

Real Estate Appraisals

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INTRODUCTION

Fundamental to ownership of forestland is knowledge of its value at any specified point in time. Lacking such knowledge an owner's capacity to effectively plan and make sound and prudent asset management decisions is greatly hindered and could place the owner and intended heirs at unnecessary risk. Should I sell? Should I buy? How can I equitably apportion my property in my estate to my heirs? What will be the estate tax liability? Is there any way to avoid the destruction of my estate? These are but a few of the typical problems an appraisal may help to resolve. A more comprehensive list of typical uses of real estate appraisals is categorically cited below¹.

Transfer of Ownership

- To help prospective buyers set offering prices
- To help prospective sellers determine acceptable selling prices
- To establish a basis for real property exchanges
- To establish a basis for reorganizing or merging the ownership of multiple properties
- To determine the terms of a sale price for a proposed transaction

Financing and Credit

- To develop an opinion of the value of the security offered for a proposed mortgage loan
- To provide an investor with a sound basis for deciding whether to purchase real estate mortgages, bonds, or other types of securities
- To establish a basis for a decision to insure or underwrite a loan on real property

Litigation

Eminent domain proceeding

- To develop an opinion of the market value of a property as a whole – i.e., before a taking
- To develop an opinion of the market value of the remainder after a taking
- To estimate the value to a property created by a taking

Property Divisions

- To develop an opinion of the market value of a property in contract dispute
- To develop an opinion of the market value of real estate as part of a portfolio
- To develop an opinion of the market value of partnership interests

Environmental litigation

- To estimate damages created by violations of environmental laws
- To estimate damages created by environmental accidents

Tax Matters

- To develop an opinion of assessed value
- To separate assets into depreciable (or capital recapture) items such as buildings and non-depreciable items such as land, and to estimate applicable depreciation (or capital recapture) rates
- To develop an opinion of the value of the real estate component of an estate plan that represents the foundation for future capital gains and inheritance taxes
- To determine gift or inheritance taxes

Investment Counseling, decision making, and accounting

- To set rent schedules and lease provisions
- To determine the feasibility of a construction or renovation program
- To help corporations or third parties purchase homes for transferred employees
- To serve the needs of insurers, adjusters, and policyholders
- To facilitate corporate mergers, the issuance of stock, or the revision of book value
- To counsel clients by considering their investment goals, alternatives, resources, and constraints and the timing of their activities
- To advise zoning boards, courts, and planners, among others, on the probable effects of proposed actions
- To assist in arbitrating valuation issues

¹ The Appraisal of Real Estate. Twelfth Edition, The Appraisal Institute. Table 1.4, Chapter 1, 2001

- To analyze supply and demand trends in a market
- To ascertain the status of real estate markets
- To value fixed assets and assist in asset value allocations

WHAT IS AN APPRAISAL?

By definition, an *appraisal* is: “the act or process of developing an opinion of value”.² In fact, an appraisal is often described as a credible solution to a problem. An appraisal deals with value. It is never a fact but always an opinion of the worth of a property at a given time in accordance with a specific definition of value. It is an economic concept. Value is always stated as an opinion. USPAP defines value as “the monetary relationship between properties and those who buy, sell or use those properties”. On the other hand, one can get a better understanding of value by making a direct contrast of *value* with its misperceived relative, *price*. As opposed to the concept of value, once stated, price is forever afterwards a fact, whether it is publicly disclosed or it is retained in private. Because of the financial capabilities, motivations, or special interests of a given buyer or seller, the price paid for a property may or may not have any relation to the *value* that may be ascribed to that property by others. But the price paid for a similar property in a recent transaction is often relevant to the value problem for the subject. *Cost* is also a fact, and it not a substitute for value. Cost is the amount required to create, produce, or obtain a property. When the element of cost is known for a similar property it may also be relevant to the valuation problem for the subject. Obviously, cost can exceed, but seldom is found to be less than value when other factors are normal. When cost is much less than price, surplus profit occurs and this tends to cause a price to come down. Neither cost nor price should be mistaken for value. But both provide data for the appraiser to consider in an analysis. And, once analyzed, they may help to provide an indication of value.

WHAT IS THE SUBJECT OF AN APPRAISAL?

Most people think of houses, lots and commercial buildings when they hear the term real estate. But in fact, forestland, to include the trees and everything else that is on the land, is also real estate. A review of the following real estate terminology will assist in understanding this concept.

