

Suggested Answers to Review and Discussion Questions: Lesson 11

1. (a) Reconciliation is a process that is applied throughout the real estate appraisal procedure. It involves rationalizing among a set of alternative data and selecting the most appropriate for the property being appraised. Final reconciliation is the last step in the appraisal process, where the appraiser must choose a value estimate from the alternatives presented by the different appraisal methods. The purpose of the final reconciliation is to develop a single rational and defensible final value conclusion (either as a single value or a value range).
- (b) In the appraisal process, reconciliation is required at any point where a decision must be made among alternative data or indicators of value. Students should list three of these decision points and briefly explain why reconciliation is necessary at that point. Below are several examples of these decision points:
- evaluating site value
 - choosing between reproduction or replacement cost new
 - setting a market rental level
 - determining appropriate vacancy and collection loss rate
 - setting a market capitalization rate
 - evaluating market value in the direct comparison approach

2. (a) *Single-Family Dwelling*

Primary Approach - Direct Comparison Method. As long as there is sufficient market data available, the direct comparison approach provides the best reflection of market behaviour for single-family dwellings. The underlying theory is sound, and the methods are easily understood, since sale price is the most common yardstick used by buyers and real estate brokers in the marketplace. If a subject dwelling is new or almost new, the cost approach can also be given considerable weight, since under these circumstances a buyer would weigh the cost of acquiring a vacant lot and constructing a dwelling against buying an existing new or almost new single-family dwelling. However, the weight to be given to the cost approach would diminish for older properties, because of the uncertainty in measuring the loss of market value due to accrued depreciation.

- (b) *Duplex*

Primary Approach - Direct Comparison Approach. This type of property is similar to the single-family dwelling. However, a duplex can also be considered to have a dual value - its amenity value is supplemented by potential rental value. Typically, purchasers see a duplex property as a principal residence with an additional income that can assist with the mortgage payments. However, market analysis can also reveal that the income approach may be relevant. This can occur in high rent areas, where purchasers do not intend to occupy the premises, but purchase for its income-generating ability and the expectation of a capital gain.

- (c) *Residential condominium unit (Strata title unit)*

Primary Approach - Direct Comparison Approach. This is similar to the single-family dwelling where the purchaser typically occupies the unit, with the amenity value being the prime concern. In addition to the typical physical property characteristics, purchasers are concerned with the quality of management and the condominium fees. The cost approach and income approach are not typically applicable to residential condominiums.

3. Generally, an appraiser uses judgment and reasoning to arrive at a final estimate of value. The appraiser will examine the data carefully and look for any trends that are apparent. In very rare cases where there are several comparables that are equal in reliability in the appraiser's opinion, a mechanical method such as averaging (median, mean, or mode) may be used. However, in general, it is NOT acceptable to use averaging for final reconciliation. Instead, the appraiser must use their reasoned judgment to form a professional opinion regarding the "best" indication of value given the evidence available.
4. If the indications of value from the three approaches vary widely, the appraiser must review the process used in each of three approaches in order to determine their relative accuracy and how much weight can be placed on their conclusions. In reviewing the preliminary steps, some of the critical factors or fundamental points to consider include:
 - (a) mechanics: look for errors in techniques and calculations;
 - (b) logic and analysis: review appropriateness of assumptions, estimates, and conclusions;
 - (c) underlying principles: review applicability of the principles of the approach; and
 - (d) data and data sources: ensure data was reliable, accurate, verified, and relevant.
5. There is logical support for appraisers providing a range of values rather than a point estimate:
 - (a) Real estate values are set by complex price negotiations between buyers and sellers and the end result of this negotiation is impossible to estimate accurately.
 - (b) Appraisal is an inexact science and an appraised value is only the opinion of the appraiser based on the circumstances.

However, there are many instances where an appraisal requires a point estimate, e.g., property tax assessment, lending value, insurable value, and any purpose that may end in litigation. In these cases, the appraiser must provide a single estimate of value.

There is no "correct" answer to the question, as a range or point estimate may each be appropriate in different situations. However, it has become standard procedure in most appraisal assignments to provide a point estimate, which may be supplemented in the final reconciliation discussion by a range of values and an explanation of how the point estimate was chosen within this range.

6. (a) The "Correlation and Final Value Estimate" should be changed to "Reconciliation and Final Value Estimate".

The reported values should be amended as follows:

- Estimated Market Value by the Cost Approach: \$326,000
- Estimated Market Value by the Income Approach: \$304,800

(Note: The use of contract or market rents in the income approach will depend upon the interests being appraised.)

