TO: All Interested Parties

FROM: Barry J. Shea, Chair
Appraisal Standards Board

RE: First Exposure Draft of proposed new Advisory Opinions and Advisory Opinion Revisions in conjunction with the 2016-17 edition of the Uniform Standards of Professional Appraisal Practice

DATE: August 27, 2014

The goal of the Uniform Standards of Professional Appraisal Practice (USPAP) is to promote and maintain a high level of public trust in appraisal practice by establishing requirements for appraisers. With this goal in mind, the Appraisal Standards Board (ASB) regularly solicits and receives comments and suggestions for improving USPAP. Proposed changes are intended to improve USPAP understanding and enforcement, and thereby achieve the goal of promoting and maintaining public trust in appraisal practice.

The changes to USPAP being proposed for the 2016-17 edition of USPAP include the retirement of the remaining STATEMENTS ON APPRAISAL STANDARDS. This exposure draft presents proposed Advisory Opinions that will provide guidance similar to that which is currently included in those Statements. While the ASB may adopt new Advisory Opinions without prior public exposure, the Board believes it is in the best interests of all to go through the exposure process and receive public input prior to adoption.

All interested parties are encouraged to comment in writing to the ASB before the deadline of October 10, 2014. Respondents should be assured that each member of the ASB will thoroughly read and consider all comments. Comments are also invited at the ASB public meeting on October 17, 2014, in Washington, DC.
Written comments on this exposure draft can be submitted by mail, email and facsimile.

Mail: Appraisal Standards Board  
The Appraisal Foundation  
1155 15th Street, NW, Suite 1111  
Washington, DC 20005

Email: comments@appraiserfoundation.org

Facsimile: (202) 347-7727

**IMPORTANT NOTE:** All written comments will be posted for public viewing, exactly as submitted, on the website of The Appraisal Foundation. Names may be redacted upon request.

The Appraisal Foundation reserves the right not to post written comments that contain offensive or inappropriate statements.

If you have any questions regarding the attached exposure draft, please contact Aida Dedajic, Standards Administrator at The Appraisal Foundation, via e-mail at aida@appraiserfoundation.org or by calling (202) 624-3058.

**Background**

This exposure draft includes four new Advisory Opinions that are being proposed in conjunction with the proposed retirement of the five remaining Statements on Appraisal Standards. In addition, the ASB is proposing revisions to ADVISORY OPINION 7. As discussed in the Third Exposure Draft of Changes to USPAP for 2016-17, the ASB is exposing the possible retirement of these STATEMENTS and related to that, this exposure draft proposes the following:

1. ADVISORY OPINION 33: Discounted Cash Flow Analysis (to replace STATEMENT 2)
2. ADVISORY OPINION 34: Retrospective and Prospective Value Opinions (to replace STATEMENT 3 and STATEMENT 4)
3. Proposed Revisions to ADVISORY OPINION 7: Marketing Time Opinions
4. ADVISORY OPINION 35: Reasonable Exposure Time in Real and Personal Property Opinions of Value (to replace STATEMENT 6)
5. ADVISORY OPINION 36: Identification of Client, Intended Use and Intended Users (to replace STATEMENT 9)
Each of the proposed Advisory Opinion numbers shown in this exposure draft are tentative; if some, but not all are adopted the next available number (i.e., ADVISORY OPINION 33) will be assigned to the first adopted, etc.

Of paramount importance to the Board when considering any potential revisions to USPAP or the Advisory Opinions is the issue of public trust. This umbrella of public trust, therefore, remains the primary consideration of the ASB in putting forth the concepts contained in this document.

Each member of the Board will review each and every comment submitted in response to this exposure draft. Based on the feedback received, the Board may issue a Second Exposure Draft sometime after its public meeting in Washington, DC in October. If that occurs, the Board will again solicit comments leading up to its subsequent public meeting to be held in New Orleans, Louisiana, on February 6, 2015.

The Board currently intends to adopt any revisions for the 2016-17 edition of USPAP and accompanying Advisory Opinions at that public meeting in February 2015. Any such revisions would become effective on January 1, 2016.
First Exposure Draft of
Proposed New Advisory Opinions in Conjunction with the
2016-17 edition of the Uniform Standards of Professional Appraisal Practice

Issued: August 27, 2014
Comment Deadline: October 10, 2014

Each section of this exposure draft begins with a rationale for the proposed new Advisory Opinion. The rationale is identified as such and does not have line numbering. The text of the proposed Advisory Opinions does have line numbers. This difference is intended to distinguish for the reader those parts that explain the Advisory Opinions from the Advisory Opinions themselves.

When commenting on various aspects of the exposure draft, it is very helpful to reference the line numbers, fully explain the reasons for concern or support, provide examples or illustrations, and suggest any alternatives or additional issues that the ASB should consider.

Except for the proposed revisions the ADVISORY OPINION 7, these Advisory Opinions are similar in content to existing STATEMENTS ON APPRAISAL STANDARDS, but the format is different and in some cases the guidance has been updated. Only ADVISORY OPINION 7 shows the changes in strikethrough and underline text as is typically done in the ASB’s exposure drafts.

For ease in identifying the various issues being addressed, the exposure draft is presented in sections.

