

# Common Errors and Issues

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**April 2, 2010**

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# Common Errors and Issues

The following are some of the errors commonly noted by the Appraisal Institute's Senior Manager of Experience Screening and Senior Manager of Ethics and Standards. This information is pertinent to both general and residential appraisal practice. These items are not listed in order of occurrence or importance.

## **Certification Statement**

The most common errors we see in appraisal reports have to do with certification statements. These errors are also the easiest to avoid. The key is to remain cognizant of current certification requirements in USPAP (Standards Rule 2-3 for real property appraisal reports, Standards Rule 3-3 for appraisal review reports, and appraisal consulting reports) as well as the requirements of the Certification Standard of the Appraisal Institute.

Designated and Associate members of the Appraisal Institute are subject to requirements of the Appraisal Institute, which include the Certification Standard. (The Standards of Professional Appraisal Practice of the Appraisal Institute include USPAP plus our Certification Standard.)

Certification requirements may change from time to time. It is incumbent on the appraiser to provide a certification that is contemporary with the appraisal date. To assist you with this, the Appraisal Institute provides sample certifications for appraisal, appraisal review, and appraisal consulting assignments on our Web site. These are Word documents that can be downloaded and copied directly into your own reports. They include both the statements required by USPAP and the statements required by the Appraisal Institute for its members. Click here for [Sample Certification Statements](#) page. This link will take you to a page showing sample certification statements for Written Appraisal, Appraisal Review, and Appraisal Consulting Service Reports. When the Word document comes up, save it to your hard drive.

The USPAP certification does not have to be exactly the same as that in Standards Rule 2-3, but it has to be similar in content. (The Appraisal Institute's certification statements **MUST** be verbatim.) You must be careful not to deviate from the intent of the language if you do not use the USPAP certification language exactly. You may make additions if they are relevant to the assignment.

If you use form reports, be careful. Often the certification included in your software is out of date or doesn't comply with Appraisal Institute requirements or with your state appraisal law. With the exception of the Appraisal Institute's AI Reports® forms, the certification provided in a form report is

not compliant with the Code of Professional Ethics and Standards of Professional Appraisal Practice of the Appraisal Institute—additions are required to be compliant. It doesn't matter where these additions go in the report, just as long as they're included somewhere. If they can't be added to the certification page, put them in a logical place.

If you have created your own certification template, it's helpful to put a version date on it so you can easily tell whether it is current.

The value conclusion need not be included in the certification. The certification need not be dated (except in the case of the certification retained in the workfile for an oral report).

Note that the proper nomenclature is "certification," not "certificate," "certificate of value," or "certification of value." The certification statements relate to the entire assignment and the manner in which it was completed, not just the value conclusion.

Finally, keep in mind that the certification is a very important part of an appraisal, appraisal review, or appraisal consulting report. Only an appraiser can make such a statement. Avoid burying the certification in the back of the report or in the addenda, or putting it in tiny or unclear print. Let your reader know you are sincere about these statements and proud to be able to make them.

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## **Identification of the Client, the Intended Use of the Appraisal, and the Intended Users**

Identification of the client, intended users, and intended use is a significant and necessary step in the appraisal process. Making these identifications defines the parties to whom you are responsible, and why. When you write a report, you are writing to your client and intended users. They are the audience for your discussion and conclusions. (Note that in Standards Rule 2-1(b), USPAP says the report must contain sufficient information to enable the intended users to understand the report properly. In order to ensure that your report contains sufficient information, you must first know who the intended users are.) And you are writing to the intended users about the particular problem they wish to resolve—a question about the value of a property or about the quality of the work of another appraiser, for example.

It is a misconception that the “addressee” named in the report is necessarily the client. A very common mistake is to assume it is understood that the addressee is the client. This may or may not be the case. It is required that you specifically identify the client by name or type.

The concept of intended user is widely misunderstood. To be an intended user, THE APPRAISER MUST INTEND for that party to rely on the assignment results. An intended user is not simply anyone who “intends to rely” or “will rely” on assignment results. Further, receiving a copy of a report does not mean that a party must be identified as an intended user. See Statement 9 in USPAP for further information.