Real estate is the physical land and appurtenances affixed to the land. Real estate is immobile and tangible. Hence, we have the reason for the use of the term “real”. Landowners should understand that the concept of land includes all things that are a natural part, such as trees and minerals. Thus, it includes “timber” as it specifically amends the condition and yield capacity, or potential of the land. Similarly, it also includes all things that are attached to the land by people, such as buildings and site improvements. It is for this reason that a single-family residence is conveyed by a seller to a buyer by using a simple warranty deed to the land.

Real Property on the other hand includes all interests, benefits, and rights inherent in the ownership of physical real estate. It is important for landowners to understand that appraisers do not appraise real estate. The subject of their investigation, analysis and reporting is “real property”.

A right or interest in real estate is also referred to as an *estate*. The ownership of all of the rights is called *fee simple*. The total range of all ownership interests in real estate is called the *bundle of rights*. If you can imagine that each interest in real estate is a separable stick, and that the entirety of these interests, when combined is therefore what is commonly known as a “bundle of rights”. A complete “bundle” contains the right to enter the real estate, the right to sell it, to lease it and occupy it, to give it away, the right to mortgage an interest, the right to do all of these things, and the right to do none of these things. Each individual right in the bundle is presumed to have some potential value. In like manner, if any or all are removed from the fee simple interest, one or more partial interests are created and will often have to be valued. The decision to remove, or convey one or more “rights” is not to be taken lightly. Due to the

² Uniform Standards of Professional Appraisal Practice (USPAP), Appraisal Foundation, 2003.

nature of the real estate market, the sum of the values of the individual partial interests will not usually equal the value of the fee simple interest. So understanding the impact that conveyance of rights will have on remaining rights is essential to good business.

Along with the issue of “rights”, appraisers focus on a number of critical elements pertaining to the physical character of property. A few of these physical character elements are:

- **Site size and shape.** Differences in size can affect value. The normal presumption is that with increases in size one expects a proportionate decrease in the unit prices. But to the extent that sizes too small can impact the rate of unit costs, this is not always true of forestlands. Shape may adversely impact operability and access by extending a portion of the land into an area of greater physical restriction. On the other hand, shape may permit an extension to a point of property access that could not otherwise be enjoyed.
- **Corner influence.** Properties with road frontage on two or more sides may reflect a higher or lower value. Higher value occurs when greater frontage is a benefit. Lower value occurs when greater frontage is undesired exposure, represents a reduction in a desire for privacy, or some other issue considered to be a property liability.
- **Plottage.** This is an increment of value that results when two or more properties are combined to produce a larger site with greater utility. Plottage is often a significant element when appraising land utilized for agricultural purposes or timber production purposes. In contrast to the benefits of plottage, some land that may best be divided in order to achieve the better returns may be sold at a lower unit cost when it is sold in bulk.
- **Excess land and surplus land.** These two terms are similar with this distinction. Land not needed to support a specific use is called **excess**. Land not needed to support the use of the subject, but that is not separately marketable is called **surplus** land, and therefore will normally be appended to the land that is the subject.
- **Topography and soils.** Access and operability for forest lands can often have much to do with the topography. When topography becomes restrictive, the unit costs associated with land use increase. The results of increased costs are normally reflected in unit prices. In similar manner, all other factors aside, the agricultural unit productivity of forestland is most commonly a function of the soil. A change in soil composition or condition can radically change the potential for forest product output. Values for forestland best suited for timber production will normally reflect some measure of this capacity.
- **Site improvements, utilities and ease of accessibility.** These characteristics may enhance property value when they provide compatible concurrent uses of the forestland. Much of the value is dependent upon the restrictions placed on one or more of the property rights by the exercising of a separated right. (See Bundle of Rights).

TIME CHANGES THE MOTIVATION OF PROPERTY OWNERS

A physical demonstration of the long-term goals, decades of waiting and the hard work toward those goals is often clear in a forested property. Forestland is a complex real property, and neither a familiarity with it, nor the knowledge of how to manage it effectively passes with the title to successive generations. Reality is that sentimental attachments and appreciation for the valiant efforts of ancestors will fade or become diluted over the successive generations. Eventually the heirs may not have even seen what they own, and frequently don't recognize its potential or worth. With this common truth brings exposure.

