that the appraisal report attached to Form 8283 was materially deficient. The report lacked a sufficient description of the appraiser's qualifications. The report used the taxpayers' intended, but incorrect, date of transfer reported as June 11, 2015, and thus the valuation date was wrong. A number of material events took place between June 11 and the actual transfer and closing dates in July 2015 and were thus not included in the report. The Court also concluded that the report had other defects such as a lack of sufficient description of the appraisal methodology.

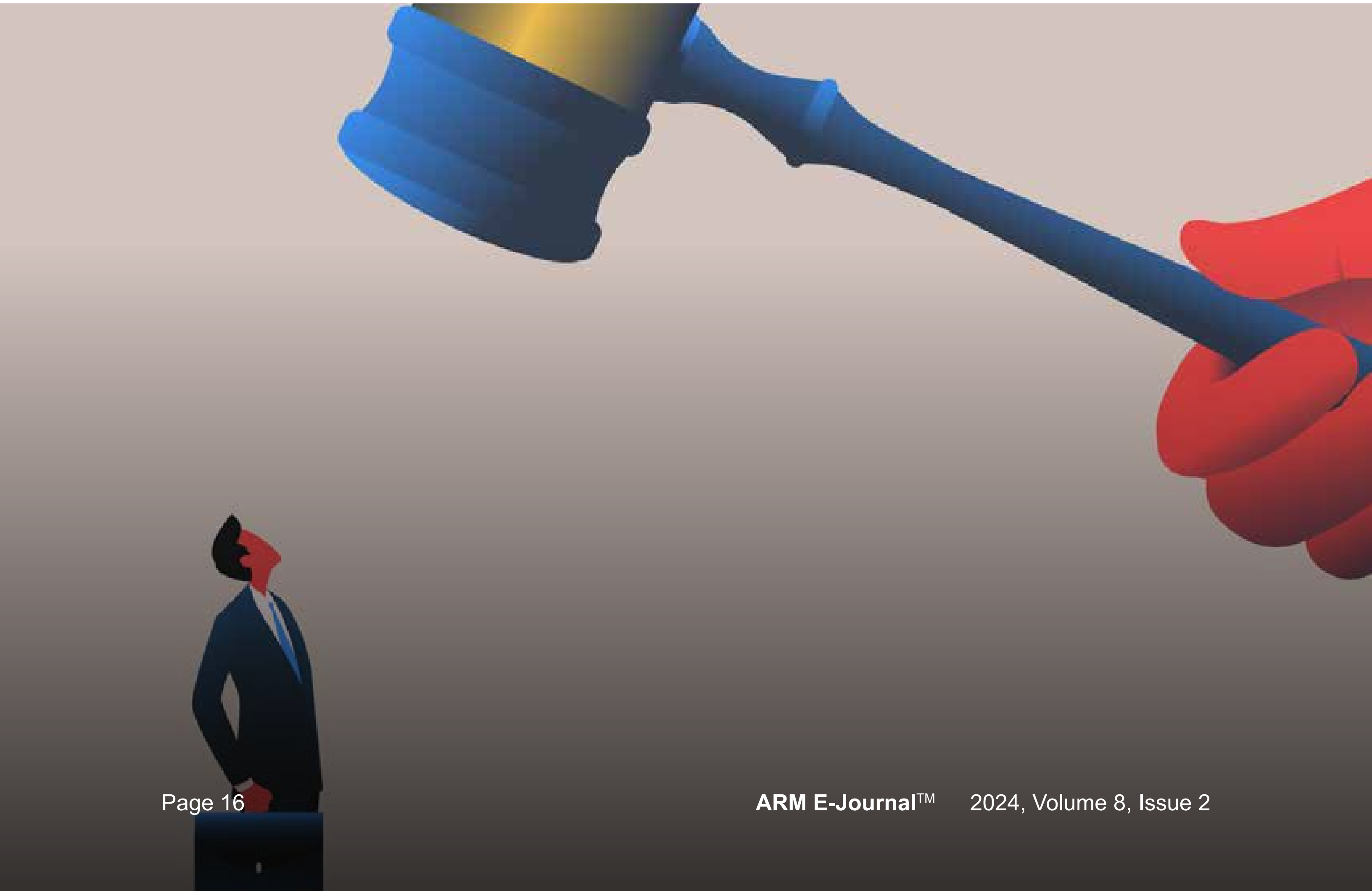
Lastly, the Court determined that the taxpayers did not have reasonable cause to rely in good faith on the defective appraisal. The Court concluded that the record was not sufficient to show that Scott (an experienced businessman) or his attorney did enough due diligence on the investment banker's qualifications or his report to determine if these were in compliance with the regulations.

But the Court did conclude that the resulting underreporting of income—because the taxpayers were not entitled to a charitable deduction—did not deserve to be further hit with an accuracy-related penalty under IRC Section 6662(a). This was because the "issue was not so clear cut" that the taxpayers would have reasonable knowledge beyond reliance on their legal counsel's advice.

