
REAL ESTATE EXPERTS: SOME FURTHER OBSERVATIONS

by Rocky A. Tarantello, CRE

In the December 1994 Edition of *Real Estate Issues*, I presented several issues pertaining to the proper role of real estate Counselors as expert witnesses and suggested how Counselors could resolve the real estate expert versus client advocate conflict. This manuscript attempts to go one step further in distinguishing how real estate counseling differs from real estate appraisal and how attorneys may better utilize real estate Counselors as experts.

The great majority of real estate Counselors are not real estate appraisers. They typically do not write or certify appraisal reports. However, they are still real estate valuation, feasibility, and investment experts. They frequently offer expert advice regarding the valuation of fee interests, mortgage instruments, leaseholds, easements, cash flows, rights of way, profitability, feasibility, pricing strategies, phasing plans, and a myriad of other opinions regarding the value or the investment performance of real estate assets. I think the time has come to clarify the common view that valuation analysis and appraisal are one and the same. They are not! Most real estate analyses are not drafted as certified appraisal reports. Frequently, the total work product consists of nothing more than a summary of data, statement of assumptions, calculations, and conclusions. On other occasions, a certified or narrative report may be inapplicable as the following case illustrates.

A few years ago, a moderate oil spill along the Southern California coastline had forced the closure of several miles of public beaches. In addition to direct clean-up costs and lost tax revenues from temporary business closures, the city attorney felt the city was also entitled to the value of the temporary loss of use (*i.e.* recreational use) of the public beach. As with any claim for damage, appropriate technical analysis and foundation is requisite to establish a defensible claim. It so happens

ABOUT THE AUTHOR

Rocky A. Tarantello, Ph.D., CRE, is a clinical associate professor of real estate and land economics at the University of Southern California. He is also president of a California-based counseling firm, Tarantello & Associates. Tarantello has extensive experience in real estate development, investment, market research, health care facilities, and litigation counseling throughout the U.S. He is also a past editor in chief of *Real Estate Issues*. (E-mail: tarantel@pacbell.net)

that there are economic theories, specifically hedonic pricing theory, which deal with the valuation of "lost recreational pleasure" or "use." Standard appraisal methodology is not designed for or even remotely applicable to this unusual case. The case ultimately settled, eliminating the need for each side to prepare the necessary analysis. Despite the "land use" character of the claim, an appraisal report employing traditional appraisal methods would hardly apply to the valuation of such a claim. And although hedonic pricing and property values have been considered in appraisal literature before, it is doubtful that even the most accomplished appraisers have even considered its use, much less applied it as a possible valuation tool. I am not advocating hedonic pricing or any other specific analytical methodology. But I do believe that valuation analyses go beyond "appraisal" and often require the education, skills, and experience of real estate analysts, institutional managers, or real estate forensic specialists outside the appraisal profession.

All appraisals are founded on the principles of economic valuation theory. But the vast majority of real estate analyses do not require strict adherence to appraisal standards or methods. Perhaps the best example of this point is the valuation process exhibited by the public securities markets. On any given business day, every publicly traded business enterprise is revalued resulting in the repricing of all classes of outstanding stock. Reappraisal would require adherence to prescribed appraisal methodology and documentation. For each issue traded, every parcel of property, business asset, and expected earnings stream is revalued on virtually a minute-to-minute basis. Various securities analysts, researchers, and economists collect and interpret the new information; make assumptions about future economic conditions; and apply stringent economic models and theories as every shred of new market information is instantaneously digested and repriced with each stock transaction. In the U.S. alone, some 1.5 to 2 billion equity shares change hands every business day. To the extent that real estate debt and equity markets are increasingly securitized and the nature of the underlying assets fall into institutional ownership and management, the analysis and valuation process must also evolve to reflect the changing nature of the industry. The legal community should recognize these changes as well as the appropriate use of traditional appraisals. More importantly, the securitization and globalization of real estate has ushered in an entirely new generation of investment bankers, capital market

analysts, regional economists, institutional managers, and a host of other real estate experts able to employ financial, economic, and real estate valuation methods more suitable to the current legal environment and its constituencies.

COUNSELORS AND APPRAISERS CAN TAKE ADVANTAGE OF THE TECHNOLOGY

According to a recent research report published by the U.C. Berkeley Fisher Center for Real Estate Studies, analysts estimate that by the year 2000, there will be approximately 400-500 million Internet users in the world, and the total number of Web sites will exceed seven million. Willingly or not, every lawyer, professional practice, or real estate expert is being led or dragged into the information age. Some experts will make the shift smoothly while others will fail by continuing to rely upon stale experience and armchair wisdom.

The best experts have embraced Web technology not merely for its e-mail or e-commerce value, but for the enormous information access it provides. Government records and statistics, university research centers, professional trade organizations, and numerous private organizations routinely put their data or information on the Web, much of it at no cost to the user. In sum, the volume of available and accessible information has increased geometrically, while the cost of compilation has fallen accordingly. As real estate analysts, we can do more in one hour at the computer than could be accomplished in days at the desk or the library.

