

# **PREPARATION OF THE DEMONSTRATION APPRAISAL REPORT**

## **INTRODUCTION**

The preparation of the demonstration appraisal report is one of the critical components of the accreditation process. The objective of the demonstration report is to illustrate the applicants understanding of the appraisal process and how the components of the appraisal process interact to result in a well-supported, logical and defensible opinion of value. The appraiser's efforts in compiling information and completing the analysis may have little meaning if it is not merged into a readable report which presents facts and conclusions in a logical and concise manner. Since the appraiser is not typically present when the report is reviewed or examined, the report is the primary method available to influence the reader's impression of the appraiser's professional competence.

A narrative appraisal report should lead the reader from the definition of the appraisal problem through the descriptive data and reasoning process to a specific conclusion. The report should be sufficiently comprehensive to enable the reader to visualize the general area and the property appraised and to follow the writer's reasoning in each step of the appraisal.

## **GUIDELINES FOR PREPARING THE DEMONSTRATION APPRAISAL REPORT**

Although not all appraisers organize their reports in the same manner, most reports contain certain common features. The required common features are specified in the Uniform Standards of Professional Appraisal Practice (USPAP). Appraisals that comply with all the requirements of the USPAP version current as of the date of the report are acceptable appraisals from the standpoint of appraisal content and the following outline provides information required by USPAP.

The Handbook of Technical Writing, Brusaw, Alred, and Oliu, St. Martin's Press, New York, NY, Fifth Edition, 1997, is an excellent reference book and guide that contains numerous examples of writing various portions of technical reports. Throughout the following outline references are made to appropriate topics in Brusaw and readers are encouraged to use Brusaw as a technical writing reference when preparing appraisals. Appraisals are commonly divided into four parts: Introduction, Factual Data, Analysis and Conclusions, and Addenda. This document discusses each section of the report with comments regarding some of the common errors found in demonstration appraisal reports.

Some appraisal organizations require members writing demonstration reports to follow a more specific outline than is required by USPAP. The following outline is recommended to members of the American Society of Farm Managers and Rural Appraisers (ASFMRA) writing demonstration reports. Within the demonstration appraisal report prepared as part of the accreditation process, the applicant's goal is to demonstrate to the reader knowledge of the appraisal process and how the various elements of the analysis interact to result in a credible appraisal. While the recommended outline is not essential to receiving a passing grade on the demonstration report, there are specific topics and content which are required for the ASFMRA demonstration report. **Please thoroughly read the Mandatory Requirements section of this document as provided below. The failure to address each Mandatory Requirement will result in the report receiving a failing grade.**

Careful consideration should be given to the selection of the subject property. Within the demonstration report, the applicant is required to address certain mandatory requirements. It is possible that a given subject property may not lend itself to meeting these requirements. The prime example is the requirement that the property includes a building improvement(s) which contributes value to the property.

***Common Errors:*** *The most common error is the assumption by the applicant that an appraisal report prepared as a typical work product will meet the requirements of a demonstration appraisal report. Rarely will a typical appraisal report prepared in the normal course of business meet the requirements of the demonstration report without additional work. Not all properties lend themselves to use as the subject of a demonstration appraisal report. It is the applicant's responsibility to select a subject property which will allow the appraiser to comply with the requirements of the demonstration report. The demonstration report must be presented in a narrative format. A form based report will require significant additional information and discussion in order to meet these demonstration report requirements.*

## MANDATORY REQUIREMENTS

The demonstration report is a requirement of accreditation and is intended to measure the appraiser's understanding of the appraisal process and how each section of the report interact to produce a credible appraisal. Since this is, in fact, a test of the appraiser's knowledge of the appraisal process certain elements must be included for the applicant to achieve a passing grade on the demonstration report. The applicant is encouraged to confirm that the items outlined below are included within the report. If the item is present, the corresponding section of the report will be graded and a grade provided. If the requirement is missing, the report will be returned to the applicant for revision. **REMEMBER:** The applicant is provided the opportunity for only one (1) re-grade. Use the re-grade opportunity wisely by confirming the mandatory topics have been addressed.

### Uniform Standards of Professional Appraisal Practice (USPAP)

- USPAP compliance is mandatory. If the appraisal report does not meet the requirements of the Uniform Standards of Professional Appraisal Practice, the report will fail.
- The Mandatory Requirements for the Demonstration Report, as outlined below, are to be considered as if they were client requirements in addition to compliance with USPAP.
- Any assumptions or hypothetical conditions utilized in the appraisal must be discussed in detail. The impact on value should the assumptions or hypothetical conditions be proven false must be discussed within the report in conformance with USPAP.
- A Scope of Work section is required and should thoroughly discuss the problem to be solved and the scope of work required to produce a credible appraisal.

### Report Format

- The report must be presented in a narrative format.

### Subject Property Requirements

- The subject property must include a building(s) which provide contributory value within the market.
- The building structures are described.

### Highest and Best Use Analysis

- The appraisal report must include a thorough analysis of the property's highest and best use both As Vacant and As Improved.
- The highest and best use analysis must address the topics of legally permissible, physically possible, financially feasible and maximally productive.