Editors Note: *If you would like to read the Hoensheid Case in full, please click* here.

About the Author

Curtis R. Kimball, ASA, ARM, president of Vinewood Investment Analytics Inc., has appeared over seventy times as valuation expert witness in U.S. District Court, U.S. Tax Court, U.S. Court of Federal Claims, U.S. Bankruptcy Court, various state courts, and alternative dispute resolution venues such as IRS audits and appeals proceedings. Curtis holds designations as a Chartered Financial Analyst (CFA) from the CFA Institute and Accredited Senior Appraiser (ASA) in business valuation and appraisal review and management from ASA. Post-retirement, Curtis continues as consultant to Willamette Management Associates where he worked as a senior managing director.



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or contact asainfo@appraisers.org or (800) 272-8258.

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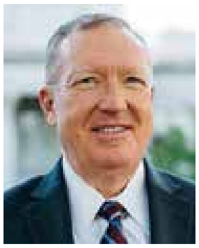
Clarifying Terminology: Purpose, Intended Use, and Definition of Value

By Jack Young, ASA, ARM

Abstract: This article clarifies the distinctions between the terms purpose, intended use, and definition of value in the context of appraisal practice, addressing common confusions and providing insights from industry expert Barry Shea, ASA. It delves into the historical evolution of these terms from pre-USPAP practices to their current interpretations within the Uniform Standards of Professional Appraisal Practice (USPAP) and the International Valuation Standards (IVS). The article emphasizes the importance of using standardized terminology to ensure clarity and consistency in appraisal reports and reviews.



Appraisal Terminology Confusion

Appraisal practitioners tend to combine the *purpose* of an appraisal with the *intended use*, and *definition of value*. Barry Shea, ASA, a seasoned Real Property appraiser and former Chair of the Appraisal Standards Board, explains that back in the pre-USPAP olden days, appraisers routinely identified and reported the *purpose and function* in an appraisal or appraisal review assignment.

Because in plain English those two terms were similar and could be confusing, USPAP made some refinements in successive editions.

Function

Function became *intended use*. Its official definition, still applicable today, applies to the use intended by the user of an appraisal or an appraisal review.

The intended use of an appraisal is the client's rationale for ordering the appraisal, answering the fundamental question of "Why do you need an appraisal?" Intended use determines the appropriate type and definition of value in appraisal assignments or the purpose of review in appraisal review assignments.

Purpose

Purpose was replaced by the phrase *type and definition of value* and used for appraisal assignments. Since the purpose of an appraisal is always an opinion of value, substituting type and definition of value for *purpose* was fairly simple. However, because no official definition of *purpose* was provided, confusion with *intended use* continued. The 2005 USPAP edition addressed this problem with wide-ranging edits:

> *Edits were made throughout the document regarding the term purpose, due to its varied intended meanings. The edits result in more accurate language, including use of the terms type and definition of value, intended use, and problem to be solved.*

One basis for on-going confusion could be attributed to IVS, which defines *purpose* in section 20.19, and that definition seems synonymous with USPAP's *intended use*:

> *The word purpose refers to the reason(s) a valuation is performed. Common purposes include (but are not limited to) financial reporting, tax reporting, litigation support, transaction support, and to support secured lending decisions.*

Some appraisers seem to think it is a violation of USPAP to use the term *purpose* in relation to an appraisal assignment, but USPAP does not require appraisers to use specific terminology, so if a report states, "The purpose of the appraisal is to develop an opinion of fair market value" and goes on to include the definition and cites the source of the definition, that aligns with USPAP requirements.

Purpose and Appraisal Review

Another opportunity for confusion is that the *purpose* of an appraisal review assignment is an opinion of the quality of another appraiser's work, with or without a review opinion of value.

The Comment to Standards Rule 3-2(c) states, in part:

> *The purpose of an appraisal review assignment relates to the reviewer's objective; examples include, without limitation, to determine if the results of the work under review are credible for the intended user's intended use, or to evaluate compliance with relevant USPAP requirements, client requirements, or applicable regulations.*

Conclusion

Understanding the distinctions among intended use, purpose, and definition of value—and using the terms consistently is important in appraisal practice.

All professions—including medicine, architecture, law, and accounting— have a vocabulary of precise, specialized meanings. These terms enable the professionals to have efficient discussions with practitioners and clients. Using these terms of art (jargon) in the relevant context matters a lot. Imagine an operating room where the medical staff used different names for the various surgical tools (scalpel vs clamp), an architect marking building plans with their personal terminology for various building materials, or an accountant interchanging the terms depreciation and amortization.

It's not surprising then that many appraisal professionals, including Barry Shea, former Chair of the Appraisal Standards Board, advocate for the adoption of standardized terminology, reserving the term purpose for USPAP reviews and IVS reports. Using consistent, specific language is what enables professionals to deliver consistent and meaningful results that are comparable and usable.