The intended use is the key driver in determining the appropriate scope of work for the assignment. Why the appraisal is needed, what the value issues are, what effective date of appraisal is required, and what interests are to be considered are among factors that make up the intended use/intended user/scope decision. Your client might not fully understand the appraisal process, the reporting requirements, or the complexities of appraisal. Your identification of these elements can help you provide your client with a valuation service that is appropriate.

Again, be careful with form reports, as they might not provide space to adequately address these key items.

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## Scope of Work

Scope of work is the most critical decision you will make in an assignment. In solving any problem, including an appraisal problem, there are three major steps to the process:

1. Identify the problem,
2. Determine the solution (or scope of work), and
3. Apply the solution.

None of the three steps can be omitted, and they must be carried out in order.

The first step, identification of the problem, involves figuring out seven key assignment elements:

- Client
- Intended users in addition to the client
- Intended use
- Objective, or type of value in an appraisal
- Effective date
- Property characteristics that are relevant to the assignment (e.g., interest valued, physical and legal characteristics)
- Assignment conditions (e.g., hypothetical conditions, extraordinary assumptions, jurisdictional exceptions)

In an appraisal assignment, USPAP under Standards Rule 1-2 requires that these items be identified, or “figured out.” They provide the framework for the assignment and allow the appraiser to identify the problem to be solved. Standard 2 of USPAP requires that the same items also be reported. They provide the “full story” about the value conclusion, which, by itself, is meaningless.

Once the seven assignment elements are figured out, the appraiser can move to the second step, determining the scope of work to solve the problem. Scope of work encompasses all aspects of the valuation process, including the question of which of the usual three approaches to value will be used. Also included in the scope decision are the questions of how much data is to be gathered, from what sources, from which geographic area, and over what time period; what is the extent of the data verification process; and what is the extent of the property inspection, if any, etc.

The scope of work decision is appropriate when it allows you to arrive at credible assignment results and when it's consistent with (1) the expectations (if any) of clients that are similar to yours and (2) what your peers would do if faced with the same sort of situation.

In 2006 USPAP was revised substantially with regard to scope of work. This represents a significant conceptual change in appraisal practice. It is important that all appraisers fully understand the ramifications of this change and are fully aware of its implications. You can find more information about scope of work on The Appraisal Foundation's Web site, where the Appraisal Standards Board has published a Q&A about scope of work. Also, the Appraisal Institute has published a book, *Scope of Work*, by Stephanie Coleman, MAI, SRA, which provides some practical assistance.

## **Extraordinary Assumptions**

The proper use of extraordinary assumptions is often misunderstood. An extraordinary assumption is an underlying premise of the assignment, something that is believed to be true for the sake of the analysis, but whether or not it is in fact true is uncertain. Extraordinary assumptions differ from the general assumptions that are often made and reported in all assignments. An extraordinary assumption is specific to the assignment at hand. Further, if an extraordinary assumption is contrary to the truth, the assignment results would be affected.

It is important to understand that when an extraordinary assumption proves to be contrary to the truth, it does not mean the appraiser was "wrong." The appraiser must ascertain that the use of the extraordinary assumption is appropriate given the client's intended use of the assignment results. Then, unless agreed upon with the client at the time of the assignment, the appraiser is under no obligation to "fix" or "correct" an appraisal upon learning that the premise—the reason for the extraordinary assumption—is false. A value opinion is always developed within the context of the assignment as defined by the scope of work and other assignment parameters such as the date of value and the type of value, as well as stated hypothetical conditions and extraordinary assumptions. If an extraordinary assumption made in an appraisal subsequently turns out to be false, the appraiser could accept a new assignment that would reflect the different underlying premise.

USPAP's SR 2-2 a (x), b (x), and c (x) says the appraisal report must "clearly and conspicuously state all extraordinary assumptions; and state that their use might have affected the assignment results." This does not mean the property must be appraised twice—both with and without the extraordinary assumption. It simply means the client and intended users must be alerted to the extraordinary assumptions so that their significance, given the intended use, can be comprehended.

Many assignments involve one or more extraordinary assumptions. In reporting, extraordinary assumptions need to be handled in a specific manner. Extraordinary assumptions must be conspicuously disclosed. They cannot be inserted in fine print or buried in the addenda where they are unlikely to be read. It may be appropriate to cite extraordinary assumptions in more than one place in your report, depending on their significance to the assignment.