### Cost Approach

- The appraisal must reference a minimum of two (2) sources of cost new for the primary improvement (defined as that improvement having the highest contributory value).
- The source of the cost new on the secondary improvements must be referenced.
- The topic of replacement cost versus reproduction cost should be discussed. This discussion should include a presentation of which type of cost new is most applicable to the subject buildings and why. The primary structure should be addressed separate from the secondary improvements.

- The report must include a presentation of depreciation extracted from market data. At a minimum, the depreciation of the primary structure must be addressed on an individual structure basis.
- The breakdown method of depreciation analysis must be presented within the report.
- The topics of functional obsolescence and external obsolescence must be considered a related to the subject property's improvements.

#### Income Approach

- Rent comps must be included within the report. Further, the rent comps must be discussed and analyzed.
- The source of at least two (2) expense items must be included and be based on market derived data such as information from suppliers or interviews with market participants.
- If the income approach is approached from an owner-operator analysis, the appraiser must include a discussion of potential going concern value.
- A discussion of how the improvements impact the concluded rental rate should be included.
- The capitalization rate or discount rate must be derived from market sales data.

#### Sales Comparison Approach

- A minimum of two (2) market derived adjustments must be included within the analysis. These adjustments may be any combination of the following:
  - o Paired sales analysis
  - o Graphic analysis
  - o Statistical analysis
  - o Calculator method for financing adjustment based on market rates
- A building mix adjustment must be conducted on an individual sale basis.
- The land mix analysis must be described (i.e. explain what it is) and, if it is not used, explain why the technique was not used. The approach should include a discussion of how the land mix ratios are developed whether or not the technique is used in the report.

## ELEMENTS OF THE DEMONSTRATION REPORT

### Preface

A preface is commonly included at the beginning of the typical narrative appraisal report. While none of the items commonly included within the preface is required under the Uniform Standards of Professional Appraisal Practice, professional reports commonly include a preface. Alternative organizations are appropriate for appraisal introductions. The traditional organization is title page, letter of transmittal and the table of contents. Some writers include the summary of salient facts and conclusions, and the assumptions and limiting conditions as part of the preface. The major components of the preface are:

**I. Title Page** (Brusaw 225-226) - The title page includes the following information.

- Property name and identification
- Address or location of the property being appraised
- Name and address of the client
- Name and address of the appraiser
- Effective date of the valuation
- Date of report preparation

**II. Letter of Transmittal** (traditional organization only) (Brusaw 701) - The letter of transmittal formally presents the appraisal report to the client. Letters of transmittal are drafted in proper business style, being as brief as the character and nature of the assignment permits. The letter of transmittal is part of the appraisal report and is not to be confused with the *cover letter* used to convey the report to a client. The letter of transmittal is used to provide a permanent record for identifying the writer and intended reader(s). A suitable letter of transmittal includes:

- Property name or identification
- Effective date of the value estimate
- Date of report preparation
- Type of value estimated
- Statement that the property inspection and all necessary investigation and analysis were made by the appraiser
- Final estimate of value
- Any extraordinary assumptions and limiting conditions
- A statement providing location of the property and a brief description
- Signature of the appraiser.

In most cases the letter of transmittal is the first item readers will read. Use special care to reflect your professionalism.

**III. Table of Contents** (Brusaw 226-228, 571) - The table of contents shows the page numbers of the various sections and subsections of the report. The table of contents is arranged to help readers locate specific items in the report. When the appraisal includes numerous tables, a 'List of Tables' may be helpful. Likewise, when there are numerous figures (drawings, photographs, maps, charts, or graphs), a 'List of Figures' containing figure numbers, titles, and page numbers, is helpful to the client/reader.

**Common Errors:** *The appraiser fails to clearly identify specific assumptions and/or limiting conditions used within the analysis. The appraiser fails to make the proper distinction between Extraordinary Assumptions and Hypothetical Conditions.*

## **Introduction**

The introduction section of the appraisal report is intended to introduce the reader to the subject property, the rights being appraised, the Scope of Work and the basic conclusions of the analysis. The introduction states the purpose (market value, investment value, insurance value, etc.) and function (use of report, i.e., mortgage, estate, etc.) of the appraisal, identifies and describes the subject property, and presents the value conclusion. The introduction also includes any assumptions and conditions that limit the report. This is the section where the appraiser provides details regarding the client's requirements and the area in which the property is located. The introduction section of the report is a suitable location for the appraiser to report and discuss many of the USPAP requirements. The information included depends on the appraisal assignment; however, the following items are generally included:

- I. Summary of Salient Facts and Conclusions OR Executive Summary** (Brusaw 200-205) - The summary of salient facts and conclusions provides readers a summary of the appraisal problem, factors considered, analyses performed, and the conclusions reached. Often the Summary of Salient Facts and Conclusions is presented in bullet form with brief statements made about each topic covered. Little or no effort is made to tie the points together.

Executive summaries are usually prepared in narrative form to provide busy readers an opportunity to be informed without reading the complete report. Executive Summaries should fully inform readers of the problem studied and conclusions reached. Executive Summaries are usually proportional in length to the appraisal document. Complex appraisal problems require more detailed summaries to adequately inform readers. Normally, Executive Summaries should have the same organization as the appraisal report.