About the Author

Jack Young, ASA, ARM, is owner and senior appraiser at NorCal Valuation in northern California. He has served as Chapter President of the Northern California Chapter of the American Society of Appraisers and as Chair of the International Appraisal Review & Management (ARM) subcommittee of the American Society of Appraisers (ASA). He currently serves the ASA on the Board of Governors as the ARM representative.

The demand for appraisal review professionals continues to grow. Especially those with experience and that are educated, credentialed and maintain membership in professional organizations like ASA. Whether you're a review appraiser searching for career opportunities or a user of appraisal services looking to hire one, ASA's Job Bank provides the comprehensive resources job seekers and employers need. All available securely and confidently online, and backed by the global profession's leading organization—ASA.

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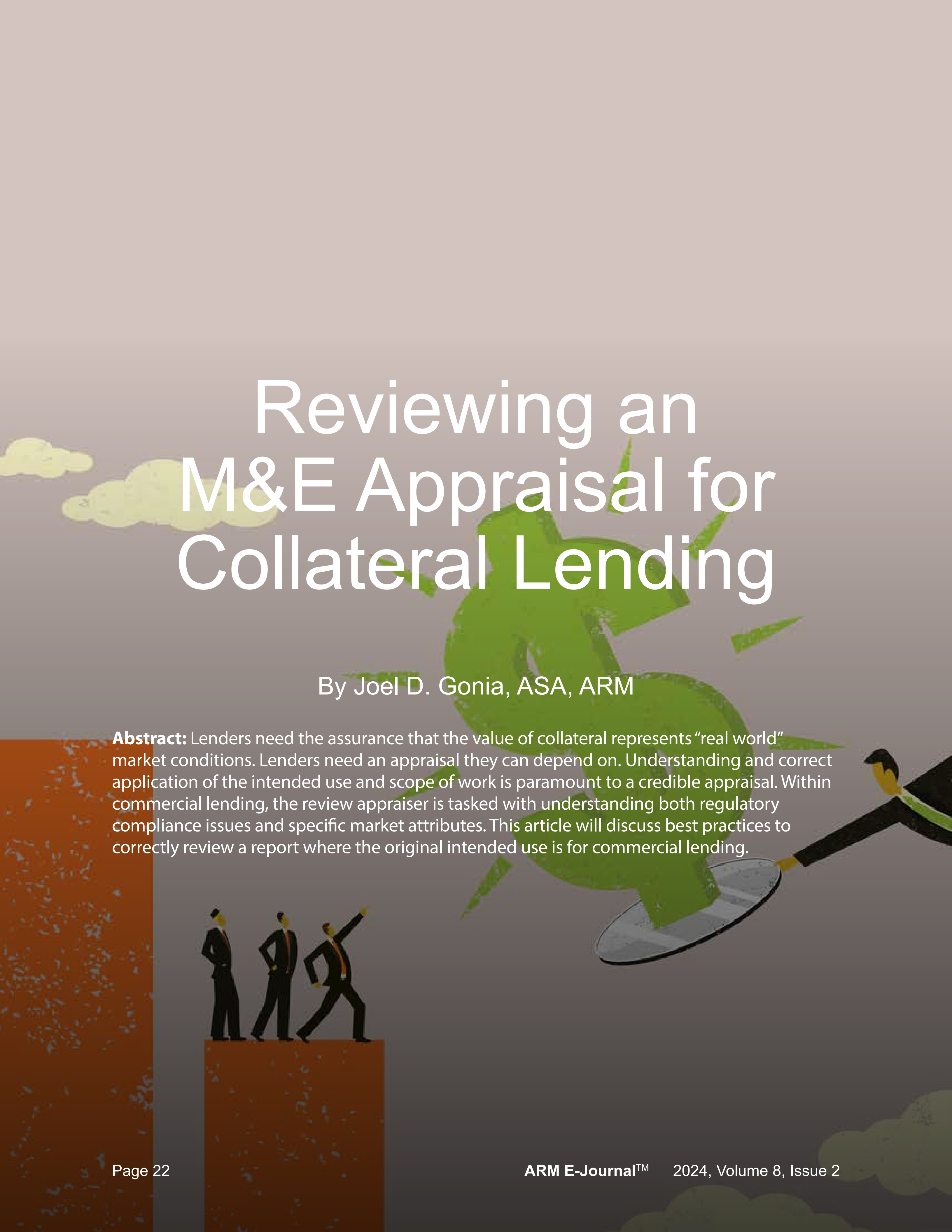


Reviewing an M&E Appraisal for Collateral Lending

By Joel D. Gonia, ASA, ARM

Abstract: Lenders need the assurance that the value of collateral represents "real world" market conditions. Lenders need an appraisal they can depend on. Understanding and correct application of the intended use and scope of work is paramount to a credible appraisal. Within commercial lending, the review appraiser is tasked with understanding both regulatory compliance issues and specific market attributes. This article will discuss best practices to correctly review a report where the original intended use is for commercial lending.