There are unfortunately those who prey on landowners who do not comprehend the complex nature of forestland, or its value. Land left to successive generations often dilutes property control, thus compounding real liabilities, such as:

- the vulnerability of the elderly or sick to slick profiteers (bad offers that sound good)
- poor decisions based on biased opinions that are offered by parties with a conflict of interest.
- inequitable property divisions resulting from a poor understanding of property worth
- economic pressures that develop due to an inability to convert assets into acceptable collateral
- destructive impacts on condition and makeup of an estate resulting from the poorly advised efforts to relieve the financial burdens of existing federal estate tax laws

HOW OFTEN DO I NEED AN APPRAISAL?

The need for an appraisal is usually signaled by some formal requirement. So the frequency of this need may have something to do with how often there are changes related to the ownership, changes to the condition of the real property, or some adjustment to financing related to the assets. Because an appraisal is only an opinion as of a specific point in time, with a specific definition of value, any new date (or update) of value technically calls for a new appraisal assignment. An appraiser has some liberties in his ability to incorporate previously developed information and data into a new appraisal, and this may often save much of the cost that was once involved with data collection and analysis with the former appraisal. However, this will be possible only to the extent that accurate information and data is available in a format that is compatible with the necessary analysis. (See the section entitled What Should I Ask For) For this reason it is important that the intended use of the original appraisal clearly identify the intent to make periodic valuation updates, and that the collection and maintenance of relevant property data is designed to facilitate this end.

WHO IS BEST TO PROVIDE ME WITH AN APPRAISAL

It is important that the forest landowner seek services from an appraiser *already possessing knowledge and experience with forest properties that is so essential to develop a credible appraisal of this complicated property type.* The appraisal profession is very broad and diverse. Appraiser competency is fundamental to obtaining a credible solution to your valuation problem. Very capable appraisers having excellent experience in one area may not be qualified to appraise property types outside of their specific areas of expertise. But it is far better to engage the services of a professional appraiser who is ethically bound by compliance with USPAP than to use unqualified opinions of those who have somehow avoided being regulated by state agencies charged by law with monitoring the activities of individual practitioners in the appraisal profession. Appraisers are strictly bound by published ethics that require them to absolutely perform their assignments in a manner that is independent, unbiased, objective and honest. Such is not always true of others.

Before you choose an appraiser for an assignment related to your forest property, first consider the qualifications of the appraiser. Request and review a statement of qualifications, and narrow your search. Don't restrict your consideration to just the basic ability to develop an appraisal. **It is essential for you to consider the full range of intended use of the appraiser's opinions and conclusions.** When anticipating litigation, you may be wise to employ an appraiser who is experience in work that has involved litigation. Some appraisers decline assignments that include this requirement, and all appraisers will expect to know of this possibility prior to accepting an assignment. The detail associated with data

collection, the time that may be involved with depositions and attorney consultation, the duties involved with providing expert testimony, and the need for a clear and pro-active demonstration of compliance with the appraisal standards beyond the scope of a common assignment.

If your objectives include the development of options for the hostile partition an estate among estranged family members it may be best to seek someone recognized as being independent and impartial of anyone involved to avoid any concern over perceptions of advocacy. It is usually best to have an attorney or authorized representative engage the appraiser. Avoid circumstances where a suspicious adversary may attempt to retaliate by filing complaints against the appraiser over advocacy. A board or professional review panel has no alternative but to seek strong assurance that this very prohibited conduct has not occurred. Avoiding these kinds of emotional issues is essential as they can result in non-productive backlashes, not to mention undue pressure on the appraiser resulting from complaints, investigations and possibly hearings.

If something about the assignment has potential for a challenge or review by the Internal Revenue Service regarding estate taxes or any other issue, you may well want to employ an appraiser that has some experience with providing appraisals that are prepared with the federal tax courts in mind. A failure to adequately publish and substantiate data, a weak explanation of the basis for conclusions, or not adequately anticipating the need to provide for this otherwise unexpected use may draw a reaction not to your advantage.

Keep in mind, not all of the good forestland appraisers are necessarily full-time appraisers. Other duties and obligations may limit their ability to meet your proposed time constraints. As soon as you suspect that you may need an appraisal, start early in your search. **Do not be afraid to look for an appraiser outside of your immediate area if the task might demand it.** The appraiser you really need may not be in your town or your county. You can inquire of availability from state appraiser licensing boards, from forestry consultants (many of whom are also active in the forest appraisal profession), appraisal trade groups, forestry associations, accountants, tax attorneys and other landowners who may have had experience with appraisers. But keep this in mind; **seldom is it to the advantage of a landowner to submit his hard built estate as a training ground for an unqualified appraiser in exchange for cheaper in appraisal fees.** Common to having heart transplants and brain surgery, it is not in your interest to risk all that is involved by reliance on an incompetently performed appraisal.