**TABLE OF CONTENTS**

<table>
<thead>
<tr>
<th>Section</th>
<th>Issue</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Proposed ADVISORY OPINION 33: Discounted Cash Flow Analysis</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>Proposed ADVISORY OPINION 34: Retrospective and Prospective Value Opinions</td>
<td>9</td>
</tr>
<tr>
<td>3</td>
<td>Proposed Revisions to ADVISORY OPINION 7: Marketing Time Opinions</td>
<td>12</td>
</tr>
<tr>
<td>4</td>
<td>Proposed ADVISORY OPINION 35: Reasonable Exposure Time in Real and Personal Property Opinions of Value</td>
<td>15</td>
</tr>
<tr>
<td>5</td>
<td>Proposed ADVISORY OPINION 36: Identification and Disclosure of Client, Intended Use and Intended Users</td>
<td>19</td>
</tr>
</tbody>
</table>
Section 1: Proposed ADVISORY OPINION 33: Discounted Cash Flow Analysis

RATIONALE

In its Third Exposure Draft of proposed changes to USPAP for the 2016-17 edition, the ASB has proposed the retirement of all of the active Statements on Appraisal Standards. This exposure draft presents proposed Advisory Opinions that will include guidance on the same topics as were addressed in the Statements, for which retirement is being proposed.

Among these is STATEMENT 2 (Discounted Cash Flow Analysis). The following proposed Advisory Opinion addresses discounted cash flow analysis. While most of the guidance included in this proposed Advisory Opinion has been taken from STATEMENT 2, some of the language has been updated to better reflect current practices and terminology.

The ASB is proposing the following new Advisory Opinion regarding the use of discounted cash flow (DCF) analysis:

1 ADVISORY OPINION 33 (AO-33)

2 This communication by the Appraisal Standards Board (ASB) does not establish new standards or interpret existing standards. Advisory Opinions are issued to illustrate the applicability of appraisal standards in specific situations and to offer advice from the ASB for the resolution of appraisal issues and problems.

6 SUBJECT: Discounted Cash Flow Analysis

7 APPLICATION: Real Property

8 THE ISSUE:

9 Discounted cash flow (DCF) analysis is an accepted analytical tool and method of valuation within the income capitalization approach to value. DCF is not a new method, but it did not enjoy widespread use until computer technology enabled appraisers to automate the process. Because DCF analysis is typically utilized to identify the potential for profit in an investment and is dependent on the analysis of uncertain future events, it is vulnerable to misuse or misapplication. What steps can the appraiser take to comply with USPAP in completing a DCF analysis?

16 BACKGROUND:

17 The acceptance of DCF analysis as a method of valuation began in the institutional real estate market and has spread to investment real estate in the general real estate market. DCF techniques may be applied in the valuation or analysis of proposed construction, land development, condominium development or conversion, rehabilitation development, and income-producing real estate of various types. DCF analysis has become a requirement of many clients and other intended users. These users of appraisal services favor the inclusion of DCF analysis as a
management tool in projecting cash flow and return expectations, capital requirements, refinancing opportunities, and timing of future property dispositions. DCF analysis is regarded as one of the best methods of replicating steps taken to reach many investor buy/sell/hold decisions and is often a part of the exercise of due diligence in the evaluation of an investment.

DCF methodology is based on the principle of anticipation - i.e., value is created by the anticipation of future benefits. DCF analysis reflects investment criteria and requires the appraiser to make rational and supportable assumptions. DCF analysis can be used for investment value and market value appraisals, as well as for other purposes such as sensitivity tests.

DCF analysis is a tool available to the appraiser and is often applied in developing value opinions in concert with one or more other approaches. However, in certain circumstances it may be the only applicable method to solve the valuation problem. This Advisory Opinion focuses on the criteria for proper DCF analysis and does not imply that DCF analysis is or should necessarily be the only method employed.

The COMPETENCY RULE specifically states that competency may apply to an analytical method. Discounted cash flow analysis is complex and requires specialized education and experience to achieve competency in its application. In addition, due to the complexity and the potential for misuse of technology, it also requires a high degree of care and diligence.

**ADVICE FROM THE ASB ON THE ISSUE:**

To avoid misuse or misunderstanding when DCF analysis is used in an appraisal assignment to develop an opinion of market value, it is the responsibility of the appraiser to ensure that the controlling input is consistent with market evidence and prevailing market attitudes. Market value DCF analyses should be supported by market derived data, and the assumptions should be both market and property specific. Market value DCF analyses, along with available factual data, are intended to reflect the expectations and perceptions of market participants. They should be judged on the support for the forecasts that existed when made, not on whether specific items in the forecasts are realized at a later date. An appraisal report that includes the results of DCF analysis must clearly state the assumptions on which the analysis is based (per Standards Rule 2-1(c)) and must set forth the relevant data used in the analysis.

Standards Rule 1-1(b) states that the appraiser must not commit a substantial error of omission or commission that significantly affects an appraisal. Standards Rule 1-1(c) states that the appraiser must not render appraisal services in a careless or negligent manner, such as making a series of errors that, although individually might not significantly affect the results of an appraisal, in the aggregate would affect the credibility of those results. These two Standards Rules are significant for DCF analysis because of the potential for the compounding effect of errors in the input, unrealistic assumptions, or possible programming errors.

Computer printouts showing the results of DCF analysis may be generated by readily available means such as an appraiser’s own spreadsheet, a commercially available spreadsheet template, or specialized DCF software. Either way, the appraiser is responsible for the entire analysis including the controlling input, the calculations, and the resulting output. If using commercial
DCF software the appraiser should cite the name and version of the software and provide a brief description of any assumptions and/or methodology unique to that software, if any. Standards Rule 1-4(c)(iv) requires that projections of anticipated future rent and/or income potential and expenses be based on reasonably clear and appropriate evidence. The Comment to this Standards Rule makes specific reference to cash flow projections, the essence of DCF analysis.