Reviewing Collateral Loan Appraisals

When approaching an appraisal review for any reason, a review appraiser will want to consider a comment in Standards Rule 3-3(a)(iii), repeated in (b)(ii), that states:

> *Consistent with the reviewer's scope of work, the reviewer is required to develop an opinion as to the completeness, accuracy, adequacy, relevance, and reasonableness of the report …*

This direction, which underlies much of ASA's Appraisal Review classes, is excellent guidance in reviewing reports for commercial lending.

Lenders don't want questions, they need answers. While you may think your review is insignificant and just represents a checked box, most likely it is paramount to closing the loan. The lender may not be a professionally trained valuation expert and is relying on your judgement and expertise to tell them what they've got! As part of the review process, we opine on the quality of work and if we believe the value conclusion is credible. We only mention an actual opinion of value ourselves if that appraisal service has been requested in addition to the upfront review.

The lender is relying on your review for several key factors, all relevant to the lending process:

1. Are the conclusions to value supported and are they accurate;
2. Is this a credible opinion to support their collateral position; and
3. Does the appraisal comply with USPAP?

Within the scope of work, you should identify the elements that allow the review to address all of these.

As a review appraiser for lenders, I have reviewed all sorts of appraisals, most are pretty good and in full compliance with USPAP, but not all. Some appraisals are contracted by the lender directly while others are provided by the potential borrower or possibly a co-lender with little to no consistency regarding qualifications and standards.

USPAP Compliance

Appraisal Reviews provided by ASAs must be USPAP compliant, in accordance with Standard 3, but our review process does not automatically assume the original appraisal must adhere to USPAP. Remember to check if the original engagement letter required the appraiser to comply with USPAP. If the original appraisal does not claim to be USPAP compliant or was not required to comply with specific standards such as USPAP or IVS, you will probably review that report differently than one that is intended to comply with USPAP.

Your client may have accepted the original appraisal regardless of whether it complies with any specific standards or not. Say the collateral is a fleet of over-the-road (OTR) trucks and trailers and the original appraiser is a local dealer with many years' experience but is not a professionally trained appraiser. Their values may be accurate, but are not adequately supported within the report, if there is one. What to do? Start by requesting a copy of the original engagement letter to confirm what, if any, requirements the appraisal was to be performed under, then proceed with the review. While we cannot hold the original appraiser to a higher standard than they were required to perform, any appraisal report should be credible and provide supporting narration and documentation as referenced in the Comment in Standard Rule 3.

Complete

Whether or not the original report is required or not to be USPAP compliant, an important question is whether it contains sufficient data to support the appraisal results. In the situation of the OTR trucks and trailers, are the values — which may be accurate — adequately supported within the report? Credible appraisals are complete and can be understood by their intended users whether or not they are technically USPAP-compliant. Does the appraisal report have all the information and explanation a lender would need to understand the value conclusion?

Accurate

Credible appraisals do not contain errors. The lender will depend on the data to determine collateral positions. We are really addressing two significant concepts: *data accuracy* and *value accuracy*. Data accuracy relates to the actual asset data (make, model, serial or VIN, and so on) necessary to secure the loan. Junk in – junk out! The lender will place a lien against the collateral and may use the asset listing within the loan documents without additional verification. If the data is incorrect, the lender may not be secured – big problem!

Value accuracy is equally important to determine an appropriate loan-to-value position. Each lender has their own unique formula to determine the amount, but it all begins with the estimated value by the appraiser. It's not good enough to be in the ballpark. Appraisals need to accurately reflect the market for subject property.

Within your review process, you are attempting to determine the quality of work and if the conclusions are credible and supported. You are determining if the conclusions appear to be accurate based on the data and methodology used within the original appraisal. Appraised values represent a specific date in time (effective date of value) and we should consider all data as it relates to that date and the scope of work. Remember you are not yielding an opinion as to the value of subject property, unless requested within a separate agreement.

Adequate

The original appraisal report must be adequate for the intended use and should align with the stated scope of work. Simply put, the appraisal services and subsequent report should address all assignment elements within the scope of work, nothing more, nothing less. Possibly more if the report is intended as a USPAP compliant report though the client did not require it.

Adequacy is a judgment call made by the review appraiser. We know the original appraisal was to be used within commercial lending, so if the listing of collateral does not contain sufficient detail then that may become an issue. VIN (vehicle identification numbers) and serial numbers are often used to identify assets within loan documents. According to your review analysis of the overall quality of work, it may be questionable if this information is not provided.

The concept of value is also of concern. Most lenders do not base their loan-to-value ratios on a continued use concept, rather a removal or in exchange concept. What does the original scope of work require? Maybe the original appraiser was required to provide a specific concept, or not.

Lenders want to rely on the original appraisal for the basis of their collateral requirements. They need to know if the original appraisal is sufficient, or not, to move forward with the loan process.