If the awareness for the need to have an appraisal came about as the result of advice provided by an attorney or an accountant, you may want to be sure to offer that person an opportunity to also review the qualifications of the appraiser. Keep in mind that attorneys and accountants often need to consult with the appraiser concerning data, minor issues of value, and other clarifications that may be needed long after delivery of the report. If you expect your attorney and accountant to provide you with good representation, recognize that they will need to have the opportunity to express their concerns should they be uncomfortable with the appraiser's professional capability. In fact, consider allowing your attorney or accountant to engage the appraiser.

Also, be aware. If an appraisal is required by a lender, then federal banking requirements clearly mandate that the lender to be the one who engages the appraiser. An appraisal prepared specifically for a landowner is not acceptable for lender's purposes. Simply re-addressing the letter of transmittal, or changing the name on the appraisal is a major violation of USPAP. The appraiser has an ethical obligation to inform potential clients of this requirement when he suspects that the appraisal is to be used for lending purposes. Landowners who don't take this issue seriously may well be out an appraisal fee and soon find themselves back at square one, seeking the services of another appraiser, and eventually paying for another appraisal as part of a lenders fee.

Any forest landowner is strongly encouraged to obtain and maintain viable information and data; to use the right tools to manage his assets; and to seek qualified professional counsel and guidance with regard to forest asset management. One very effective tool toward this goal is a well-defined, well-planned, well-researched, properly executed real property appraisal. It should be developed by a state-regulated

professional appraiser who is operating in compliance with the Competency Rule of the Uniform Standards of Professional Appraisal Practice (USPAP). USPAP has been the clear standard for all real property appraisals in the United States as a result of Title XI of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). Because of this federal mandate, each state has a regulatory board empowered to license and certify appraisers, receive and administrate complaints, and police their ethical conduct. USPAP has become the universally accepted standard that describes what must be met in terms of general competency. Competency includes such factors as, but not limited to an appraiser's familiarity with a specific type of property, a market, a geographic area, or an analytical method that may be unique to a property. Such unique analytical methods abound in dealing with timber and timberland.

WHAT SHOULD I ASK FOR?

Because an appraisal is really just a solution to a stated problem regarding value, the definition of the value to be used and the effective date of that value opinion are always considered to be the *purpose* of any appraisal assignment. But of equal importance is what the intended user of the appraisal is intending to do with the opinions and conclusions provided by the appraiser in his report. This must be clearly defined **at the time of the assignment**. To do this, you need to consider the following:

- the problem that must be addressed,
- the scope of work will be that is necessary to complete the assignment, and
- the full extent of development and reporting that will be necessary for the report to be understood by the intended users, and for it to be meaningful given the intended use, or uses.

It is important for forest landowners to not just consider the immediate, short-term use, but also define any future uses of the data and conclusions as well. For example, **if the intended use of the appraisal is to establish the estate tax liability for a timberland estate, recognized that this will simultaneously establish the acquisition basis for the heirs of an estate. This basis will affect the utility of capital gains tax calculations in the future.** In such an assignment, the data provided to the client by the appraiser should probably be reported in units associated with management components. Given such circumstances:

- If the land is a larger holding that is already divided into management blocks with a schedule of projected harvests, then the reporting of data (separated by land, timber and improvements) that sets the acquisition basis should be in the same basic format. Doing so in this manner would be meaningful because it would also permit simplified accounting for depletion of the basis as the original assets are liquidated by harvests. It would also provide for the ability to account isolated losses, or provide the flexibility to make overall adjustments to the account for any disposition by conveyance; or additions by purchase.
- If the land is not already divided into operative units as indicated above, it might be wise to use the appraisal as a tool to do this. The appraiser's experience in forest management will come into play, or he may need to employ others to acquire this capability. This additional effort may expand the assignment beyond the basic appraisal, but it will provide major dividends for the owners in the future operations on the property.