DCF accounts for and reflects those items and forces that affect the revenue, expenses, and ultimate earning capacity of real estate and represents a forecast of events that would be considered likely within a specific market. For example, in the appraisal of a multi-tenant property, a lease-by-lease analysis addresses contract and market rents, specific escalations, operating expenses, pass-through provisions, market-derived or specific concessions, capital expenditures, and any other measurable specific provisions applicable. Revenue growth rate or decline rate assumptions are premised on analysis of supply/demand factors and other economic conditions and trends within the market area of the subject. Operating expense change rates should reflect both overall expense trends and the specific trend of significant expense items.

Discount rates applied to cash flows and estimates of reversion should be derived from data and information in the real estate and capital markets. Surveys of investor opinion and yield indices are also useful in the rate selection process, but only when the type of and market for the real estate being appraised is consistent with the type of and market for the real estate typically acquired by the investors interviewed in the survey. Primary considerations used in the selection of rates are risk, inflation, and real rates of return.

When reversion capitalization rates are used, they should reflect investor expectations considering the real estate type, physical characteristics, age and condition, cash flow projections, and related factors. The projection or forecast period is a variable and should be based upon the same factors that typical market participants are using. The results of DCF analysis should be tested and checked for errors and reasonableness. Because of the compounding effects in the projection of income and expenses, even slight input errors can be magnified and can produce unreasonable results. For example, it is good practice to test whether cash flows are changing at reasonable rates and to compare the reversion capitalization rate with the inferred going-in capitalization rate to see if the relationship between these rates is reasonable.

STANDARD 2 requires the appraiser to communicate each analysis, opinion, and conclusion in a manner that is not misleading. Appraisals using the DCF method in the income capitalization approach may contain computerized projections of itemized future cash flow supported by exhaustive printouts that can be misleading. The seeming precision of computer-generated projections may give the appearance of certainty to projections and forecasts that are actually variable within a wide range. In DCF analysis, all of the assumptions (growth rates, decline rates, rental rates, discount rates, financing terms, expense trends, capitalization rates, etc.) directly affect the conclusion and must be clearly and accurately disclosed in the appraisal report.
SUMMARY:

- Use of DCF analysis requires specialized knowledge and experience. Its application requires a high degree of diligence.

- DCF analysis is a tool available to the appraiser and is often applied in developing value opinions in concert with one or more other approaches. It is the responsibility of the appraiser to ensure that the controlling input is consistent with market evidence and prevailing market attitudes. The appraiser is also responsible for the resulting output.

- Market value DCF analyses should be supported by market-derived data, and the assumptions should be both market- and property-specific.

- If using commercial DCF software the appraiser should cite the name and version of the software and provide a brief description of any assumptions and/or methodology unique to that software, if any.

- DCF accounts for and reflects those items and forces that impact the revenue, expenses, and ultimate earning capacity of real estate and represents a forecast of events that would be considered likely within a specific market.

- The results of DCF analysis should be tested and checked for errors and reasonableness.
Section 2: Proposed ADVISORY OPINION 34: Retrospective and Prospective Value Opinions

RATIONALE

In its Third Exposure Draft of proposed changes to USPAP for the 2016-17 edition, the ASB has proposed the retirement of all of the active Statements on Appraisal Standards. This exposure draft presents proposed Advisory Opinions that will include guidance on the same topics as were addressed in the Statements for which retirement is being proposed.

Among these are STATEMENT 3 (Retrospective Value Opinions) and STATEMENT 4 (Prospective Value Opinions). The following proposed Advisory Opinion addresses the development and reporting of both retrospective and prospective value opinions. While much of the guidance included in this proposed Advisory Opinion has been taken from STATEMENTS 3 and 4, some of the guidance has been revised.

The ASB is proposing the following new Advisory Opinion regarding the development and reporting of retrospective and prospective value opinions:

ADVISORY OPINION 34 (AO-34)

This communication by the Appraisal Standards Board (ASB) does not establish new standards or interpret existing standards. Advisory Opinions are issued to illustrate the applicability of appraisal standards in specific situations and to offer advice from the ASB for the resolution of appraisal issues and problems.

SUBJECT: Retrospective and Prospective Value Opinions

APPLICATION: Real Property, Personal Property, Intangible Property

THE ISSUE:

Two dates are essential to an appraisal report. Standards Rules 2-2(a)(vi) and (b)(vi), 6-8(g), 8-2(a)(vi) and (b)(vi), and 10-2(a)(vii) and 10-2(b)(vii) require that each appraisal report state the effective date of the appraisal and the date of the report. The date of the report indicates the perspective from which the appraiser is examining the market. The effective date of the appraisal establishes the context for the value opinion. Three categories of effective dates - retrospective, current, or prospective - may be used, according to the intended use of the appraisal assignment.

When either a retrospective or prospective effective date is used, how can the appraisal be communicated in a manner that is not misleading?

BACKGROUND:

Current appraisals occur when the effective date of the appraisal is contemporaneous with the date of the report. Because most appraisals require current value opinions, the importance of specifying both the date of the report and the effective date of the analysis is sometimes lost.
Retrospective appraisals (effective date of the appraisal prior to the date of the report) may be required for property tax matters, estate or inheritance tax matters, condemnation proceedings, suits to recover damages, and other similar situations.

Prospective appraisals (effective date of the appraisal subsequent to the date of the report) may be required for valuations of property interests related to proposed developments, as the basis for value at the end of a cash flow projection, and for other reasons.

ADVICE FROM THE ASB ON THE ISSUE:

Relevant USPAP References

Standards Rules 2-1, 6-8, 8-1, and 10-1 state that each written or oral appraisal report must: “clearly and accurately set for the appraisal in a manner that will not be misleading…” In order to accomplish this, appraisers must use care when developing the appraisal to analyze appropriate market data when retrospective or prospective estimates of value are a part of the assignment.