At a minimum, both the Summary of Salient Facts and Conclusions and the Executive Summary cover the following points.

- A. Brief property identification
- B. Effective date of the valuation and date of report preparation
- C. Property ownership and property rights appraised
- D. Property location
- E. Acreage breakdown and brief list of improvements
- F. Zoning
- G. Highest and best use
- H. Brief summary of subject leases, if any
- I. Value indicated by the cost approach
- J. Value indicated by the income approach
- K. Value indicated by the sales comparison approach

- L. Final opinion of value
- M. Assumptions and Limiting Conditions and Hypothetical Conditions which have a direct impact on the opinion of value

**II. Assumptions and Limiting Conditions** - These statements inform the client and other readers of the report of the limiting conditions that are outside the scope of the assignment or not within the responsibilities of the appraiser. The appropriate conditions should be stated clearly and relevant to the current appraisal problem. The best location for the assumptions and limiting conditions section is early in the report to alert readers to the premises underlying the analysis and used to prepare the appraisal. The number and type of assumptions and limiting conditions vary depending upon the nature of the appraisal assignment. The letter of transmittal should contain a summary of extraordinary assumptions or limiting conditions. Special notice is given to any assumptions and/or limiting conditions that have a direct impact on value and it is imperative that appraisal readers understand those important assumptions and limiting conditions. The assumptions and conditions must be reasonable and justifiable. The impact on value should the assumption not be correct should be included. It is important that the client agree to the limiting conditions at the time of assumption. Otherwise, you may be assuming away a condition that the client wants the appraisal to address.

**III. Hypothetical Conditions** – The use of hypothetical conditions within the appraisal requires an increased level of discussion within the appraisal report. Hypothetical conditions are contrary to what is known to exist on the effective date of the appraisal and a discussion of the impacts on value must be presented within the report.

**IV. Appraisal Objective** - The appraisal objective informs readers of the purpose and function of the report. The appraiser, perhaps in consultation with the client, determines the appraisal's purpose while the client indicates the intended use or function of the report.

**A. Purpose of the Appraisal**

The purpose of the appraisal is answering the value question the client wants to answer. The purpose may be to estimate market value, insurable value, or some other type of value.

**B. Function of the Appraisal**

The client's expected use the appraisal should be clearly stated. Readers should be told whether the appraisal is to be used for loan purposes, estate settlement, bankruptcy, or some other use. The name of the person authorizing the appraisal report should be included.

**C. Intended Users/Use of the Appraisal**

The USPAP requires disclosure of the intended users of the appraisal. The intended user(s) or use may be different than the client and the reader should fully understand the identity of the intended users of the report.

- V. Property Rights Appraised** - The particular rights or interests being valued are identified. This is particularly important in assignments that involve partial interests such as limited rights (surface or mineral rights only), fee simple estates subject to long-term leases, or leasehold interests. Also, other encumbrances such as easements, mortgages, or special occupancy or use requirements impacting the property should be listed. These encumbrances should be discussed relative to the value being estimated.
- VI. Effective Date of the Appraisal** - The effective date of the value estimate must be stated along with the date the report is prepared. Appraisal assignments may call for estimating current value or value at some other point in time. Stating the date of valuation precisely is essential for proper use and interpretation of the report. The effective date of the appraisal establishes the context for the value estimate. The date of the report indicates the perspective from which the report is prepared.
- VII. Definition of Value** - A precise definition of the value sought should be provided. After reading the definition, readers should not question the type of value being determined. When estimating market value, the appraisal should state whether the estimate is expressed in terms of cash, terms equivalent to cash, or other precisely specified terms. The source of the definition of value should be included with the definition.
- VIII. Scope of Work** – This section is required to meet the requirements of USPAP. In an appraisal, the appraiser must identify the problem to be solved and determine the level of work needed to produce a credible result. The Scope of Work section is the location within the report in which the appraiser presents the scope of work developed and implemented within the appraisal report to produce a credible assignment result. The assignment results are always measured relative to the intended use of the appraisal.
- IX. Area-Regional and Neighborhood Analysis** - The area-regional and the neighborhood analysis should provide a foundation that will lead readers to recognize and accept your conclusions of the property's highest and best use(s). Include only information pertinent to the appraisal problem. Discuss both the positive and negative aspects of the area. If only positive or only negative factors are included, the report is likely to be misleading. If significant supporting statistical data are needed, incorporate the information into tables or include a brief summary in the body of the report that refers to more lengthy material provided in the addenda.

For each item included in the Area-Regional Analysis and the Neighborhood Analysis, you should ask:

- a. "Is the data relevant?"
- b. "Does the information add to the understanding of the physical, social, political, economic, or market setting of the subject property?"
- c. "Does the material flow logically from section to section?"