- Estimated Market Value by the Direct Comparison Approach: \$315,000
- (b) The age of the apartment building suggests that the cost approach will be the least reliable. The final estimates of value suggest that it is a small apartment building, based on current levels of value throughout Canada. Therefore, the direct comparison approach and the income approach can probably be given equal weight, although regional differences in markets may influence whether one or other of these approaches should be given more weight.

7. "The Concise Oxford Dictionary" defines "exact sciences" as "admitting of absolute precision". Appraisal is the process of "estimating" market value. Oxford defines "estimate" as an "approximate judgment (of number)". Appraisals are estimates of value, and are not precise, absolute indications. There is always a degree of variance that is tolerable (by the courts) in an appraised estimate of value. The real estate market is imperfect in that two identical, side-by-side properties can sell for different amounts between different buyers and different sellers. There is an element of subjectivity in real estate values, particularly for residential properties where peoples' tastes vary, and their sense of amenity value and benefits can value greatly.

The implication of this for appraiser liability is that some degree of error, or variation between the predicted sale price and actual sale price, is acceptable in appraisal work. In other words, because it is an estimate, an appraisal will always vary from the actual value. Therefore, the presence of an over- or under-valuation is not in itself sufficient to prove negligence in an appraisal; a judge would look to the circumstances of the appraisal and to the standard of care expected of the appraiser in the task at hand.

8. This question highlights a number of issues related to appraiser liability.

Contract law: there is no contract for services, and no consideration paid, making it questionable whether the professional services were rendered. However, as a general rule of thumb, professionals must be cautious to not give off-the-cuff professional advice, even for free, with even a remote possibility of being held liable. A better answer in this instance would be "here's my card, please call me at my office in the morning", bringing the discussion into a more professional context (not to mention where both parties have not been drinking).

Tort law/negligence: there is no contractual relationship between the lender and the appraiser. However, a professional owes a duty of care to third parties who they can reasonably foresee may rely on their opinion. Here, you knew the host was pursuing financing, so it was possibly foreseeable (although perhaps unlikely) that a lender may have relied on your professional opinion and suffered as a result. Again, this remote risk is enough to promote caution. As a general rule, always specify who may rely on a value opinion and who may not, as well as under what circumstances, and put this disclaimer in writing.

Standard of care expected: an implied term of a professional services contract is that the appraiser will perform his or her duties in a manner that complies with generally accepted practices for that service. Here, ignoring the issue of whether or not there was a contract, the appraiser has given an off-the-cuff value opinion, with no support, research, analysis, or inspection. This would not likely meet the standard of care expected for even the simplest of valuation tasks. For a start, an appraiser cannot simply make up numbers out of thin air. Second, for most appraisals, an appraiser is expected to carry out (or contract for) at least a cursory inspection, for visible defects that might impact value.

Damages: while highly unlikely in this far-fetched example, would ordinarily relate to either the difference between the value opinion given and the actual value, or the loss suffered as a result of relying on the negligently prepared value opinion.

9. A few misconceptions need to be corrected:

- appraisers are not licensed in most provinces in Canada;
- both an appraisal and a CMA can be a legal document depending on its use;
- an appraisal is not a "legal opinion of value", rather it is an independent third-party estimate of value that may be recognized by some legal bodies (e.g., courts, appeal boards);and
- appraisals are no longer demanded in all mortgage lending transactions today, and for those which are, it is up to the lender to decide what is acceptable, i.e., the lender may specify a full appraiser by an accredited appraiser, a drive-by form report (comparable to a CMA), or a value estimate from an automated valuation system such as that used by assessors or CMHC's emili system.

In a CMA, the real estate broker generally makes no written comments about the subject property or the listings or sales provided to the client. The appraiser, on the other hand, must investigate all sales and also must comment as to how they compare to the subject. Adjustments are made to the sales to equate them to the subject.

Appraisers have up-to-date sales information and historical information to assist them in arriving at their written estimate of value (in fact, often the same databases that real estate brokers are relying upon). They generally do keep in contact with real estate brokers to see what trend is prevailing; for example, is market activity increasing or decreasing and what direction are prices moving? Appraisers emphasize sales as the best indicator of market value, but will rely on listings if necessary.

Finally, appraisers offer a source of an independent estimate of value that is not related to any sales company that may be soliciting a listing. Independence and the fact that appraisers can be held accountable for their reports should ensure well-researched and well-documented reports.