Appraisal Disclaimers, Disclosures and Material Uncertainty Clauses in Appraisal Reports

Subject:

Appraisal Disclaimers, Disclosures and Material Uncertainty Clauses in Appraisal Reports with regard COVID-19 Impact and Reliance on Conclusions.

Purpose:

The purpose of this bulletin is to help users of appraisal reports understand the required use as well as the possible interpretations of the words contained in the COVID-19 clauses that are being included in appraisal reports.

Summary of Conclusions:

The COVID-19 crisis resulted in many appraisal reports including COVID-19 specific language to describe that the crisis has occurred. Description of market conditions is an integral part of an appraisal report so the appraisal should analyze and consider COVID-19 impact on the appraised property’s market and resulting value conclusion. Market value appraisal reports intended for financial reporting purposes should accept disclosure language but, would find it unacceptable for the appraisal to include a COVID-19 disclaimer since that means the user could not rely on the report conclusion as a fair value estimate.

The following narrative provides the rationale leading to the above conclusion including excerpts from leading appraisal industry professional bodies. Also included herein are examples of generally acceptable language and the reasoning behind how to determine if it is acceptable for financial reporting fair (market) value estimates. Users of this document should refer to the various sources to get updated or more complete guidance directly from the professional organization.

Disclaimer versus Disclosure:

_The difference between whether the appraiser is “disclosing” versus “disclaiming” the COVID-19 impact should be understood by the reader and it must be consistent with the intended use of the appraisal results so not to result in a misleading conclusion._

When an appraisal discloses a material event like the COVID-19 crisis, whether implicitly or explicitly, it is expected the market observation of the material event is analyzed and considered in the valuation results to the best of the appraiser’s professional judgement. Whether there are good comparable leases and sales, or a lack of empirical market evidence, the appraisal will analyze all available and observable indicators and provide in the report the steps and rationale that led to resulting conclusion.
Note: there may be reasonable business needs for a client to request an appraisal assignment to intentionally not consider the impacts of a material event (like the COVID-19 crisis). If this occurs, the appraiser would include a disclaimer in clear and visible areas in the report and utilize a “hypothetical condition” so not to be misleading. Using a disclaimer would be a specific client request and is not typical or acceptable for a fair value assignment for financial reporting.

In the normal course of business, the appraisal report should be produced utilizing observations of market conditions as of the date of the appraisal.

According to the Appraisal Institute:

“the appraisal report should address the uncertainty in the market caused by the COVID-19 crisis not as a limiting condition, extraordinary assumption, or disclaimer, but rather as part of the discussion of market conditions. While the crisis is still unfolding, it might also be a good idea to highlight key points in the letter of transmittal relating to COVID-19 as a significant factor.”

Further guidance from the Appraisal Institute follows:

- An important part of any appraisal assignment is analysis of market conditions. The coronavirus threat may be impacting market conditions. However, in most markets it is not yet clear to what extent, if any, market conditions are affected. Related, complicating factors include fluctuations in the stock market and changes in mortgage interest rates.
- Market analysis includes observing market reactions. This analysis becomes more complicated when market participants themselves are facing uncertainty.
- Appraisal reports should include a discussion of market conditions, and so mention the Coronavirus outbreak and its possible impact. However, it is not appropriate to include a disclaimer or extraordinary assumption that suggests the appraiser is not taking responsibility for analysis of market conditions.
- The Appraisal Institute has published Guide Note 10, Appraising in the Aftermath of a Disaster, Guide Note 11, Comparable Selection in a Declining Market and Guide Note 12, Analyzing Market Trends. These three Guide Notes, which can be found on the Appraisal Institute’s web site, (www.appraisalinstitute.org) provide helpful guiding principles.

According to The Appraisal Foundation (TAF): (www.appraisalfoundation.org)

Neither TAF nor the Appraisal Standards Board (ASB) has issued any type of “uncertainty clause” in response to the COVID-19 crisis. However, the ASB does have FAQ #220 that addresses market changes due to catastrophic events which generally states that the economic characteristics relevant to a property requires an analysis of supply and demand. The response to the FAQ says:

“Appraisals involving properties in markets that are changing rapidly, for any reason. Standards Rule 1-2(e) requires an appraiser to identify economic characteristics relevant to the subject property, and Standards Rule 1-3(a)(iii) specifically requires analysis of supply and demand. For Appraisal Reports, Standards Rule 2-2(a)(iv) requires an Appraisal Report to contain information, documents, and/or exhibits sufficient to identify the real estate involved in the appraisal, including the physical, legal, and economic property characteristics relevant to the assignment. Market conditions (including sudden market changes related to catastrophic events) are economic
property characteristics, and, as such, should be identified in the development of an appraisal and disclosed in the appraisal report.”