The type of appraisal problem and the nature of the subject property dictate, to a large extent, the information that you should include in this section. The relevant area for a specific property may, in some cases, have a five to ten mile radius, while in other cases, several counties or entire states are included. Always address physical, social, economic and governmental considerations having an effect on real estate values within the general area and neighborhood. Use the following partial list of topics as a guide for preparing the area-regional and neighborhood analysis.

d. Physical Considerations

- i. Location and the boundary of the area defined
- ii. Access and transportation within the area defined
- iii. Land use, tenure, and expected changes in land use
- iv. Terrain, soils, and climatic considerations within the general area
- v. Adequacy of utilities

e. Social Considerations

- i. Community facilities and population
- ii. Schools, church and recreation available
- iii. Heritage of community and prestige of area
- iv. Conformity of development

f. Economic Considerations

- i. Proximity and adequacy of commodity markets
- ii. Types of farms and rent levels
- iii. Crop production levels
- iv. Typical management practices
- v. Livestock carrying capacities
- vi. Local economy and possibilities for off-farm employment
- vii. Urban growth or population changes that may indicate trends in property values
- viii. Detriments and hazards

g. Governmental Considerations

- i. Discussion of taxes and their trends
- ii. Zoning or other governmental restrictions
- iii. Special easements or assessments that are common to the area.
- iv. Government policies as they impact returns to agricultural land.

Avoid stereotyped or biased assumptions relating to race, age, color, religion, gender, or national origin. Do not presume racial, ethnic, or religious homogeneity is necessary to maximize value in the neighborhood.

The appraiser should provide some conclusions within the discussion of the area-regional and neighborhood analysis focusing on those issues and trends relevant to the subject property. Keep in mind the area and neighborhood factors are fundamental to the highest and best use of the property. Interpret the relevant data in terms of how they affect the subject property. Without this interpretation and summary, the area and neighborhood analysis lacks significance.

**Common Errors:** *The appraiser fails to present information within the area-regional and neighborhood analysis relevant to the property being appraised. In some instances, the area-regional and neighborhood analysis may lead the reader to expect a highest and best use conclusion which is contradictory to the appraiser's conclusions.*

## **Factual Data**

The factual data section contains property facts affecting the appraisal. In general, all information used to prepare the appraisal (except comparable sales information) is included as factual data and it is not appropriate to introduce additional information in the analysis that is not presented as factual data. The information included depends on the appraisal assignment. However, the following items are generally required.

- I. Property Identification** - The property location is presented clearly along with distances to the nearest population centers. The size and overall type of the property should be noted, i.e., "a 759 acre farm located along the south side of County Road XYZ, 17 miles northwest of Anytown, Iowa."
- II. Legal Description** - The legal description of the estate appraised is provided. If the description is longer than one or two paragraphs, the description should be placed in the addenda and readers referred to its location.
- III. Ownership History of the Property** - At a minimum, the appraisal should include a summary of any agreement of sale, option, or listing of the property being appraised, all sales of one to four family residential properties within the last year and sales of all other properties within the last three years. If a sales history is not included, there should be an explanation of efforts undertaken to obtain the information. A preferred ownership history for the subject property is five years. The sale price, terms, and other pertinent information should be included in the history.
- IV. Property Description**

Describe the property so the reader develops an accurate mental image of the property. Use sufficient detail to answer all important questions that the client or reader might pose as to the physical characteristics of the property, its economic contribution, and any specific benefits or constraints attributed to it. The following list provides an example of topics that may be relevant to the property being appraised. Additional items may be required to fully describe the property.

  - a. Size and general shape of the property
  - b. Location and access, including distance to markets and major trade centers
  - c. Land use (i.e., acreage in cultivation, acreage irrigated, woodland acreage, minerals, etc.)
  - d. Crop history, including yields, carrying capacity, rotation, fertilizer program management methods, etc.
  - e. Farm/Ranch operational and lease information
  - f. USDA farm program information applicable to the property
  - g. Terrain, drainage, and other physical features

- h. Soil information
- i. Vegetation
- j. Water rights, irrigation systems, stock water, well information, etc.
- k. Utilities
- l. Taxes and assessments
- m. Zoning
- n. Easements, encroachments and deed restrictions
- o. Descriptions of Land improvements, including fences, corrals, levees, roads, ditches, etc.
- p. Description of building improvements, including condition, quality, size, amenities, and utility of each
- q. Disadvantages of the property in relation to its market area
- r. Advantages of the property in relation to its market area

Exhibits such as maps, photographs and sketches often provide descriptive information which is not easily transmitted to the reader in words. Photographs of major components of the subject property, especially building improvements, convey a wealth of information to the reader which would often be omitted in a narrative description. Good quality maps of the property are typically available from common appraisal sources such as the USDA Web Soil Survey.

In the presentation of maps and photographs within the report, the writer should ask themselves what order of presentation makes logical sense and would be the most helpful to the reader. While photographs and maps can be placed in the addenda, the presentation of these items in the addenda may detract from the flow of the report. All items placed in the addenda should be referred to in the body of the report.

As appropriate for the appraisal problem, include soil maps, topographical maps, site characteristics maps, building plats, etc. Agricultural properties are diverse and some require significantly more data than others. For example, if the majority of the overall property value consists of land, include fewer improvement photos. By contrast, if a significant portion of the total property value is attributable to the improvements, include fewer land photos. Assist the reader in understanding maps, photographs, and other exhibits by adequately describing what is shown.