Relevant

If the contents of the work are not applicable, the lender may question if sufficient effort was performed. Boilerplate discussing details beyond the appraisal problem and the scope of work may be a red flag. Many appraisers utilize a template for their report, and many include data and information that may not be immediately relevant to the assignment. How much is too much? This is another judgment call made by the review appraiser when considering the type and extent of discussion within the original report. The reviewer should notice if the original appraisal stays on point or interjects a bunch of data and discussion that really isn't necessary.

For example, think of a commercial real estate appraisal of a significant property with full development of all three approaches to value. This report will typically be 60 – 100 pages long plus numerous addendums addressing overall market analysis, macro- and micro-neighborhood analysis, rent and occupancy trends, and so on. Rather extensive to say the least. Now compare that to an appraisal of a machine shop with 20 – 30 CNC machines of common type and manufacture. This appraisal will typically only include the sales comparison approach due to the abundance of data currently available and the report may be 10 – 30 pages long.

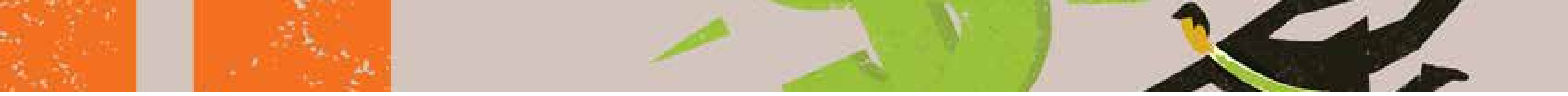
Each report is relevant for the stated purpose! However, what if the M&E appraisal included full development of the cost approach and discussion of both direct and indirect replacement cost new values, yet clearly states that there is an abundance of used market data currently available similar to subject property? Is it necessary, or is it relevant to the overall appraisal to include the extra commentary and analysis to determine RCN? Probably not.

Within your review, try to determine if the original report was excessive, or conversely if it may not contain adequate supporting documentation.

Reasonable

Does the work performed and conclusions reached make sense? Given the scope of work, is it reasonable that others would reach a similar result? This is actually my favorite part of the appraisal review – I call it the sniff test! After I've read the original engagement letter and scope of work, after I've read the report, after I've reviewed the analysis, and after I've read the report again, I ask myself some questions: What do I think—Is the argument supported? Do I believe it? Yes, no, maybe. And then I go back and read the report for the third time, now making notes and comments according to my particular scope of work for the review.

"Providing review appraisals to commercial lenders is an important part of the lending process."



The lender is asking the reviewer, either directly or indirectly, do we agree with this appraisal, and if not, why. If we think it is reasonable, then we need to relate that opinion to the client. If we don't think it is reasonable, then we need to point out exactly where and why we believe it is inadequate. Sometimes an appraisal just doesn't make sense, like maybe the appraiser didn't understand the industry. Or maybe they didn't address the scope of work elements or provide a proper concept of value. Or maybe the appraiser used the wrong effective date of value. Maybe the effective date of value represents a retrospective appraisal, yet the market data reflects current comparables! What does this thing smell like?

Conclusion

Providing review appraisals to commercial lenders is an important part of the lending process. Appraisal reviews are considered to be the additional support to justify collateral value and firm up the loan-to-value ratio so the loan can be booked. Of equal importance is to confirm compliance with standards so the original appraisal doesn't get rejected down the road.

An appraisal review that has been performed well, that has addressed all assignment elements within the scope of work, will allow the lender to proceed with loan funding, or identify where the original appraisal failed so they can request a new appraisal. It is far better to know now that the collateral value is inadequately supported than find out later when the lender thought they were adequately protected.

About the Author

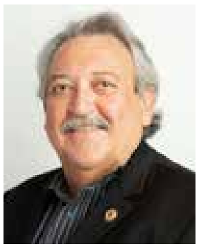
Joel D. Gonia, ASA, ARM, Senior Review Appraiser, KATS Machinery & Equipment Appraisals, has spent his entire career within the valuation industry – 35 years and counting! Joel received his MTS ASA from the American Society of Appraisers in 1989 and his ARM in 2016. At KATS, Mr. Gonia is responsible for all work performed by the firm, including value accuracy and consistency, USPAP compliance, internal policies and procedures, and continuing education. The clientele consists primarily of professional service providers for middle market firms, providing valuation and consulting services for financial reporting, commercial lending, insurance, tax, and litigation purposes.

On Tangible Property Appraisal and Valuation Reconciliations

By Richard J. Conti, ASA, ARM

Abstract: Valuation standards of USPAP and IVS state that the appraiser or valuer[2] should reconcile the quantity and quality of data. This article offers an enhancement to the Standards, based on a statistical model to do so. This article explores the types of variables used in statistics which the personal property appraiser or valuer faces in a valuation assignment. It then offers how the appraiser or valuer might incorporate those variables in a narrative report's reconciliation of value as a conclusion as a more credible and defendable report.

[2] The term *appraiser* is generally used North America; *valuer* in the rest of the world.