Retrospective Appraisals

The use of clear and concise language and appropriate terminology in appraisal reports helps to eliminate misleading reports. To avoid confusion, the appraiser must clearly establish the date to which the value opinion applies. In retrospective value opinions, use of a modifier for the term market value and past verb tenses increases clarity; If a report written in 2014 states, “On August 19, 2009 the value was $X” the retrospective perspective is clear from the context. It would also be correct to state that “the retrospective value as of August 19, 2009 is $X” because on August 19, 2009, the value opinion would not have been retrospective – it is retrospective because it has been developed now and looks back.

A retrospective appraisal is complicated by the fact that the appraiser already knows what occurred in the market after the effective date of the appraisal. Data subsequent to the effective date may be considered in developing a retrospective value as a confirmation of trends that would reasonably be considered by a buyer or seller as of that date. The appraiser should determine a logical cut-off because at some point distant from the effective date, the subsequent data will no longer provide an accurate representation of market conditions as of the effective date. This is a difficult determination to make. Studying the market conditions as of the date of the appraisal assists the appraiser in judging where he or she should make this cut-off. With market evidence that data subsequent to the effective date was consistent with market expectations as of the effective date, the subsequent data should be used. In the absence of such evidence, the effective date should be used as the cut-off date for data considered by the appraiser.

When direct excerpts from then-current appraisal reports prepared at the time of the retrospective effective date are available and appropriate, they may help the appraiser and the intended users understand market conditions as of the retrospective effective date.

Prospective Appraisals
The use of clear and concise language and appropriate terminology in appraisal reports helps to eliminate misleading reports. To avoid confusion, the appraiser must clearly establish the date to which the value opinion applies. 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 (i.e., “…the prospective market value is expected to be…” and not “…the market value is…”).

Prospective value opinions, along with available factual data, are intended to reflect the current expectations and perceptions of market participants. They should be judged on the support for the forecasts that existed when made, not on whether specific items in the forecasts are realized at a later date.

When prospective value opinions are required with regard to proposed improvements to real property, the Comment to Standards Rule 1-2(e) regarding identification of the extent and character of the proposed improvements and Standards Rule 1-4(c)(iv) regarding the basis for anticipated future rent and expenses are relevant. Evidence that proposed improvements can be completed by the effective date of the appraisal is important. Support for projected income and expenses at the time of completion of proposed improvements and during the rent-up or sell-out period require the incorporation of sufficient market research in the appraisal and the consideration of existing and future competition. It is appropriate to study comparable projects for evidence of construction periods, development costs, income and expense levels, and absorption. Items such as rental concessions, commissions, tenant finish allowances, add-on factors, and expense pass-throughs must be studied to develop realistic income expectancy.

With regard to proposed developments of real property, two prospective value opinions may be required: one as of the time the development is to be completed and one as of the time the development is projected to achieve stabilized occupancy. These prospective values form a basis for investment decisions and loan underwriting.

In a prospective appraisal, the appraiser analyzes market trends to provide support for forecasted income and expense or sell-out opinions, absorption periods, capitalization rates, and discount rates as of the effective date of the appraisal. Economic trends such as growth in population, employment, and future competition are also analyzed. The overall economic climate and variations in the business cycle should be considered and weighed in the performance of the appraisal process. All value conclusions should include reference to the time frame when the analysis was prepared to clearly delineate the market conditions and the point of reference from which the appraiser developed the prospective value opinion. It is essential to clearly and accurately disclose any appropriate assumptions, extraordinary assumptions, and/or limiting conditions when citing the market conditions from which the prospective value opinion was made.
Section 3: Proposed Revision to ADVISORY OPINION 7: Marketing Time Opinions

RATIONALE

In its Third Exposure Draft of proposed changes to USPAP for the 2016-17 edition, the ASB has proposed the retirement of all of the active Statements on Appraisal Standards. Among these is STATEMENT 6 (Reasonable Exposure Time in Real and Personal Property Opinions of Value). Issues that arose in the course of preparing that new Advisory Opinion led the Board to conclude that edits should also be made to the existing Advisory Opinion on Marketing Time (ADVISORY OPINION 7).

ADVISORY OPINION 7 is currently identified as being applicable to real property and personal property. The ASB would appreciate any feedback regarding applicability to personal property. The following proposed Advisory Opinion updates and clarifies the topic of the development and reporting of opinions of Marketing Time.

ADVISORY OPINION 7 (AO-7)

This communication by the Appraisal Standards Board (ASB) does not establish new standards or interpret existing standards. Advisory Opinions are issued to illustrate the applicability of appraisal standards in specific situations and to offer advice from the ASB for the resolution of appraisal issues and problems.

SUBJECT: Marketing Time Opinions

APPLICATION: Real Property, Personal Property

THE ISSUE:

Although it is not specifically addressed in USPAP, some assignment conditions require the appraiser to analyze and report a reasonable marketing period (also referred to as marketing time) for the subject property when developing and reporting an opinion of market value of real or personal property.

How is this reasonable marketing period opinion developed, and what is the relationship of this opinion of marketing time to the appraisal process?

ADVICE FROM THE ASB ON THE ISSUE:

Reasonable marketing time is an opinion of the amount of time it would likely take to sell a real or personal property interest at the concluded market value level or at a benchmark price during the period immediately after the effective date of an appraisal.
Stakeholders often confuse exposure time and marketing time. Marketing time is a forecast that is made looking forward from the effective date. Marketing time differs from exposure time, which is always presumed to precede the effective date of an appraisal.