### **Data Analysis and Conclusions**

Use the data analysis and conclusions portion of the report to lead readers through the logical sequence of steps you are completing to develop your opinion of value. Base your analysis and valuation conclusions on the data presented in preceding sections and be sure nothing in the analysis or valuation process conflicts with information you provide earlier in the report.

#### **I. Highest and Best Use**

Relate the highest and best use conclusions to information presented in preceding and succeeding sections of the appraisal report. Always provide a definition of "Highest and Best Use" and convey the following ideas to your readers.

- Highest and best use conclusions are the foundation of the appraisal and the appraisal report.
- Highest and best use conclusions must be consistent with the area-regional data and subject property data. You must understand market behavior to develop the concept of highest and best use.
- Highest and best use conclusions form the foundation for applying the three approaches to value, performing the reconciliation, and concluding the final value.

Determine the highest and best use for the property "as if vacant" using the following four criteria. If the property is improved, also determine the highest and best use of the property "as improved" using the same four criteria.

- s. **Legally permissible** - The use must be legally permissible considering both public and private restrictions. If the property is subject to zoning, discuss the uses allowed under the current zoning. If subject to deed restrictions (i.e. conservation easements or deed restrictions), discuss the limitations on use imposed by these restrictions. Also, discuss any possibility and/or the likelihood of a change in what is legally permissible (change in zoning).
- t. **Physically possible** - The use must be physically possible considering the size, shape, soil, and terrain of the property. Discuss the physical limitations on use and any remedial actions which may allow for a different physical use of the property.
- u. **Financially feasible** --The use must be financially feasible by producing returns greater than operating expenses. Discuss and analyze the probable uses expected to produce a positive return. Properties often have multiple financially feasible uses. For instance, both cultivation and use as pasture land may be financially feasible uses of a property.
- v. **Maximally productive** -- The maximally productive use is the financially feasible use producing the highest value.

Report the highest and best use of vacant tracts assuming they will be developed to their highest and best use. Decide the "as if vacant" highest and best use of an improved property by using the four criteria to evaluate how the property would be used if the existing improvements are removed. Decide the "as improved" highest and best use by using the four criteria to identify how the property would be used if the existing improvements are not removed.

Conclude both the "as if vacant" and "as improved" sections with summaries. In each summary discuss the four criteria for determining highest and best use. Finally, conclude the highest and best use section with your conclusion about the highest and best use of the property being appraised.

## **II. Appraisal or Valuation Process**

Use this section to present the mechanics and theory of the appraisal process, particularly the rationale underlying the three approaches to value. There are alternative organizations for this section. You can include a section on valuation methodology after the highest and best use section and before the sections discussing the approaches to value. Title the section "Appraisal Process" or "Valuation Theory." Discuss the steps you are following in the current appraisal assignment and indicate why certain approaches to value are being used while others are excluded. When using this alternative, discuss the mechanics of each approach as an introduction to the section on that approach.

An alternative organization of the appraisal or valuation process is to completely discuss the methodology and mechanics of each approach in this section. When using this approach, begin the discussion of the three approach sections with little or no introduction to the methodology you are using.

## **III. Cost Approach**

If you have completely discussed the cost approach methodology in the above section, proceed to discussing land values. If you have not discussed the cost approach, summarize the theoretical basis, the principle of contribution on which the cost approach is based, the methodology, and the procedures you are using to determine the opinion of value by the cost approach. Readers should have a clear understanding of how you are performing the cost approach after reading this introduction. Use terms that will be understood by readers and define technical terms.

### **A. Land Value**

Present market data and other information pertaining to land values along with the data analysis and reasoning leading to the land value conclusion. In a clear and precise manner, identify and discuss all factors affecting land values on the property being appraised.

For most rural appraisals, the cost approach begins with valuing each of the various classes or types of land found on the subject property. Common land types include dry cropland, irrigated cropland, native pasture, improved pasture, woodland or other land uses. Use whatever types are appropriate for the appraisal problem.

The values concluded for each land type should be based on comparable sales having no improvements (whenever possible). Describe each comparable sale's location, size, zoning, utilities, soils, and other physical characteristics. When determining the land value using the cost approach, the best comparable sales have no improvements and one land type. The most desirable situation is having adequate comparable sales which require no adjustment. However, it is rare to have adequate sales requiring no adjustment. In the analysis of land values or value ratios for each land type, care should be used to select sales which require minimal adjustment. After the values per unit for each land type are determined, calculate the total value of the land component.

The use of tables throughout this analysis will improve the ability of the reader to follow the analysis. A purely narrative discussion is often confusing and difficult to follow.

***Common Pitfalls:*** *Common problems within the land value analysis are the absence of any explanation as to how the sales prices were allocated between land classes, the absence of a tabular presentation and inconsistencies between the analysis of sales in this approach and the Sales Comparison Approach.*

#### B. Cost of Improvements

Estimate either the replacement or reproduction cost of the subject property's improvements. For a particular appraisal problem, use either replacement or reproduction cost, but not both. For major improvements, present cost data on an item-by-item basis. Indicate the source of the cost estimates (contractor's bid, equipment supplier, or evaluation service such as Marshall & Swift, etc.). The Cost Approach within the demonstration report should present two sources of cost data for the primary improvements (highest contributory value). The appraiser should note the demonstration report requires the presentation of physical depreciation along with one of either functional obsolescence or external obsolescence. The choice of the type of cost new used in the analysis may impact the appraiser's analysis of the subject property.