- Should a landowner be utilizing some form of forest management services it is likely that the input of the service provider will be required. Information regarding the amount and disposition of merchantable timber volumes may already exist in a format that can be used for appraisal purposes. If not, then a new inventory of forest products may be required. This may incorporate some agreement between the appraiser and the persons that will do the inventory work, or the appraiser may have to do the work himself, if he is qualified to do so. But the credibility of the data provided by such a service is subject to the acceptance and approval of the appraiser. USPAP requires that the signing appraiser relies on work provided by others, he must have a reasonable basis for believing that those individuals performing the work are competent and that their work is credible³

Should the intended use be **to assist the client in setting a fair price for all or part of the land**, then the client and the appraiser should first identify and agree on the manner in which the subject property is offered and will be considered; or when the client is the potential seller, the appraiser may need to identify the intended manner in which it may be offered for sale. Since the value of any partial segment of the whole will change as the segment size and property characteristics are altered and offered, the appraiser will need to define “what” is being appraised before he can begin the assignment. Any modifications of the nature or character of the part that is to be appraised will probably invalidate the value opinion or conclusions of the appraiser.

WHAT TYPES OF SERVICES DO APPRAISERS OFFER?

The three most common services offered by appraisers are appraisal, appraisal review and appraisal consulting. The Uniform Standards of Professional Appraisal Practice apply different standards rules to each of these identified services.

- As previously stated, an *appraisal* is an opinion of value.
- An *appraisal review* is the act or process of developing and communicating an opinion about the quality of another appraiser’s work. The subject of an appraisal review may be all or part of a report, work file, or a combination of these. The standards require that the reviewer’s opinion about quality must encompass the completeness, adequacy, relevance, appropriateness, and reasonableness of the work under review, and be developed under the context of the requirements applicable to that work. The competency requirements of appraisal standards apply to the reviewer just as the do to the one who did the work under review.
- *Appraisal consulting* is the act or process of developing an analysis, recommendation, or opinion to solve a problem, where an opinion of value is a component of the analysis leading to assignment results.

WHAT ARE THE LIMITS OF SERVICE I CAN EXPECT FROM APPRAISERS

By definition, an *appraiser* is one who is expected to perform valuation services competently and in a manner that is independent, impartial, and objective. Individuals, acting as an appraiser, are **absolutely not** allowed to be biased or an advocate in any form. To violate this restriction provides grounds for strict disciplinary sanctions. Do not expect an appraiser to argue your position, or represent your interests. That is not his role. He is only permitted to communicate

³ USPAP 2003, Comment on certification statement, page 30.

his unbiased, objective, independent and impartial opinions developed in compliance with applicable standards.

Since the early 90's, appraisers of real property are all subject to regulation in the form of licensure and certification in every state and territory of the USA. Some states have added additional categories such as interns, trainees, apprentices or registered appraisers to facilitate the in-growth of new practitioners, or to regulate those who are not involved in federally related transactions, but still provide appraisal services. These appraisers are required, as a minimum to order and conduct their services in compliance with the Uniform Standards of Professional Appraisal Practice as promulgated by the Appraisal Standards of the Appraisal Foundation. State appraiser licensing boards pre-existed USPAP in some states, but by 1991, every state and territory was required by federal law to organize and populate boards to regulate appraisers in their practice.

In many states it is unlawful to appraise real property, to include forestland, or trees valued as attached and growing on the land, unless one first becomes subject to the states regulatory authority and to any of the applicable the federal mandates. There are some jurisdictional exceptions, but those seeking services of an appraiser should be aware of this requirement and insure that the person they use is qualified.

In many areas forestry consultants are also appraisers and undertake assignments involving property in regard to which they do provide, or have provided other services. Others may choose to avoid any appearance of an impropriety and may refer those assignments to associates who can work in an environment that is clearly independent. While this is understandable and honorably motivated, there is no prohibition to appraisers in undertaking such an assignment. The fact that they may have some foreknowledge of the history, nature and character of real property is not automatically indicative of bias or advocacy. Nor is there a requirement for an appraiser to turn down an assignment because they may have had some prior interest with regard to the property or parties involved. There is, however an unavoidable disclosure requirement regarding these interests.⁴ And the appraiser must insure that he has no bias with regard to the property or toward any parties involved (such as would be probably implied if he were to be providing the services to a close relative or possibly a close friend).

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⁴ Certification Statement content regarding specified present or prospective interest, page 30 USPAP2003.

David is an Appraiser Qualifications Board (AQB) Certified Instructor for teaching the national Uniform Standards of Professional Appraisal Practice, qualifying and annual update courses. He has served for many years on the tax committee and the governmental affairs committees of the Arkansas Forestry Association, and has written a number of articles for professional journals and periodicals. He has been called on as a forester, appraiser and a land surveyor to testify in local, state and federal courts, and appeared before the legislature to testify on a number of occasions concerning appraiser regulation.