**Developing a Marketing Time Opinion**

The development of a marketing time opinion uses some of the same data analyzed in the process of developing a reasonable exposure time opinion as part of the appraisal process and is not intended to be a prediction of a date of sale or a one-line statement. It is an integral part of the analyses conducted during the appraisal assignment. The opinion may be expressed as a range or a number. An Appraisal Report should include a summary of the analysis upon which that opinion is based. The opinion may be a range and can be based on one or more of the following:

- statistical information about days on market,
- information from data collection services,
- information gathered through sales verification,
- interviews of market participants, and
- anticipated changes in market conditions.

Related information garnered through this process includes other market conditions that may affect marketing time, such as the identification of typical buyers and sellers for the type of real or personal property involved and typical equity investment levels and/or financing terms. The reasonable marketing time is a function of price, time, use, and anticipated market conditions, such as changes in the cost and availability of funds, and is not an isolated opinion of time alone.

Appraisers should not simply use the estimate of reasonable exposure time as their forecast of the marketing period. A key difference in the analysis of marketing time is that the appraiser must also research and consider anticipated changes in market conditions. For example, while conducting research, the appraiser observes signs of strengthening in the market place. Signs could include shortening exposure periods, rising prices, lowering interest rates, increases in the ratio of listing price to sale price or reductions in inventory. An improving market place suggests property may be selling faster than it has in the past. Of course the opposite is also true.

**Discussion of Marketing Time in the Appraisal Report**

Marketing time occurs after the effective date of the market value opinion and the marketing time opinion is related to, yet apart from, the appraisal process. Therefore, it is appropriate for the section of the appraisal report that discusses marketing time and its implications to appear toward the end of the report after the market value conclusion. The request to provide a reasonable marketing time opinion exceeds the normal information required for the appraisal process and should be treated separately from that process.

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1 See Advisory Opinion 35, Reasonable Exposure Time in Real Property and Personal Property Opinions of Value.
It is also appropriate for the appraiser to discuss the impact of price/value relationships on marketing time and to contrast different potential prices and their associated marketing times with an appraiser’s market value opinion for the subject property.

**Applications to of Client Conditions on Uses of an Appraisal**

Some clients attempt to solve their problem by ordering a “120-day market value,” a “six-month market value,” or a “one-year market value” from the appraiser. Unless the opinion of reasonable exposure time made by the appraiser in the course of such an assignment coincides with the precondition imposed by the client, the answer to this assignment cannot be stated as will not be market value under a typical definition of the term. In such situations, the appraiser must clearly distinguish between a market value opinion allowing for reasonable exposure time and any alternative, appropriately defined, value opinion(s) subject to a special limiting condition resulting from the client-imposed marketing time.

Whether or not the appraiser and client define the appraisal problem to include more than one opinion of market value, the roles of the parties must be kept clear. The appraiser provides the client with a supported opinion of defined value in an appropriately documented report that includes a section on reasonable marketing time and any inherent price/value implications. The ultimate decision on issues like such as what price to ask, when to accept a particular offering price, and how to account for the asset during the interim rests with the client.

**SUMMARY:**

- An estimate of marketing time is often an assignment condition but it is not a requirement of USPAP.
- The appraiser’s opinion of marketing time is a forecast of time that begins as of the effective date of the appraisal.
- Marketing time is different for various types of property and under various market conditions.
- Marketing time may be expressed as a single point in time or a range.
- The answer to the question “what is reasonable forecast of marketing time,” should always incorporate the answers to the question “for what kind of property at what price range,” rather than appear as a statement of an isolated time period.
- When value is predicated on a marketing time that differs from the subject’s reasonable exposure time the resulting value will not be market value.
Section 4: Proposed ADVISORY OPINION 35: Reasonable Exposure Time in Real and Personal Property Opinions of Value

RATIONALE

In its Third Exposure Draft of changes to USPAP for the 2016-17 edition, the ASB has proposed the retirement of all of the active Statements on Appraisal Standards. Among these is STATEMENT 6 (Reasonable Exposure Time in Real and Personal Property Opinions of Value). The following proposed Advisory Opinion addresses the development and reporting of opinions of reasonable exposure time (as required in USPAP).

ADVISORY OPINION 35 (AO-35)

This communication by the Appraisal Standards Board (ASB) does not establish new standards or interpret existing standards. Advisory Opinions are issued to illustrate the applicability of appraisal standards in specific situations and to offer advice from the ASB for the resolution of appraisal issues and problems.

SUBJECT: Reasonable Exposure Time in Real Property and Personal Property Opinions of Value

APPLICATION: Real Property, Personal Property

THE ISSUE:

The concept of exposure time has an important role in the appraisal process. Appraisers must develop an opinion of the exposure time linked to the value opinion because reasonable exposure in the market is a condition of the definition of market value.

BACKGROUND

Reasonable exposure time is one of a series of conditions in most market value definitions. Exposure time is always presumed to precede the effective date of the appraisal.

The DEFINITIONS in USPAP include the following:

EXPOSURE TIME: estimated length of time that the property interest being appraised would have been offered on the market prior to the hypothetical consummation of a sale at market value on the effective date of the appraisal. Comment: Exposure time is a retrospective opinion based on an analysis of past events assuming a competitive and open market.

The Comment to Standards Rules 1-2(c) and Standards Rule 7-2(c) states:

When reasonable exposure time is a component of the definition for the value opinion being developed, the appraiser must also develop an opinion of reasonable exposure time linked to that value opinion.
The Comment to Standards Rules 2-2(a)(v) and 2-2(b)(v), states:

When an opinion of reasonable exposure time has been developed in compliance with Standards Rule 1-2(c), the opinion must be stated in the report.