Many technical words are included in this portion of appraisal. Include definitions for all technical terms such as physical deterioration, functional obsolescence, external obsolescence, replacement cost new, reproduction cost new, etc. The Dictionary of Real Estate Appraisal and The Appraisal of Real Estate contain definitions of commonly used technical terms.

***Common Errors:*** *The absence of a source for the cost estimates, confusion between the terms reproduction cost and replacement cost and mathematical errors are common sources of deductions.*

### C. Depreciation

Depreciation may be present from multiple sources including physical deterioration (curable and incurable), functional obsolescence (curable or incurable, excess or deficiency) and external obsolescence. Depreciation estimates can be developed through the following methods: physical age-life, economic age-life, modified age-life or breakdown method.

**For demonstration report purposes, the use of the breakdown method is mandatory.** The applicant should describe the procedure and carefully define all the technical terms of the analysis within the report. The demonstration report must employ an analysis of depreciation which includes the use of relevant market data. The demonstration report must include a market based analysis of at least two forms of depreciation (physical deterioration and one, or both, of functional obsolescence/external obsolescence).

**Common Errors:** *The failure to use the breakdown method of depreciation analysis is a common reason for demonstration report failure. The use of the breakdown method is a mandatory requirement. The applicant must also include an analysis of at least two forms of depreciation. The applicant is encouraged to review their course materials regarding the development of these estimates.*

### D. Conclusion

The purpose of the demonstration report is to test the applicant's understanding of the appraisal process and how the elements of the report interact to produce a credible and well-supported appraisal report. While there are multiple methods to use in the development of depreciation estimates, the demonstration report requires the breakdown method of depreciation analysis. The applicant should think of these requirements as questions on a test or as specific client requirements.

Discuss your conclusions at the end of the cost approach presentation. Add the depreciated cost of improvements to the land value estimate to arrive at the indicated value by the cost approach. Explain to readers the applicability of the cost approach and point out any limitations that the cost approach may have for this particular problem.

**Common Errors:** *The failure to properly prepare the Cost Approach is a common reason for failing the demonstration report. The writer should pay particular attention to the inclusion and proper presentation of the following:*

- *The absence of any explanation as to how the sales prices were allocated between land classes.*
- *The use of the breakdown method of analyzing depreciation*
- *The absence of the presentation of either functional obsolescence or external obsolescence.*

## IV. Income Approach

Unless discussed as part of the valuation process, introduce this section with a summary of the income approach and its foundation, including the principle of anticipation. Include a discussion of the theoretical basis and the relationship of the income approach to the highest and best use of the property. Point out that income and expense estimates are consistent with the highest and best use conclusion and that any renovation or conversion of improvements suggested in the highest and best use section is reflected within this approach.

### A. Subject Property Operating Statement

Prepare a properly constructed operating statement for the subject property; indicate whether it is based on cash rental, share rental, or owner/operator information; and explain the basis for the estimated potential gross income. Include comparable rents, yields, and terms documenting your income estimates.

The cash rent analysis is the most common form presented in demonstration reports; however, a properly prepared share rent or owner/operator analysis is acceptable. **The demonstration report requires the presentation and analysis of market rent data to provide the basis of the appraiser's opinion of market rent.** If a share rental analysis is employed, the appraiser must still provide market rent data to support the property owner's share of income in order to meet this requirement. The owner-operator analysis requires a thorough presentation of the yield history, crop/product mix and price data reflective of the prices received in the subject property's neighborhood. The use of aggregate data (i.e. futures prices) without adjustment to local market prices is not acceptable.

***Common Errors:** The failure to include market data in support of the appraiser's opinion of market rent is a common reason for failing the demonstration report. The writer should make sure market data is included in the report. The market data should be adjusted to the subject property and its characteristics. The opinion of market rent should be based on these indications.*

### B. Income Adjustments and Expenses

Explain and justify vacancy or other typical annualized losses. Allowances for items such as mortality losses (livestock) are anticipated within an owner/operator analysis.

Explain in detail the basis for estimating expenses. The demonstration report requires the source of at least two expense items be provided. There are many acceptable sources of operating expenses which can be utilized such as an insurance estimate from a local insurance agent, historic maintenance and repair expenses from the property owner or from a similar property, etc. Think in terms of how you would answer a client's question regarding where you obtained a given expense estimate presented in your report. **Identify your sources, whether they be historical data (subject and sales), suppliers, U.S.D.A., Cooperative Extension Service, etc.**



**Common Errors:** *The failure to cite a source for at least two (2) expense estimates is a common source of deductions within the Income Approach. If actual historical data is not available, the writer should research and document the source of the various expenses applied within the Income Approach. As an example, the appraiser could cite an interview with an insurance agent as the source of the insurance expense.*

C. Capitalization Methodology

Explain in detail the capitalization methodology applied. Frequently, this section of the report is confusing to readers, so strive for clarity and simplicity. Always use definitions and explain your rationale for the methodology used.

