

Appraising Diminished Value

IN THE WORLD OF REAL ESTATE, WHAT GOES UP DOES NOT necessarily come down. But when it does, obtaining a credible expert opinion of a property's diminished value can be costly—sometimes \$2,500 or more. Although experienced counsel appreciate that valuation issues often involve complex inquiries, attorneys frequently wonder why an appraiser can't simply cut to the chase and render an opinion based on "experience and judgment."

Good question.

DIMINUTION IS DIFFERENT

In fact, a diminution in value is not the same as a general price decline due to market conditions. It involves specific factors—detrimental conditions—that might affect the value of a given property or group of properties. For that reason, a standard appraisal will not be adequate.

Allegations of diminished value may arise from a variety of conditions: environmental contamination, geotechnical issues, construction defects, water intrusion, and proximate nuisances, to name a few. In this context, appraisal is problematic because the search for "comparable" properties can be difficult. Conditions that affect a given parcel may not apply to adjoining or neighboring properties.

Indeed, this very circumstance separates diminution analysis from a conventional appraisal. A standard appraisal assignment typically involves a search for *direct* comparables—properties that are most similar in significant respects to the subject property—along with traditional applications of the cost, sales comparison, and income approaches to value.

When a property is affected by a detrimental condition that is alleged to have a negative impact on its value, sales of comparable properties with similar conditions are often scarce, and sometimes nonexistent. This requires an appraiser to expand the search criteria to encom-

pass *analogous* comparables—properties that might not be directly comparable to the one at issue, but which share some similarity with respect to the condition being studied. Standard data sources are often inadequate for this task, so creativity and considerable time must be spent searching for relevant information. Establishing causality and the level of the buyer's knowledge of the condition are also important. Furthermore, the techniques used to measure value diminution—including case studies, statistical analysis, and market surveys—may be unfamiliar to many appraisers. The scores of books and articles devoted to the subject of real estate damages attest to the specialized nature of this field. (Many titles are available online at the Appraisal Institute's bookstore or in *The Appraisal Journal* and other professional publications).

USPAP GOVERNS

Appraisers learn to support their opinions with market data. At the most basic level, residential appraisals used for acquisition or refinancing invariably contain at least three comparable sales, along with requisite analysis and reconciliation into an opinion of market value.

In California, as in other states, appraisers must comply with the Uniform Standards of Professional Appraisal Practice (USPAP), published by the Appraisal Foundation (www.appraisalfoundation.org). This mandate is refer-

enced in both a governing statute and in administrative regulations. (See Cal. Bus. & Prof. Code § 11319; Cal. Code Regs. tit. 10, § 3701.) Many appraisers also belong to the Appraisal Institute or other professional organizations that require compliance with USPAP.

The uniform standards mandate that appraisers be competent to perform the specific assignment, understand and correctly employ recognized methods, and analyze all the information necessary for credible results.

There is no more basic USPAP requirement than competence with regard to *assignment type*. Appraisers unaccustomed to measuring diminution in value might not understand the specialized research and analytical techniques necessary for this type of appraisal practice; they may be tempted to rely exclusively on "experience and judgment" in lieu of market data. This temptation is particularly dangerous, because appraisers who are unfamiliar with this type of work probably have the least experience upon which to make any kind of informed judgment. Because appraisal is both an art and science, judgment calls are inevitable, but disregarding market evidence is clearly not appropriate.

When it comes to appraising diminution in property values, improper reliance on experience and judgment alone falls below the standard of care and does a disservice to the client and the legal system. Appraisal experts with real market information to support their opinions will usually be more persuasive to the trier of fact, have better demonstrative exhibits, and even help facilitate settlement long before a case goes to trial. 📌

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