
CRE PERSPECTIVE

APPRAISAL OR VALUATION: AN ART OR A SCIENCE?

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Herein, the author looks at the age-old conundrum to see whether, in today's hi-tech world and with the advent of Global Valuation Standards, there is a consensus of opinion.

Art: *thing in which skill may be exercised.*

Science: *systematic and formulated knowledge.*

- Source : *The Concise Oxford Dictionary*

There seems to be a common view among those I interviewed for this article that roughly correlates with the dictionary definitions. Another way of distinguishing between the two might be that one is *subjective* whilst the other is *objective*. Which is which? Well, I believe that whilst art is a subjective view, a scientific view should be objective. However, in terms of an appraisal, it could be argued that a client is paying the appraiser for a subjective interpretation of the objective scientific analysis and calculation. There will always be an esoteric mix of factors to interpret, such as current market sentiment, the micro-location of the asset, age, and precise specification of the building, among many others.

NEW VIEWS FOR OLD

Is this ratio of subjectivity a new view? Has this view changed in recent years? Folk have been valuing property for centuries. The Roman trader needed to assess an asset's value just as much as today's real estate bond trader. What has changed, particularly in very recent years, is the methodology by which the number is calculated. Indeed, the very word *calculated* implies a more scientific approach than when I first valued property. Gut feel had a lot to do with a value then, based on the comparables method. Yes, there was some mathematics—the application of a years purchase multiplier to the rent. Even then, the valuer needed to apply a subjective

judgement to arrive at the number reported to the client.

Perhaps appraisal was, in the past, a cottage industry, as the quality of the output depended on the appraiser's ability to gather market information that used to not be so readily available. Lack of data needs more experience. More data leads to a better opinion.

Nowadays, most appraisers would not dream of undertaking an appraisal without the benefit of a computer package. It is not for me to give credit to a particular supplier—there are many on the market...some better than others. However, some packages require so many fields to be completed that the appraiser can end up making judgements on judgements, and the ensuing variables call for considerable (artistic) interpretation.

However, even when the factual data has been input, the appraiser still needs to make assumptions. Is this the art or the science at play? Assumptions as to market rent, probable yield, discount rate, and the like, all call for considerable relevant experience and subjective judgement. Is this not what scientists do when hypothesising a theory? Appraisals cannot be proved empirically. Even a genius has to make a judgement of whether a theory is proven or not. Does that make it any less scientific? I think not.

So, maybe appraisal is an imprecise science rather than an art.

DATA MINING

When an appraiser conducts market research, this can produce raw data. The client could, most likely, get that data from the Internet or another source. There is so much data available today, with increasing transparency in the marketplace. Data mining is part of the science. However, the client is willing to pay for the interpretation of the data to determine an opinion of value, which can be relied upon. The interpretation is the art.

Deals happen. There is not a perfect market. This imperfection makes an appraiser's task very difficult. The appraiser has to interpret where the market is going. A valuation is like a snapshot in time. Imagine a photograph containing a ball in flight. Is it actually going up, or going down? That's what the client wants to know. He would really like to know where that ball will be after an agreed period of time, but that is probably too difficult for all but the crystal-ball gazers.

Appraisers have to reflect, not make, the market. An appraisal could be a surrogate pricing process.

Whereas, worth is what the purchaser is prepared to pay. What is value? Does value exist? Can value really be measured, or is it ethereal?

Does an appraiser work in the property market, or measure the market in property?

UNDER THE INFLUENCE

For some time, probably since the need for independent appraisals began (whenever that might have been), appraisers have come under pressure—usually from the person wanting to borrow the money, or to buy or sell the asset—to move the number in a particular direction. Has this pressure increased or decreased lately? Well, appraisers know the answer. Is it wrong to change a number? The reader will have a view. If the number is purely the product of scientific or mathematical application then probably, yes—it is wrong. If the number is the result of objective analysis and subjective judgement, then possibly, no. What is wrong, though, must be the changing of the judgement by influence, other than by new data. Opinions can change, of course they can. It just depends what has caused them to change. The prospect of a cut-off in supply of future work is one example of undue, and wrong, influence.

A recent survey published by the Investment Property Forum, in the UK, suggests that valuations can “alter significantly” following the appointment of new valuers. Is this because of previously or currently exerted pressure, or because valuation is not scientific—there is always more than one answer? If valuation was an exact science there would be no need for independent, third-party, arbitrators to settle rent review disputes, for example.

In reference to the same report, the *Estates Gazette*, one of the

leading real estate journals in the UK, in its leader column, suggests that these are moral hazards, with conflicts of interest grinding beneath the surface to distort valuations and undermine trust. The leader column also makes a link between this pressurised distortion and the year-end bonuses of investment fund managers being based on demonstrable growth, usually measured by valuations measured against, say, upper quartile performance of a recognised industry benchmark.

It could be argued that the market is made by institutions that buy, hold, and sell property. These institutions are judged by and against their peer group. The arbiter is the benchmark, such as IPD or NCREIF. But, what makes the benchmark? Why, the returns from the funds managers, of course. So, are all fund managers chasing comparison with a set of indices which could be inherently flawed? This could be so in a falling market, when fund managers will be looking for a soft landing rather than a hard crash.

GLOBAL STANDARDS

If valuation standards become more global, then does that make them more like a science than an art? Possibly so. Art is essentially individual. Standardisation is essentially scientific. It is certainly more prosaic. However, to be truly effective, international standards need to make the valuation process globally significant yet locally relevant.

Currently, valuation standards—whether local to a territory, region, theatre, continent, or global—primarily address the product and the way in which the process is undertaken. They do not usually tackle methodology. Why not? It seems illogical not to determine how a valuation should be undertaken, if the standard for the process is the same.

I believe that we will see the regulatory bodies across the world getting to grips with methodologies. The lead needs to be taken by the International Valuation Standards Council—a lead that others will follow. TEGoVA has declared, for example, at a European regional level, that methodology is important, by adding some detail on the topic in its latest edition. The RICS, at a UK level and the Appraisal Institute at a USA level and both at a global level, must also set an example, unhindered by tradition but responsive to market needs.

Clients need to understand that a valuation produced in Massachusetts, Manchester, Melbourne, Moscow, or Matabeleland is reliable in its standards and its methodologies. That must increase the value of the product.

So, will clients pay extra for a valuation that is more scientific than arty? Yes, I believe that they will, if they can be assured of common standards and methodologies across the planet. Global clients, whether actual or aspirant, need a global product. So, too, do local clients—one never knows when they might be taken over and the valuation needed in due diligence.

THE FEW

Perhaps it could be argued that most appraisers are keen to keep it an art. It has been said that good quality institutional work is done by 10 percent of the appraiser population—sometimes at a loss, to encourage the more lucrative (if speculative) brokerage instructions from the same institutional clients. So, 10 percent do 90 percent of the work. Maybe the other 90 percent want to keep it less scientific, and more judgmental, so that there can be less scrutiny. A rule of thumb guide, thought to be based on a legal precedent in the British courts, used to suggest that valuers were unlikely to be considered negligent