Similar Comments appear in Standards Rules 8-2(a)(v) and 8-2(b)(v).

How is the opinion of reasonable exposure time developed? Is it presumed to occur prior to or starting from the effective date of the appraisal?

ADVICE FROM THE ASB ON THE ISSUE:

Exposure time is different for various types of property and under various market conditions. It is noted that the overall concept of reasonable exposure encompasses not only adequate, sufficient, and reasonable time but also adequate, sufficient, and reasonable effort.

The fact that exposure time is always presumed to occur prior to the effective date of the appraisal is substantiated by related facts in the appraisal process: supply/demand conditions as of the effective date of the appraisal; the use of current cost information; the analysis of historical sales information (sold after exposure and after completion of negotiations between the seller and buyer); and the analysis of future income expectancy projected from the effective date of the appraisal.

The Importance of Exposure Time

The answer to the question “what is reasonable exposure time,” should always incorporate the answers to the question “for what kind of property at what value range,” rather than appear as a statement of an isolated time period.

Take for example an appraisal of a desirable mountainside second home. In this immediate resort neighborhood, these homes often sell for upwards of $1,000,000 and average 120 to 180 days to sell. Research reveals that the community generally has an average exposure time of 60 to 90 days and that home values are typically below $300,000. The appraiser must be certain that research is based upon locations, price ranges and overall appeal as the subject property. Failure to do so may impact the appraiser’s ability to deliver credible results.

An analysis of exposure time also impacts comparable selection. If a particular property sold faster than one would expect, the appraiser must investigate whether this property was underpriced or if the buyer or seller were highly motivated. The opposite is true when it took much longer than market evidence would suggest. Apparent inconsistencies such as these may also provide vital insight into changes in the market, neighborhood, and the subject property’s appeal within the market in general.

These sales may not reflect the conditions requisite to the requirement of the definition of market value. Failure of the appraiser to investigate these circumstances may impact the appraiser’s ability to deliver credible results. It is possible these sales can still be used with the application of appropriate adjustments. Nonetheless, this determination cannot be made without market research.

Rationale and Method for Developing an Opinion of Reasonable Exposure Time
The opinion of the time period for reasonable exposure is not intended to be a prediction of a date of sale. Instead, it is an integral part of the analyses conducted during the appraisal assignment. Sources that may be relied upon include one or more of the following:

- statistical information about days on market;
- information gathered through sales verification;
- interviews of market participants; and
- information from data collection services

Related information garnered through this process may include the identification of typical buyers and sellers for the type of property involved and typical equity investment levels and/or financing terms.

The opinion of reasonable exposure time may be expressed as a range (e.g., the appraiser’s opinion of reasonable exposure time for the subject property is 90 to 120 days) or a specific number (e.g., the appraiser’s opinion of reasonable exposure time for the subject property is 6 months).

The reasonable exposure period is a function of price, time, and use, not an isolated opinion of time alone. As an example, an office building, an important artwork, a fine gemstone, a process facility, or an aircraft could have been on the market for two years at a price of $2,000,000, which informed market participants considered unreasonable. Then the owner lowered the price to $1,600,000 and started to receive offers, culminating in a transaction at $1,400,000 six months later. Although the actual exposure time was 2.5 years, the reasonable exposure time at a value range of $1,400,000 to $1,600,000 would be six months. The answer to the question, “what is reasonable exposure time,” should always incorporate the answers to the question, “for what kind of property at what value range,” rather than appear as a statement of an isolated time period.

**Applications to Client Uses of an Appraisal**

When an appraisal is commissioned as the result of a mortgage application after a potential seller and buyer enter into a Contract for Sale, no conflict exists between the presumption in the appraisal process that exposure time occurs prior to the effective date of the appraisal and the intended use of the appraisal.

Appraisers need to be aware that clients and other intended users often confuse exposure time with marketing time. A key difference is that exposure time is assumed to occur before the effective date, and marketing time occurs after the effective date. The misconception is easily understood because most sources of market information report historical information about days on market as “marketing time.”

When the value opinion developed is not predicated on reasonable exposure time, the appraiser’s opinion of reasonable exposure time is not required. For example, many appraisals

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2 See ADVISORY OPINION 7: Marketing Time Opinions
commissioned for employee relocation, asset evaluation, foreclosure, or asset management purposes require a value based on a client imposed limited marketing period. In these cases, the resulting value is usually not market value. Problems may arise when clients attempt to make business decisions or account for assets without understanding the difference between reasonable exposure time and marketing time (see related Advisory Opinion 7, Marketing Time Opinions).

Most residential appraisal report forms have a field in which the appraiser must enter an opinion of the neighborhood marketing time. However, most residential appraisal report forms do not have a field for which the appraiser must report the reasonable exposure time. In these cases, the appraiser must supplement the form to comply with USPAP.

**SUMMARY:**

- The reasonable exposure time inherent in the market value concept is always presumed to precede the effective date of the appraisal.
- Exposure time is different for various types of property and under various market conditions.
- Exposure time may be a single point in time or a range,
- Exposure time is dependent on the characteristics of the subject property and the market conditions as of the effective date.
- When the client specifies a time period upon which the appraiser is to base the value, and that requirement differs from the appraiser’s opinion of a reasonable exposure time, the final opinion of value is not market value.
Section 5: Proposed ADVISORY OPINION 36: Identification and Disclosure of Client, Intended Use, and Intended Users

RATIONALE

In its Third Exposure Draft of proposed changes to USPAP for the 2016-17 edition, the ASB has proposed the retirement of all of the active Statements on Appraisal Standards. This exposure draft presents proposed Advisory Opinions that will include guidance on the same topics as were addressed in the Statements for which retirement is being proposed.