An example of an extraordinary assumption could involve the appraisal of an older gas station. The date of value is the current date. It is known that many gas stations of the subject's vintage have leaking underground storage tanks. If so, the cost to remediate the problem can be sizable—especially if leaking fuel has made its way into the groundwater. However, the status of the subject's tanks is uncertain. If you proceed with the assignment based on the assumption that the property does not have leaking tanks, you would be using an extraordinary assumption—it is specific to your assignment and would likely affect your value conclusion if found to be incorrect.

A second example is the very common case of a “drive-by appraisal,” in which the subject improvements are visually inspected only from the curb. To proceed with such an assignment, the appraiser must establish something to be true about the size, condition, and other characteristics of the property that are relevant to the valuation problem. Sources for such information may include prior appraisals completed by another; county records; or even the verbal information from the owner or agent. The information may be true, but from the appraiser's viewpoint there is uncertainty attached to it, and the valuation will hinge on one or more extraordinary assumptions about the “gaps” in the facts.

## **Hypothetical Conditions**

Hypothetical conditions are things that you know to be contrary to fact but you take them to be true for the purpose of the analysis. Contrast these with extraordinary assumptions, which are about uncertainties. The decision to use a hypothetical condition must be carefully considered. The hypothetical condition must be appropriate given the client's intended use of the assignment results and can't be so outlandish that it leads to non-credible results.

It may be necessary to use a hypothetical condition for legal or comparison purposes. The resulting analysis and conclusions must be credible, and the hypothetical condition must be clearly disclosed. Your client needs to know what the hypothetical condition is and how it might affect your value conclusion. In reporting, hypothetical conditions need to be handled in a specific manner. According to SR 2-2 a (x), b (x), c (x), you must “clearly and conspicuously state all hypothetical conditions; and state that their use might have affected the assignment results.” The difference in reporting between a general assumption and a hypothetical condition is that the latter must be conspicuously disclosed, not buried in the back of the report or shown in tiny print. It may be appropriate to cite all hypothetical conditions in more than one place in your report, depending on their significance to the value conclusion.

One of the most common reasons for using a hypothetical condition is to develop a value opinion of a proposed property as of the current date. Almost all appraisals of residential construction projects are performed this way and therefore are based on a hypothetical condition—that is, that improvements are already complete when, in fact, the improvements don't exist.

When using a hypothetical condition, terminology is important. It is appropriate to note that the value is based on the hypothetical condition. You then explain the condition. The value itself is not hypothetical—that is, it's not a "hypothetical value." Rather, the value is based on a hypothetical condition.

## **Prospective Value**

One key assignment element is the effective date of value, which may be a current date, a retrospective date, or a prospective date. If your assignment is for a proposed project, your client may need a value that is effective as of the date of completion and/or date of stabilization (prospective values). Or your client might need to know what the property would be worth if it were completed as of today (current value). Either is allowable. Each can provide the client with a useful conclusion. See *Advisory Opinion 17, Appraisals of Real Property with Proposed Improvements*, for further information.

There is confusion about how to qualify your reporting of a prospective value. Extraordinary assumptions help you report prospective value without being misleading; they assist you in being clear about your valuation process, opinions, and conclusions. To some it is confusing whether the value of proposed construction or of non-stabilized properties should be based on a hypothetical condition or an extraordinary assumption. If your effective value date is a current date, your appraisal will be based on the hypothetical condition that the improvements exist when, in fact, they do not. If your value date is in the future, when you anticipate completion (a prospective value), then your appraisal will be based on the extraordinary assumption that the improvements will indeed be completed as proposed as of that date.

Whenever the date of value is a prospective date (even in cases that don't involve proposed construction), there will be one "automatic" extraordinary assumption that relates to the potential changes between the current time, when you are researching and writing the report, and the effective future value date. Because you cannot see into the future, you want to point out that you assume no significant changes will take place.

Reporting prospective values must be done with care. According to Statement No. 4 in USPAP, "In prospective value opinions, use of the term 'market value' without a modifier such as 'forecasted' or

'prospective' and without future verb tenses is improper." It's correct, for example, to state your conclusion as "market value as of (future date) will be \$XXX," rather than "the market value is...."

## **Prospective Value – Value Date**

In a prospective value assignment, you may be asked for the value as of either a specific date or a specific event. The date of value to be used in an analysis is identified based on the nature of the problem to be solved.