Using Logic

Reconciliation is the final step in the appraisal process, resulting in the final opinion of value. The reconciliation step involves an analysis of (1) the relative appropriateness of the approaches applied; (2) the accuracy of the data collected and calculations made in each approach; (3) the quantity of data available for each approach; and (4) the consistency in the manner in which the approaches to value are applied.

Much has been discussed and printed on the role of logic in an appraisal report, for good reasons. True premises and conclusions used in the reconciliation argument supporting the concluding value gives the appraiser or valuer the opportunity to be most convincing.

The appraiser or valuer can add to the impact of logic by weaving statistical methods used for quality improvement which they inadvertently collected as they faced the value decision. In each report, the author will develop an analysis of the item being valued, the choices leading to the accuracy of the description and the data collected and the choice of calculations made in each approach. With tangible property, the analysis is not necessarily numerical. The author could be more convincing if the choices made (variables) are disclosed and explained to the reader.

Variables in the Appraisal Process

In statistics a variable is an attribute in the sample population. In appraising or valuing tangible property, a variable is a property characteristic.[2] That property characteristic is what drove the data collection in a market approach. Decisions about that property characteristic were made while selecting the data for the analysis. Those decisions are variables. Variables can be quantitative (objective amounts) and qualitative (subjective) and the typical appraisal reader does not know much about them. However, readers of narrative appraisal reports want to

[2] Lanmon, Dwight., *Evaluating Your Collection. The Fourteen points of Connoisseurship*, Winterthur Museum

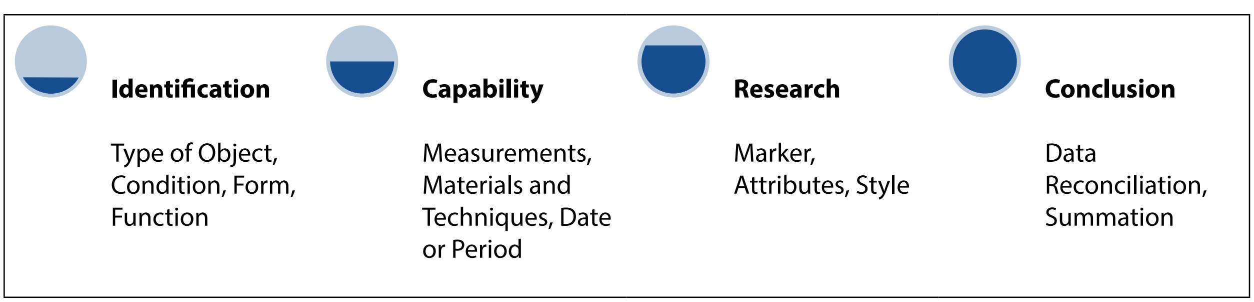


Figure 1: Variables in the Appraisal Process

"...inclusion of a variable discussion makes the review easier to review..."

Types of Data	Types of Variables	Variable Examples
Quantitative	Discrete	Limited options: weight, measurement, number of items
	Continuous	Unlimited options: grade, craft technique, color, age
Qualitative	Categorical	Binary: to be in the group or not
		Nominal: no difference
		Ordinal: ranked good, better, best, superior, masterpiece[3]

Figure 2: Variables

know how the appraiser or valuer identified variables and how they contributed to the valuation decision. If the variable is critical to the valuation, the reader wants to know the options that were available to the appraiser or valuer to make the decision. This is especially true if the reader is a lawyer or judge.

There is a process to including statistical methods used for quality improvement in an appraisal or valuation report:

Throughout the process the appraiser or valuer makes decisions based on education and experience. Keeping track of these decisions is important because they identify the variables of the assignment. Variables—developed for statistical analysis and adapted for appraisal practice—come in quantitative data (amounts) and categorical data (groupings). Some value characteristics could fall into more than one variable.[4]

Quantitative Variables

Quantitative variables important to an appraisal will be discrete — with limited options — or continuous — with unlimited options. These two quantitative variables provide various influences on value decisions that the appraiser or valuer must explain to the reader of the appraisal report. Quantitative variables are in the identification and data analysis stages of the report. Quantitative variables are the choices made by the author to define the item and its value.

Discrete Variables

Discrete variables provide limited options. A discrete variable might be the weight, measurement, or number of an item. Variable options that affect the valuation are most relevant. The author should identify them and relate what impact they have on the valuation and how they should be considered in a reconciliation. Information about discrete variables, woven into a report's logical argument, will support the appraisal process and value opinion.

Every discipline has particular discrete variables that influence a valuation decision. For the personal property appraiser or valuer, examples of quantitative discrete variable depend upon the subject assets. Variables for appraising or valuing

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[3] Sack, Albert., *The New Fine Points of Furniture*, Crown Publishers, NY

[4] US Bureau of Labor and Statistics Consumer Price Calculator https://data.bls.gov/cgi-bin/cpicalc.pl

hallmarked silver, would include the weight, measurement, number of the item and the identifying marks which tell the appraiser or valuer much of how to proceed to a value. For the Gems and Jewelry discipline, variables would be the four Cs of a diamond (cut, color, clarity, and carat weight). For the Real Property appraiser or valuer, variables for valuing improvements on land would include materials, age, square feet, and number of rooms. For the MTS appraiser or valuer, number, age, materials, use or function and the quality of construction may be the variables. For the Business Valuation appraiser or valuer looking at real property improvements that has income generation, the most frequently used discrete variables would be potential gross income, effective gross income, and net operating.