RICS COVID-19 Guidance Language: (www.rics.org)

There has been some confusion as to whether it’s appropriate for the appraisers in the United States to use RICS COVID-19 guidance language in U.S. appraisal reports.

The term “Material Uncertainty” was not a common term in the United States amongst appraisers or users of appraisal services so it is often misunderstood. Also, the appraiser expressing confidence levels of the appraisal results is not typically explicit in the appraisal reports produced in the United States, rather it is more common to use ranges or other types of indicators. When a material event occurs that impacts the value conclusion, U.S. appraisers state what is occurring, and proceed to analyze, and conclude.

The term “Material Uncertainty” is common outside of the United States as international valuations standards as set out in VPS 3 and VPGA 10 of the RICS Valuation – Global Standards):

“This requirement is mandatory only where the uncertainty is material. “Material” means where the degree of uncertainty in a valuation falls outside any parameters that might normally be expected and accepted. Typically, markets can be disrupted by relatively unique factors, a valuer would express in qualitative terms his reduced or limited confidence in his valuation opinion. In short, the qualitative wording is to express a lack of empirical data (market transactions) to inform or support a quantitative estimate/ valuation.”

The Royal Institution of Chartered Surveyors (RICS) states within its Professional Standards:

“... a valuation is not a fact. Like all opinions, the degree of subjectivity involved will inevitably vary from case to case, as will the degree of ‘certainty’ – for example, the probability that the valuer’s opinion of market value would exactly coincide with the price achieved were there an actual sale at the valuation date, even if all the circumstances envisaged by the market value definition and the valuation assumptions were identical to the circumstances of an actual sale”

Reliance on Appraisal Conclusions when a Disclosure or Material Uncertainty Clause is in an Appraisal Report:

Utilizing disclosures or uncertainty clauses informs the user of the appraisal that circumstances have changed which renders the range of value wider than previously accepted. This is acceptable and necessary. These types of clauses should not be meant to suggest that the valuation cannot be relied upon; rather, that given these changes in market conditions there is less empirical evidence (transactions) to help support the value conclusion. In order to arrive at an estimate of value, an appraiser likely needed to do more due diligence, and rely on other methods to support the rationale and conclusions. The extent of the due diligence and other steps taken to arrive at a value conclusion should be explicit within a narrative appraisal report.
Acceptable versus Less than or Unacceptable Disclosure Clauses:

It is important to for the appraisal to state that it utilized the best professional judgment and provide the appraisal observations of the appraised property’s position in the current COVID-19 market as of the effective date of appraisal or date of the report.

As of the writing of this bulletin, the U.S. appraisal standard setters haven’t published recommended wording for an actual COVID-19 disclosure beyond the need to analyze the market conditions in the appraisal report. Below are few examples/tips as to what is generally acceptable versus less to unacceptable if the intended use of the appraisal is for fair value reporting.

Acceptable

- To explain the COVID-19 situation (fluid, unprecedented, unknown, uncertainty, empirical evidence is limited, etc.) and state that:
  - the estimated “as is” market value opinion is specific only to the effective date of value using the best information observed.
  - the market value and underlying assumptions in the report incorporate this risk and reflect the appraiser’s best estimate of underlying market assumptions as of the date of the report.
  - summarize the appraisal view as to how the subject property is competitively positioned in the current and longer term COVID-19 market.

  Why? Appraisal reports prepared for market value estimates in compliance with USPAP would require an appraisal to be prepared and presented in a credible and not misleading way. In addition, it is useful for the appraisal to alert the reader in the conspicuous way areas of importance to the user of the value/report.

Less than or Unacceptable

- After explaining the situation:
  - To say if evidence emerges subsequent to the effective date of the appraisal, that the appraiser reserves the right to amend the analysis and conclusion.

  Why? It is not appropriate to say after providing a final, signed appraisal based on a “point in time” that this estimate may not be valid. If this statement is used because it is a prospective value, the appraisal should clearly state the date of the analysis as a condition to understanding the appraisal results so not to provide misleading results.

  - The appraisal states it is too early to tell, there is insufficient evidence to measure any impact, and/or they will continue to monitor the situation.

  Why? The appraisal report should go farther to state the value conclusion is considering the current situation and explain to the reader the steps they took since there were no transactional evidence.

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This appraisal is based on the extraordinary assumption that market conditions will normalize to pre-Covid-19 outbreak levels within the estimated marketing time expressed in this report.

- Why? According to USPAP's FAQ # 232, An extraordinary assumption is defined as an assignment-specific assumption as of the effective date regarding uncertain information used in the analysis for which, if found to be false, could alter the appraiser’s opinions or conditions. If the appraisal supported that there is a degree of likeliness that the conditions will normalize, it may be acceptable, but should provide further conclusive language.