If your client requests a value as of a specific event, such as completion of construction or stabilization of the property, you will need to figure out what future date will be associated with that event. The client, developer, or other parties to the assignment may provide you with dates reflecting their estimate of completion, lease-up, or stabilization. These may be reasonable estimates, but you cannot assume they are without some consideration. It is not appropriate for you to accept the developer's estimate of completion or stabilization at face value. You must consider the market and determine if the completion, lease-up, sellout, etc., is likely to occur by the specified date.

## **Analysis of the Subject Property History**

It is not sufficient to simply report the subject's sales history. In fact, simply reporting it does not meet the USPAP requirements on this issue. When an opinion of market value is to be developed, you must *analyze* all sales of the subject property that occurred in the three years prior to your date of value. You must also analyze any agreements of sale (contracts), options, or listings that are current as of the date of appraisal. Listing the sales or other agreements is just a start. See Standards Rule 1-5 as well as reporting requirements covered by Standards Rule 2-2 (a) (ix), 2-2 (b) (ix), or 2-2 (c) (ix). Also see Advisory Opinion 1, *Sales History*.

USPAP has no requirement to analyze the sales history of each comparable sale. However, Fannie Mae and certain other government bodies require comparable sales histories. This regulation is applicable to lenders, and it's reflected on the URAR form.

## **Highest and Best Use**

Highest and best use is commonly one of the weakest areas in an appraisal. It is too often viewed as a "necessary but fruitless exercise," when it is the meat of the assignment in an analysis of market value. Even though many improved properties do represent the highest and best use, there are still issues that must be considered. If you do not adequately address highest and best use, you may inappropriately analyze the property.

When your assignment objective is to develop an opinion of market value, you must address the question of the highest and best use for whatever you are valuing. That is, if you're valuing an improved property, you must address the question of the highest and best use *as currently improved*. If you're valuing a vacant site, then you must address highest and best use *as vacant*. If you're valuing a site as if vacant (as in the case of an improved property when we complete a cost approach), you must address the question of the highest and best use *as if vacant*. If you're valuing a proposed property, you must address what the highest and best use *WILL* be when complete. If you're valuing a proposed property as of the current date based on a hypothetical condition, you must address what the highest and best use *WOULD* be if the improvements were complete as proposed.

To answer the question of highest and best use of a vacant site, four tests apply: physical possibility, legal permissibility, financial feasibility, and maximum productivity. Many uses may be physically possible, but only some of those will be legally permissible. And of those, only some will be financially feasible. The question ultimately becomes, which of those uses (physically possible, legally permissible, financially feasible) brings the highest economic return to the owner of the rights to the land?

To answer the question of the highest and best use of an improved site, the same four tests apply. But they generally don't provide a sufficient framework for answering the HABU question. Rather, you need to consider three possible scenarios regarding the improvements, and which of the three makes the most sense. What would the most probable buyer of this improved site do with the improvements? Would the buyer:

1. Keep using the improvements the way they exist?
2. Make modifications to what exists?
3. Demolish the existing improvements to obtain a vacant site?

Using the framework of these three questions, you can better refine your highest and best use analysis. Many times, appraisers miss the mark because they don't recognize the opportunity to alter the existing improvements that the market sees for the property. Remember, as an appraiser you are trying to reflect the actions of the "most probable buyer" for that property. Put yourself in those shoes. If it were your property, what would you do with it to maximize its value?

An incorrect conclusion of highest and best use as improved may seriously impact your value conclusion. A common error in highest and best use analysis is failure to recognize or address property characteristics that may have been mentioned in the description sections. There are many obvious property issues that trigger additional highest and best use analysis. Excess land, a legally non-conforming use, obsolescence, the need for renovation or conversion of use, interim use, and transitional use are a few. If you do not properly address these issues, they can affect the credibility of the work. If you do not recognize them in your analysis of highest and best use, you may miss

them in the valuation analysis. And, if these are issues for your property, you should expect to include some discussion in the highest and best use section.