Armed with the capacity to search a global Web network for empirical data provides at least two immediate benefits to our attorney clients. First, we are able to present a more comprehensive empirical basis for value conclusions. Correctly or not, an expert is often viewed as an advocate of the client rather than an expert to the court. Solid empirical foundation significantly helps to overcome this perception. Nothing speaks louder than the "numbers." This allows the expert to be the messenger, not the message. In the way that the federal courts have imposed "Daubert" standards for expert testimony to insure the proper foundation and reliability of expert testimony, the World Wide Web gives us a new and effective weapon to meet and even exceed the highest standards at an effective cost. Secondly, the speed at which opinions may be reached has been drastically accelerated. Prior to Internet access, data was both expensive and time-consuming to collect. In the absence of adequate information, expert opinions were often delayed

until sufficient data had been gathered or the analysis had been completed. Until then, many experts withheld opinions that may or may not have supported a particular claim or position. That process is now accelerated by Web technology. Real estate experts will better serve their attorney clients by providing timely opinions to assist in settlement negotiations or to establish their willingness and ability to support positions favorable to the client. Conversely, if unable to support the client, sufficient time remains to search for an expert of differing opinion. In either case, the trial attorney is provided with valuable advance notice. In effect, real estate experts are now able to utilize Web technology to customize research and work product without the encumbrance of unnecessary, costly, and time-consuming research. Remembering our example of the public securities markets, surely real property is no more or less financially or physically complex than a business enterprise. Why not streamline the analysis while lowering cost and adding data?

MAINTAINING EXPERT CREDIBILITY: SET REALISTIC BOUNDARIES

For one reason or another, appraisals are a fact of life throughout the real estate industry. Lender appraisals, tax assessment appraisals, insurance appraisals, and a host of other transaction-based situations clearly require the preparation of an appraisal report drafted in accordance with trade organization appraisal standards, Uniform Standards of Professional Appraisal Practice (USPAP), or state licensure requirements. The purpose of this article is not to diminish the importance of the appraisal process or the professional appraisers charged with the responsibility of their preparation. Instead, my purpose is to point out the advantages of utilizing real estate experts outside the appraisal profession when the required analysis falls clearly outside the scope of an appraisal document.

Cost and timeliness provide obvious advantages to attorneys and their clients. But an equally, if not more important advantage, lies in the area of expert credibility. Notwithstanding the inherent credibility of a member of The Counselors of Real Estate, the Appraisal Institute, or other credentialed individual members of professional real estate organizations, the analytical technique, theory employed, or presentation of the result may add meaning and reasonableness to the expert's opinion.

When subjective opinions are called for, they should be given within a reasonable range of possibilities.

Prior to Internet access, data was both expensive and time-consuming to collect. In the absence of adequate information, expert opinions were often delayed until sufficient data had been gathered or the analysis had been completed. Until then, many experts withheld opinions that may or may not have supported a particular claim or position. That process is now accelerated by Web technology. Real estate experts will better serve their attorney clients by providing timely opinions to assist in settlement negotiations or to establish their willingness and ability to support positions favorable to the client.

The traditional appraisal format typically presents a single estimated value. No one expects a real estate Counselor or any other expert to provide perfect answers. We rely on observations, forecasts, and historical data. Simple point estimates are very often counterproductive. Attorneys and the courts appreciate candor, reason, and the inherent difficulty of providing perfect answers to subjective questions. Hence, while the analysis may be generally close to what the true answers are, the probability that any single point estimate is correct, is nearly zero. In my view, certified appraisals suffer from two inherent flaws rendering them less useful to attorneys and the courts. First, they are drafted according to narrow standards of appraisal practice which can frequently lead to the collection of unnecessary general information which adds to the cost of the document and time of preparation. Secondly, the conclusions are nearly always presented as single point estimates which invite opposing scrutiny and claims of inaccuracy or bias.

A much more practical and defensible valuation analysis would present a damage claim, value, or performance measure conclusion within a plausible range of values. By presenting expert opinions within a range of possible values, the real estate expert is demonstrating his or her willingness to consider alternative assumptions and possibilities without sacrificing credibility to the court. Simply put, the best real estate experts carefully present what they know and freely admit what cannot be

known with certainty. However, it is essential to establish a strong empirical foundation in the estimation of the value boundaries, and every effort should be made to establish as narrow a range as possible. This is intended to provide helpful guidance to the court in reaching a fair and reasonable conclusion without having to "buy" into a single value.

CONCLUSION

Starting with the first offering of GNMA securities in the early 1970s, the real estate industry has been in a state of rapid change. The securitization of the mortgage markets, institutional ownership, investment trusts, globalization, and information technology have fostered a new era in valuation analysis and the people who do it. The scope of real estate valuation has grown beyond the original boundaries defined by traditional appraisals. The parallel growth in litigation counseling has created demand for real estate analysts who bring specialized knowledge of valuation theories, capital markets, and other emerging real estate issues to the litigation process. The traditional use of appraisals is not diminished, but merely used only when and where appropriate. The Counselors of Real Estate is a unique organization composed of real estate experts from numerous disciplines. Many members of The Counselors come from these emerging real estate market segments and can offer the legal community an enhanced array of economic, financial, and real estate valuation methods.^{REI}