D. The Capitalization Rate

Provide calculations showing the development of the capitalization rates. The rates are to be calculated "as of" the date of the sale with the income and expenses applicable at that time. The estimated capitalization rates should be based on comparable sales information and developed in a manner consistent with the net income estimate for the subject. In other words, do not mix capitalization rates developed from both an owner-operator or share rent analysis with those developed through the use of cash rents. Present the sales price and net income figures for comparable properties and calculate the indicated rates. The use of tables within this presentation is appropriate.

Reference to published rates is recommended only as secondary support for the market derived rates. The exclusive use of a capitalization rate from a published source will not meet the requirements of the demonstration report.

**Common Errors:** *The lack of consistency in the development of the capitalization rate. The appraiser should explain wide variations in operating expense ratios should they be present. Likewise, the appraiser should discuss the variability in indicated capitalization rates.*

E. Value Calculation

Show the calculations for capitalizing income into value. If more than one capitalization method is used, provide a reconciliation of the value indications into a single value for the income approach.

F. Conclusion

Discuss your conclusions at the end of the income approach presentation. Explain to the reader the applicability of the income approach and point out any limitations that the income approach may have for this particular problem.

## V. Sales Comparison Approach

Unless previously discussed as part of the valuation process section, provide a brief summary of the methodology used in the sales comparison approach, emphasizing that the approach is based on the principle of substitution. Summarize how the proper execution of the sales comparison approach is tied to the conclusions reached within the area-regional, neighborhood, property description, and highest and best use sections.

### A. Units of Comparison

Establish and discuss units of comparison. Depending on the property type and location, these might be price per bushel, price per box, price per animal unit, GIM/GRM, etc., rather than, or in addition to the "overall price per acre."

### B. Selection of Comparable Sales

Choose comparable sales that have a highest and best use similar to the property being appraised and that have an area-regional situation similar to the property being appraised. Discuss the rationale for selecting the properties and discuss similarities and differences between the comparable sales and the property being appraised.

### C. Comparable Sales Description and Analysis

Place individual comparable sales descriptions and analyses either in the body of the report or in the addenda. You may wish to present a condensed version of the sales information in the body of the report either in paragraph form or as a summary table. The goal is providing readers clear and accurate information in a logical order comparing the sales to the subject property. The sales descriptions should sufficient detail such that any information utilized within the analysis of the sales is also provided in the description. Additional information such as the buyer and seller's names, legal description and courthouse/recording data should also be included.

Prepare a comparable sales map showing the location of the comparable sales relative to the subject property and include the map either in this section or in the addenda. Label maps clearly and completely. Remember, it is the writer's goal to help the reader understand the information provided. There is nothing wrong with providing maps or other exhibits in multiple locations in the report if they assist the reader in understanding the appraiser's analysis and conclusions.

When you execute the sales comparison approach, you should support your adjustments based on market data. Adjustments may be supported through the use of multiple methods of market data analysis with paired sales being the most common. The potential for "pairings" exists in most markets if you have all available data and sufficient knowledge of the circumstances surrounding each sale. In certain instances, pairings may result in isolating the effects of two or three variables. You may then use other sales data to further refine the indications into

meaningful adjustment estimates. The lack of definitive market support does not eliminate the necessity to present a complete discussion of your adjustment reasoning for each category, e.g., location, size, time, productivity, etc. Demonstrating that market data is conflicting or inconclusive is an important part of the process of providing a defensible data analysis for the sales comparison approach. **The demonstration report requires the presentation of at least two (2) market data derived adjustments.**

**Common Errors:** *Common errors resulting in the failure of the Sales Comparison Approach are:*

- *The absence of market derived adjustments.*
- *The absence of a building mix adjustment on an individual sale basis.*

*Common errors receiving deductions in the demonstration report include the following:*

- *Inconsistencies between the information presented in the sale description and the information presented in the analysis (i.e. different sales prices).*
- *The development of multiple adjustments based solely on the sales presented for direct comparison. The use of sales data not used for direct comparison in support of an adjustment is encouraged.*
- *The inconsistent treatment of a sale or other market data throughout the three approaches to value.*
- *The lack of discussion in the conclusion of a particular adjustment particularly when there is variation in the indicated level of adjustments provided by the market data.*

#### D. Sales Comparison Grid

Prepare a market data table showing the adjustments to the sales and providing an indication of value by each comparable sale. Follow the table with a paragraph discussing the adjustment factors used. All adjustments entered in the analysis should be directly supported using market evidence developed in the sales analysis section. Remember, at least two of the adjustments presented in this approach must be market data derived adjustments. Any adjustments that cannot be supported by market extraction should be clearly supported using solid market-based logic. The sales comparison approach becomes less defensible as the number of subjective adjustments increases.

The sales analysis should be conducted through quantitative analysis. While qualitative adjustments are often used in typical appraisal practice, qualitative adjustments are not acceptable within the demonstration report.