In all appraisal disciplines, the expertise is in the interpretation of the data. It is the weaving of explanations and discussions of the variables into logic that makes a great reconciliation.

Continuous Variables

A continuous variable may be grade, craft techniques, color, or age. Typically, the variable is a number that is measurable and non-finite and so, unlike the distinct variable, has a wide range of options, with unlimited choices and is subject to interpretation by the report. Here, the appraiser's experience and training come through in the process of investigating, analyzing, and verifying the item, creating a tight knit of unique ingredients and explaining why any variable was selected. A reconciliation that discusses the important continuous variables by leading the reader through an interpretation of the value characteristics becomes a very convincing argument and is a great read. Tell your reader how you interpreted a continuous variable.

For the personal property report writer, continuous variables can be graphed, and such a graph can bring a report to life. The $/square inch of a painting with a discussion of the mean, median, standard deviation and coefficient of variation have been discussed to exhaustion. Sales ratios of auction estimates to sales prices have also been included in many a magazine article and valuation report. Sales adjusted for time are a quantitative variable and because inflation is not a constant it is a continuous variable.

Qualitative Variables

In addition to quantitative variables, there are qualitative variables known in statistics as categorical variables. These are groups of attributes, not actual numbers of things but a category of them. They can be binary (yes or no), nominal (no difference) or ordinal (ranked). Ordinal has been the subject of many a book on an appraiser or valuer's bookshelf. A critical categorical variable is the market, which sets the item being valued into a particular rating. All ordinal variables should be explained by the way the market reacts to the variable.

In personal property attribution, condition, craft technique, finish, ornament, style, and material could be quantitative. Also, a school of art such as Barbizon or Hudson River can easily be seen as categorical and qualitative, as would Edwardian, Victorian, or Continental.

A market reaction to a qualitative variable is important in an appraisal report and should be included in the reconciliation. The reconciliation can go beyond the items described in the report by placing perspective of the class. Every narrative appraisal report— either in the reconciliation or the asset description—should contain a discussion of the qualitative variables.

This discussion is an opportunity for you to display your expertise regarding the assets you have valued—the reason you got the assignment. Do your best to make your experience and knowledge obvious without stating it directly (ipse dixit).

Variables in the Reconciliation Discussion

An appraisal or valuation addressing a marital dissolution, an estate facing equitable distribution, an insurance claim on a loss, all have readers wanting closure on the valuation discussions. It is why they chose an appraiser or valuer, an independent professional opinion, an expert who can apply the variables to the conclusion.

A reconciliation is the final step in the appraisal process and the perfect place to discuss how the variables relate to the appraisal and to the valuation's intended use, giving the reader an opportunity to follow the author's knowledge and expertise of the subject. The appraiser or valuer can display market expertise if the variables are part of the problem and display statistical expertise if the variables are explained to solve the valuation problem. This applies best in describing the accuracy of the data collected because decisions were made, variables were narrowed, some data found was left out and some data has more weight than others due to the variables. Additionally, the research may have been expanded to increase the quantity of data due to a variable. Let's consider some examples, first with property characteristic variables driving the accuracy of the data:

"We restricted some variables in the data collection to increase, statistically, the confidence in our results. The data collected was restricted to the past three years due to the trending changes in the market explained in the Market Section of this report. The data collected was also restricted to sales in the Northeastern region of the United States because there is evidence of a regional market, also detailed in the Market Section of this report."

"We restricted some variables in the data collection to increase, statistically, the confidence in our results. Only works by the artist of the same scene were considered in the data as he produced many of them with minor modifications and they form a data set, in this case, 15 sales."

"We restricted some variables (time, location of sale and number of auction bidders) in the data calculations to increase, statistically, the confidence in our results. We sought the median in the sales then calculated the standard deviation."

Identifying Variable Choices

I have read many appraisal reports without any mention of why potentially useful variables were not selected. Worse, the selected variable may be identified and dismissed in a single sentence, such as: "The cost approach utilized a 50% depreciation [in a hospital appraisal] because the facility was constructed in the 1950s."
USPAP and IVS do not have enough armament to express my discontent. This explains nothing. I might have a different reaction to this appraiser's justification of depreciation if he had instead written: "The cost approach is a continuous variable and typically used for new construction where the cost of goods used to build are purchased at market prices."