Unfortunately, it is very common to see a statement that reads: "The subject property's highest and best use is as improved." This is a weak comment about any property, but it is particularly inappropriate for an appraisal of a proposed project or one where renovation is being analyzed. Highest and best use as improved for a proposed property should address the proposed improvements. A proposed project needs the same critical analysis as that for an existing improved property. It is crucial to recognize that a proposed project may not be the highest and best use of the property. The developer may not know the market or may be constructing something that is an over-improvement or an under-improvement to accommodate special needs of the buyer/user. It is your job to recognize the keys to highest and best use and analyze the proposed improvements AND deal with them appropriately if they are not the highest and best use of the property.

### **Highest and Best Use – Reporting**

A common misconception is that in a Summary Appraisal Report it is acceptable to just summarize your conclusion. This is incorrect. You must summarize your analysis. If the objective is market value, there will always be some degree of analysis of highest and best use. Granted, in some cases that analysis is quick, and the highest and best use conclusion of the property as it exists doesn't take more than a flash to figure out. For example, consider the case of a single-family residence located within a subdivision of similar houses, where there is no chance that a likely buyer would demolish the house to maximize value, and where modifying the improvements would not significantly increase the value above the cost to make them. But it's still necessary to provide some reasoning or rationale for your conclusion. USPAP language reads: "summarize the support and rationale for that opinion" [SR 2-2 (b) (ix)].

It is not necessary to repeat sections of the report in the highest and best use analysis. Report sections are not intended to be stand-alone. The Market Analysis and other descriptive sections of the report can be used to support highest and best use conclusions as well as the valuation sections. Material from other report sections may be referenced in the Highest and Best Use section to support the analysis and conclusions.

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## **Highest and Best Use – Residential Form**

Another common misconception is that it is only necessary to check the box on a form report if the highest and best use is “as improved.” This is incorrect. Highest and best use in a summary form report still requires some detail even when the existing improvements represent the highest and best use. (See comments above.) USPAP language relating to highest and best use in a Summary Appraisal Report reads: “summarize the support and rationale for that opinion” [SR 2-2 (b) (ix)]. You may provide a brief statement, but to meet the requirements of the Standard, you must provide more than a checked box.

## **Excess Land and Surplus Land**

Excess land is commonly mishandled in assignments. It is often confused with surplus land. It is too often lumped in with the value of the entire property or ignored altogether. Excess land may be sold off separately from the rest of the property, so in effect, the subject property becomes two subject properties. Excess land may have a different highest and best use than the rest of the site. This must be addressed in the highest and best use analysis. Further, excess land will have to be treated separately in the valuation process. An entirely different set of comparable data may be required. The value of excess land must be reported separately. Be careful about adding the value of the excess land to the value of the rest of the property, as the sum of the parts may or may not equal the whole.

Surplus land does not have a separate value, as it cannot be sold off separately. It is “extra” land that may or may not contribute value to the overall property. It does not have an independent highest and best use. It may have the same value per unit of comparison (e.g., value per square foot, value per acre) as the rest of the site, or it may contribute less per unit of comparison.

## **Reporting Requirements**

In 2006 the Departure Rule was eliminated from USPAP, along with all the disclosure requirements relating to departure. USPAP no longer uses the terms “complete appraisal” and “limited appraisal” to describe the development process. The change did not affect the written appraisal reporting options (Self-Contained, Summary, and Restricted Use) or the requirement to disclose which option you used.

Advisory Opinion 11 provides a good overview of the content requirements for each of the three reporting options and includes a report content comparison chart that is very helpful in determining what is required for each. It is important that you meet all of the requirements for the option that you choose. It is inappropriate and misleading to state that you are providing a Self-Contained Appraisal Report when the level of detail is no more than that required for a Summary Appraisal Report, or that you are providing a Summary Appraisal Report when its content level is that of a Restricted Use Appraisal Report.

Many clients do not fully understand the different reporting options. It's the appraiser's responsibility to explain the differences and provide the report needed. Often clients request a Self-Contained Appraisal Report but ask for a "shorter version"—it is necessary for you to explain that if you call it a Self-Contained Appraisal Report, it must be one. If the client wants one detailed approach and cursory secondary valuation approaches, you can write a Summary Appraisal Report and provide a more detailed reporting of the emphasized section. It is *not* acceptable to call this report "Self-Contained."