**Common Errors:** *Common errors receiving deductions related to the sales comparison grid/presentation include the following:*

- *Inconsistencies between the adjustment discussion and the adjustments presented in the grid.*
- *Mathematical errors*
- *Incorrect order of adjustment.*

## E. Conclusion

The sales comparison analysis provides an indication of the subject property's value based on each comparable sale. Summarize the strengths and weaknesses of the value indicated by each sale used in the grid and discuss how you are reconciling the indications of value into a single opinion of value by the sales comparison approach. Finally, discuss the strengths and weaknesses of the sales comparison approach value indication relative to the sales data available for this appraisal problem.

## VI. Reconciliation and Final Value Estimate

Use the reconciliation to lead readers to your final estimate of value. Discuss the interdependence of the three approaches and the limitations of each approach for the appraisal problem. Restate the value conclusions derived from the three approaches and provide the reasoning for selecting your final opinion of value. Base your final value on the data and analysis presented. In effect, this discussion represents "an appraisal of the appraisal". Discuss the quantity, reliability, and sensitivity of the data used in each approach, the reliability of the value indication for each approach, and what makes one of the approaches provide a better value estimate than one or both of the other approaches.

State the final opinion of value as a single figure or a range of values. The appropriate choice depends on the nature and complexity of the appraisal problem and the client's requirements.

## VII. Certification

The purpose of the certification is to certify that you are preparing the appraisal in a professional, objective, and ethical manner. The certification should indicate that you are abiding by the code of ethics of an appraisal organization and state whether you are or are not state licensed or certified. Indicate whether state and/or appraisal organization continuing education requirements have or have not been met. Sign the certification page showing the effective date of the appraisal report.

The certification should be similar in content to the following statement taken from USPAP Standards Rule 2-3:

I certify that, to the best of my knowledge and belief:

- the statements of fact contained in this report are true and correct.
- the reported analyses, opinions, and conclusions, are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- I have no (or the specified) present or prospective interest in the property that is the subject of this report, and I have no (or the specified) personal interest or bias with respect to the parties involved.

- my engagement in this assignment was not contingent upon developing or reporting predetermined results.
- my compensation is not contingent upon the reporting of a predetermined value or direction in value that favors the cause of the client, the amount of the value estimate, the attainment of a stipulated result, or the occurrence of a subsequent event.
- I have performed no (or the specified) services, as an appraiser or in any other capacity, regarding the property that is the subject of this report within the three-year period immediately preceding acceptance of this assignment.
- my analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Uniform Standards of Professional Appraisal Practice.
- I have (or have not) made a personal inspection of the property that is the subject of this report. (If more than one person signs the report, this certification must clearly specify which individuals did and which individuals did not make a personal inspection of the appraised property.)
- no provided significant real property appraisal assistance to the person signing this report. (If there are exceptions, the name of each individual providing significant real property appraisal assistance must be stated.)

If you are an Accredited or Professional member of the American Society of Farm Managers and Rural Appraisers who has met the continuing education requirements, you may include the following statement.

- The American Society of Farm Managers and Rural Appraisers conducts a mandatory program of continuing education. I am current with the requirements of the program.

### **Addenda**

Include necessary supplemental exhibits in the addenda. Examples of items that may be included are leases, lengthy legal descriptions, lengthy soil descriptions, supplemental maps of the subject property or comparable sales, additional photographs of the subject or comparable sales, more detailed comparable sales information, and copies of governmental restrictions placed on the subject.

You may place the section "Qualifications of the Appraiser" either in the body of the report after the certification or in the addenda. Provide qualification information pertinent to your education, technical training, type of work, and years of experience.

## GENERAL SUGGESTIONS

The written narrative appraisal report reflects your professionalism as an appraiser. The demonstration report reflects your understanding of the appraisal process and methodology required to develop a market data supported opinion of value. Organize the report in a logical manner clearly stating the facts, assumptions, and conclusions. The importance of correct spelling, grammar, punctuation and sentence structure cannot be overemphasized.

The following suggestions may also be helpful:

- Have the report proofread carefully, preferably by someone not involved in writing the report.
- Rarely are first drafts acceptable as final products. Edit the report carefully to make sure the appraisal is being presented in a clear and concise manner.
- Consider what factors affecting the subject property in one approach should also be considered in the other approaches to value.
- Explain any departure from normal appraisal practice and state the effect of any adverse conditions on the subject property.
- Place "North" directional arrows on maps, plats, and aerial photos.
- Make sure the exhibits presented in the report are clear and legible.
- Refrain from hand lettering maps, plats, or charts.
- Provide the sources of definitions in an acceptable footnote format.
- Use a font and type size which promotes ease of reading.
- Separate sections of the report to enhance the appraisal's appearance.
- Never conclude that present use is the highest and best use simply because it conforms to other properties in the area or to zoning.
- Always include a table of contents and number all pages.
- Avoid using technical terms prior to defining those terms.
- Double-check all calculations.
- Date and describe photographs of the subject property, sales, and rent comparables. Place photos in a logical sequence.
- Include legible, good quality copies of ownership, soil, topographical and aerial maps of

the subject property and comparable sales. Draw floor plans to scale and show dimensions. Reductions of actual surveys or blueprints may also be used.

- Identify all exhibits included in the Addenda of the report and refer to them by title in the body of the report. Copies of original documents should be clear and legible.
- When feasible, present critical data such as sales data adjustment charts, adjustment analysis, and income information in chart or table form to enhance reader understanding.