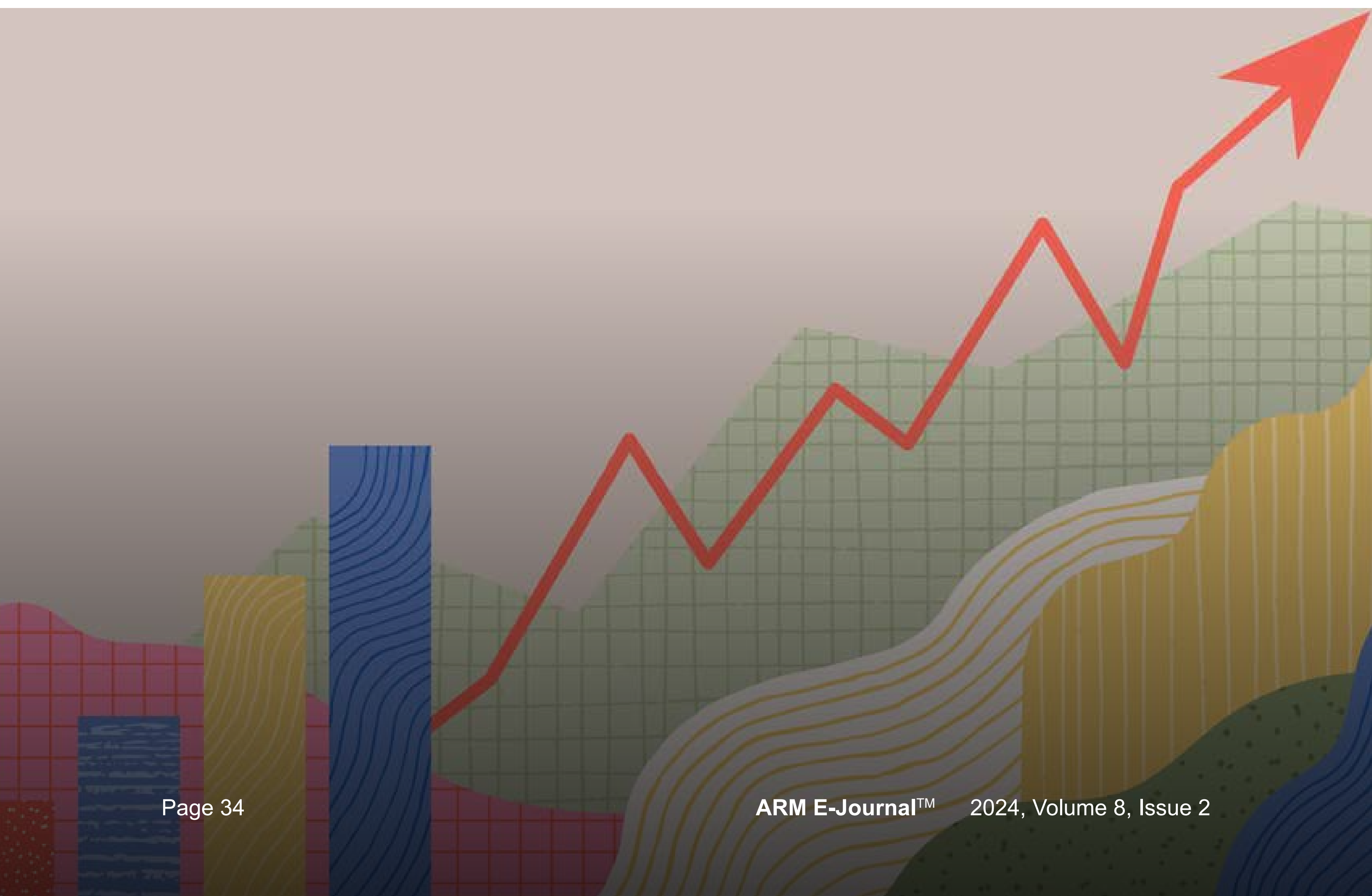
The problem is that due to interpretation of depreciation, the cost approach variable is less reliable over time. The reconciliation did not discuss this variable in enough detail to educate the reader. In this example the appraiser used the cost approach because he wanted to compare at least two approaches for a value conclusion. He had sales and used the sales approach. The third approach, the income approach, was not possible because the report was being written to be used in a trial and hospital management would not disclose finances which could become public record.

Conclusion

For the report reviewer, inclusion of a variable discussion makes the review easier to review because the thought process is exposed. For the readers or intended users of the appraisal report, it can provide important clarification of the appraisal process and a deeper confidence in the appraiser's expertise. It might also make the reconciliation narrative longer. The next time you write a report, take a moment to reflect on the variables you faced in the assignment and see if they made it into your reconciliation. If not, consider re-writing it.

About the Author

Richard J. Conti, ASA, ARM, owner and principal appraiser at Conti Appraisal Service, is an accredited personal property appraiser and Chief Assessor at City of Taunton, MA. An ASA since 2004 and a Past President of the Boston Chapter ASA, he currently serves as Chair of the ASA International Marketing Committee and the ARM Discipline Board and is a Co-Editor of the ARM E-journal.



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