Among these is STATEMENT 9 (Identification of Intended Use and Intended Users). Despite its title, STATEMENT 9 addresses both identification and disclosure, and it addresses the client as well as intended use and intended users. The following proposed Advisory Opinion addresses the identification and disclosure of the client, intended use, and intended users. While much of the guidance included in this proposed Advisory Opinion has been taken from STATEMENT 9, some of the guidance has been revised.

The Third Exposure Draft of Proposed Changes to USPAP for the 2016-17 Edition, which is being distributed concurrently with this exposure draft, includes proposals to revise the definitions of intended use and intended user. Those proposed definitions are also shown in this exposure draft.

The ASB is proposing the following new Advisory Opinion regarding the identification and disclosure of the client, intended use, and intended users:

ADVISORY OPINION 36 (AO-36)

This communication by the Appraisal Standards Board (ASB) does not establish new standards or interpret existing standards. Advisory Opinions are issued to illustrate the applicability of appraisal standards in specific situations and to offer advice from the ASB for the resolution of appraisal issues and problems.

SUBJECT: Identification and Disclosure of Client, Intended Use and Intended Users

APPLICATION: Real Property, Personal Property, Intangible Property

THE ISSUE:

An appraiser must identify and consider the client, any other intended users, and the intended use of the appraiser’s reported opinions and conclusions in order to identify the problem to be solved and to understand his or her development and reporting responsibilities in an appraisal or appraisal review assignment. An appraiser must state the intended use and intended users of the opinions and conclusions in a report.
What kind of information must an appraiser identify and consider regarding the intended use and intended users in the course of accepting and completing an assignment, and how much of that information must an appraiser include in the report?

ADVICE FROM THE ASB ON THE ISSUE:

Relevant USPAP and Advisory References

The term “Client” is defined in the DEFINITIONS section of USPAP as:

the party or parties who engage, by employment or contract, an appraiser in a specific assignment.

Comment: The client may be an individual, group, or entity, and may engage and communicate with the appraiser directly or through an agent.

The term “Intended Use” is defined as:

the use or uses of an appraiser’s reported appraisal or appraisal review, as identified by the appraiser based on communication with the client at the time of the assignment.

Comment: The appraiser must identify the intended use in order to determine an appropriate scope of work and to comply with the SCOPE OF WORK RULE. This identification should occur prior to engagement. Changes to the initially identified intended use may occur during the assignment. These changes could cause a change in the scope of work but would not create a new assignment unless the appraiser has already submitted a report.

The term “Intended User” is defined as:

the client and any other party as identified, by name or type, as users of the appraisal or appraisal review report by the appraiser on the basis of communication with the client at the time of the assignment.

Comment: The appraiser must identify the intended users in order to determine an appropriate scope of work and to comply with the SCOPE OF WORK RULE. This identification should occur prior to engagement. Changes to the initially identified intended users may occur during the assignment. These changes could cause a change in the scope of work but would not create a new assignment unless the appraiser has already submitted a report.

Specific Issue to be Addressed

In order to properly define the problem under study and to understand his or her responsibilities in an assignment, an appraiser must identify the client and other intended users. This is accomplished by communication with the client prior to engagement or at the beginning of the assignment.

An appraiser should use care when identifying the client to avoid violations of the Confidentiality section of the ETHICS RULE. In instances where the client wishes to remain...
anonymous, the appraiser must still document the identity of the client in the workfile but may
omit the client’s identity in the appraisal or appraisal review report. The client may be identified
as a person or entity, or as an agent of an intended user. When the identity of the client is
withheld, the identity must be documented in the appraiser’s workfile and the report must state
that the client’s identity has been withheld at the client’s request.

The appraiser is not obligated to identify additional intended users by name. If identification by
name is not appropriate or practical, the appraiser may identify an intended user by type.

An appraiser’s obligations to the client are established in the course of considering and accepting
an engagement. If, during the assignment, an appraiser becomes aware of a change in the
intended use, the appraiser must consider whether the extent of the development process and
report content initially planned are still appropriate. If they are not, the appraiser must make the
necessary changes.

An appraiser’s obligations to other intended users may impose additional development and
reporting requirements in the assignment. It is essential that an appraiser establish with the client
a clear and mutual understanding of the needs of all intended users prior to starting an
assignment.

A party receiving a report copy from the client does not, as a consequence, become a party to the
appraiser-client relationship. Parties who receive a copy of an appraisal or appraisal review
report as a consequence of disclosure requirements applicable to an appraiser’s client do not
become intended users of the report unless they were specifically identified as intended users by
the appraiser at the time of the assignment.

Disclosure of Client and Other Intended User(s) in an Appraisal or Appraisal Review
Report

Except when specifically requested by the client not to do so, an appraiser must state the identity
of the client in the report. Other intended users, if any, may be identified by name or type. The
purpose of this reporting requirement is to (1) ensure that the client and other intended users can
recognize their relationship to the assignment and report, and (2) ensure that unintended users
will not be misled by notifying them that they are neither the client nor an intended user. For
example, a statement similar to the following may be appropriate:

This report is intended for use only by (identify the client) and (identify any other
intended users by name or type). Use of this report by others is not intended by
the appraiser.