If you are preparing a Restricted Use Appraisal Report, you must intend that it be used by only one party. That is, it must be for client-use only. If you intend for parties other than the client to use the report, a Restricted Use Appraisal Report is not appropriate. If your client needs more than just the value conclusion (for example, data and analyses), then a Restricted Use Appraisal Report is not appropriate. It is unacceptable to provide a Restricted Use Appraisal Report just to keep costs down. Your report must include the information the client requires and address the reason why the client needs the appraisal from you.

For instance, in legal situations, often an attorney will request a Restricted Use Appraisal Report to make an initial determination about the extent of a legal issue. It may be appropriate to provide such a report if it is your intention that the attorney is the only one who will use the report. But it is not appropriate to provide a Restricted Use Appraisal Report for eminent domain purposes when it is your intention that the attorney, the client, and the court will all use it.

You may use any number of forms for reporting. Beware of forms that do not in themselves call for all of the information required under Standard 2. Some forms need to be supplemented with such items as intended use, intended user, scope of work, etc. It is incumbent on you, the appraiser, to understand whether the form or format you are using allows for compliance with the reporting requirements of Standard 2 of USPAP.

## **Residential Reporting Requirements**

The new URAR form (March 2005) does not need addenda to meet USPAP's reporting requirements. It will need the addition of the Appraisal Institute's certification statements. This form is intended for a specific use, and you may continue to use the old URAR form for other assignments.

The old URAR form does not meet all the reporting requirements as outlined in USPAP. It is possible that with careful and concise language you could fit the majority of the additions into the body of the form; however, this is unlikely. In most instances, supplementation will be needed to address the

reporting requirements not covered by the form, in addition to a current certification as required by Standards Rule 2-3.

We highly recommend the use of the Appraisal Institute's AI Reports® forms when the appraisal does not need to meet the requirements of Fannie Mae, Freddie Mac, FHA, or VA. If the assignment is with a lender who is not concerned with these entities, use of the new URAR is not required. For a non-lending client, the new URAR is not appropriate.

## **Reconciliation**

Standards Rule 1-6 requires the appraiser to reconcile the quality and quantity of data. The corresponding reporting requirements are in Standards Rule 2-2 (a) (ix), 2-2 (b) (ix), and 2-2 (c) (ix). A reconciliation section consisting of boilerplate and stock comments does not often present useful information. A discussion of the data used, its application to the subject, how the approaches apply to the subject, and so on, is essential to a meaningful reconciliation.

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## Miscellaneous -- Theory and Practice

The following are common errors noted in a significant number of assignments:

- Failing to complete a sufficiently thorough market analysis when analyzing highest and best use, income, vacancy, and expenses
- Including irrelevant data in the report but leaving out relevant information; for instance, including a detailed market analysis covering retail and office properties but providing only a weak analysis of the apartment market when the subject property is an apartment
- Improperly handling or ignoring excess land
- Allowing gaps in the reporting of the analysis, which require the reader to take “leaps of faith” to understand a conclusion or analysis
- Failing to recognize the market for the property—local, regional, or national
- Valuing a leased fee interest without knowing or analyzing the lease terms
- Analyzing a single-tenant, owner-occupied property using multi-tenant comparables
  
- Analyzing rent comparables without considering the size of the demised spaces in either the comparables or the subject
- Failing to recognize the date leases were initiated in completing rent comparable analysis
- Failing to use a DCF for leased fee analysis when it is necessary for credible results
- Not understanding what is included in Marshall Valuation Costs
  
- Applying percentage adjustments in an improper sequence
- Not using or citing up-to-date materials; for instance, referencing old textbooks
- Not having or reviewing current editions of the Standards—akin to filing your taxes using an old form
- Not discussing excess land or functional issues in a highest and best use analysis
- Failing to reconcile the data and analysis in the appraisal
- Careless editing of boilerplate

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## Resources and References

The Code of Professional Ethics and Standards of Professional Appraisal Practice of the Appraisal Institute are available on the Appraisal Institute Web site (<http://www.appraisalinstitute.org>).

If you have additional questions or need more information, contact:

Stephanie Coleman, MAI, SRA

Senior Manager, Ethics and Standards for the Appraisal Institute

Phone: (877) 777-6939

[scoleman@appraisalinstitute.org](mailto:scoleman@appraisalinstitute.org)

Janice F. Young, MAI, SRA

Senior Manager, Experience Screening

Phone: (503) 235-8755

[jyoung@appraisalinstitute.org](mailto:jyoung@appraisalinstitute.org)