If the client’s identity is omitted from an appraisal report, the appraiser must (1) identify the
client in the workfile, and (2) provide a notice in the appraisal report that the identity of the client
has been omitted in accordance with the client’s request and that the report is intended for use
only by the client and any other identified intended users.
Identification of the Intended Use in an Appraisal or Appraisal Review Assignment

Identification of the intended use is one of the assignment elements necessary to properly identify the appraisal or appraisal review problem. Identification of the intended use helps the appraiser and the client make two important decisions about the assignment:

- the appropriate scope of work for the appraisal or appraisal review development process; and
- the level of detail to provide in the appraisal or appraisal review report.

Disclosure of the Intended Use in an Appraisal or Appraisal Review Report

An appraiser can avoid misleading parties in possession of an appraisal or appraisal review report by clearly identifying the intended use in the report and stating that other uses are not intended. For example, a statement similar to the following may be appropriate:

*This report is intended only for use in (state the use). This report is not intended for any other use.*

The intended use description provided in the statement must be specific to the assignment.

Illustrations:

1. A homeowner calls an appraiser and asks for an appraisal of the owner’s home. The owner wants to determine how much equity is in the property. The owner is content to know the market value of his home in the form of a range of value. He does not want to pay for a written report or the time involved in a property inspection. The owner does not intend to give the appraisal to the lender because the owner knows the lender will order a new appraisal when a loan application is submitted.

2. The next week a lender calls the appraiser for a “drive-by appraisal” on the same property in connection with a home equity loan. The lender is happy with the owner’s credit rating and plans to keep the loan in their portfolio. The lender sees very little risk in the transaction and seeks the appraiser’s opinion of the property’s market value based on an exterior inspection only.

3. Several months later an attorney for the wife asks the appraiser for an appraisal on the same property because the owners are getting a divorce. The attorney needs the appraiser to conduct a thorough inspection of the home and to provide an in-depth study of the sales of comparable homes in the market area making sure to verify the sales information with the buyers, real estate agents and the county recorder’s office. The attorney wants the appraiser’s report to contain a complete and exhaustive description of the subject property, the comparable sales, and of the analysis leading to the appraiser’s opinion.

Each of these assignments involves the same subject property and the same type and definition of value. What changes are the intended use and intended users.
What is the impact of the different intended users on the scope of work in the three assignments?

In the first assignment, the client was the only intended user. In the second assignment, the lending institution that engaged the appraiser may not be the only intended user. In the third assignment, the attorney is the intended user. In the third assignment the intended use entails scrutiny of the report by the court and/or opposing counsel. When additional intended users are identified, the scope of work may increase. This is because the assignment results typically need to satisfy more objectives as the number of intended users increase.

What is the impact of the different intended use on the scope of work in the three assignments?

The objective of the appraisal in the first assignment was to establish a range of value so the owner could resolve a question about his equity. The owner was only interested in the appraiser’s opinion and had no intention of reviewing the evidence or reasoning used to support the appraiser’s opinion. In this case, the appraiser could develop an opinion of value without a property inspection, relying on an interview with the owner, assessment records, or other data to identify the property’s relevant characteristics. Without personal inspection by the appraiser, however, such information is assumed to be correct. Because some of these assumptions will have a significant effect on the assignment results, the assignment will involve the use of extraordinary assumptions and require proper disclosure.

In the second assignment, the intended use requires a property inspection by the appraiser to gather some key information, though it also permits assumptions with respect to interior components of the subject property. The development process in this assignment is likely to be expanded by the lender’s appraisal guidelines as well.

In the third assignment, the intended use requires a higher degree of inspection of the subject property and a more thorough verification and analysis of the comparable sales. The information gathered during these investigations may affect the analysis and may extend the development process beyond what is required in the other assignments.

PERSONAL PROPERTY AND INTANGIBLE PROPERTY

Changing the above illustrations’ subject property from real estate to an item or group of items of personal property (artwork, machinery, jewelry, etc.) or an interest in a business would not change the results, i.e., the impact of the different intended use and different intended users on the scope of work would still be the same, with possible differences of discipline-specific terminology. Therefore, Illustration #1 would involve an owner of the property seeking a range of value for the owner’s own knowledge. Illustration #2 would involve some form of loan against the property, but at an amount that did not exceed 20% of the value. Illustration #3 would involve a lawsuit in which the value of the property, or the value of the owner’s interest in the business, is an important issue.

Illustration Conclusions
There are two important points to be made here. First, the needs of the client and other intended user established the type of information and analysis required in the development and reporting process. Second, the intended use provided the context for the depth of the analysis required in development and the level of detail required in reporting.

**SUMMARY:**

- An appraiser must identify the client and other intended users as part of the process of identifying the intended use of an appraisal or appraisal review report, based on communication with the client.
- Identification of the intended use and intended users are necessary steps in determining the appropriate scope of work.
- Whether or not assignment results are credible is measured in the context of the intended use of the opinions and conclusions.
- An appraiser should use care when identifying the client to ensure a clear understanding and to avoid violations of the Confidentiality section of the ETHICS RULE.
- The appraiser’s obligations to the client are established in the course of considering and accepting an assignment.
- The appraiser’s obligation to intended users other than the client is limited to addressing their requirements as identified by the appraiser at the time the appraiser accepts the assignment.
- Appraisers can avoid misleading parties in possession of a report by clearly identifying the intended use and any intended users in the report and stating that other uses and/or users are not intended by the appraiser.
- Except when specifically requested not to do so as part of the agreement with the client, an appraiser must disclose the identity of the client in the report.
- If the client’s identity is withheld from a report, the appraiser must (1) document the identity of the client in the workfile, and (2) provide a notice in the appraisal report that the identity of the client has been omitted in accordance with the client’s request.
- An appraiser must identify the intended use of the appraisal or appraisal review and must state the identity of the intended users in a report.