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 **Future of Valuation**

By M. Lance Coyle, MAI, SRA

Saying that the valuation profession – and, indeed, the real estate industry as whole – has withstood a seismic shift over the last several years would be stating the obvious. When the behemoth that is the U.S. housing market collapsed, new rules and regulations were put in place to prop it up again ... and their effects on the valuation profession are still in question. However, rather than take a wait-and-see approach to this new phase, the Appraisal Institute is proactively looking at the valuation profession and examining the challenges and opportunities of the future.

**Fewer Appraisers**The decreasing number of appraisers is a major challenge for the long-term health of the valuation profession. The number has steadily declined; as of June 30, 2015, there were approximately 78,800 real estate appraisers currently practicing (not retired) in the U.S., down from 98,450 in 2007, or a cumulative decline of 20 percent.

It’s anticipated that over the next five to 10 years, the number of U.S. appraisers will decrease sharply with retirements playing a major role.

The reasons for fewer people in the profession are complex, and involve demographics, the recession, changes in appraisers’ business models, clients using alternative valuation products, and new complex regulations that discourage new entrants into the field.

An Appraisal Institute survey determined that the average U.S. valuation professional is a white male between the ages of 51 to 65, with 11 percent age 66 and over. Women comprise 26 percent of the field.

As experienced appraisers retire, it is essential to attract new people to replace them in order for the profession to thrive. However, statistics indicate that fewer early- and mid-career aged professionals are now active appraisers. The Appraisal Institute survey shows that 12 percent of U.S. appraisers are ages 36 to 50, with one percent age 25 or less.

Starting in 2015, a bachelor’s degree is the minimum education requirement to become an appraiser. Currently, 58 percent of appraisers hold bachelor’s degrees. Approximately 19 percent of appraisers with active licenses have master’s degrees. But for some, the cost of the degrees and all the additional education that it takes to become an appraiser isn’t justified by the profession’s financial return. Forty-one percent of appraisers earn annual incomes of $50,000 to $99,000, and another 20 percent earn less than $50,000 per year.

**Commoditization**Appraiser incomes and their business models have been affected by the process of commoditization. Commoditization is the process by which goods and services that have economic value and are distinguishable in terms of attributes (uniqueness or brand) end up becoming simple commodities in the eyes of the market or consumers. The key effect of commoditization is that the pricing power of the business owner is weakened: when products become more similar from the buyers’ points of view, they will tend to buy the cheapest. This has clearly happened in the residential mortgage lending appraisal space. Although appraisers understand that the quality of analysis can differ, appraisals prepared on forms generally look alike to buyers of the product. Even the words and codes are now uniform, adding to the process of commoditization. Appraisers working in the highly-regulated mortgage lending environment must consider how to adapt their business models to the effects of commoditization.

**Regulatory Environment**While the declining number of appraisers continues to be a challenge for the valuation profession, so too is the current regulatory environment.

*Financial Institutions Reform, Recovery, and Enforcement Act*

In 1990, five regulatory agencies issued a final rule implementing FIRREA, which included a provision requiring appraiser independence. By 1994, the Interagency Appraisal and Evaluation Guidelines stated the lending institutions could expect bank examinations. However, federal banking regulatory agencies cut staff, reducing supervision of these functions. Lending institutions folded appraisal functions into their loan departments, leaving mortgage brokers in control of order processing.

*Appraisal Subcommittee*

The ASC provides federal oversight of state appraiser regulatory programs. States have been issuing licenses to appraisers for 20 years; by contrast, mortgage originators have had licensing for about half a decade.

*GSEs*

The Appraisal Institute has expressed concerns with the government-sponsored enterprises that Collateral Underwriter ratings could become a set of rules used by lenders. This was true for the Selling Guide in the past, but it should not happen to CU. Fannie Mae has learned a great deal over the last number of years and it is emphasizing appraisals in a positive manner. However, an ongoing concern is the continued allowances for the staffs of untrained loan sellers to review appraisals.

*Dodd-Frank*

The Dodd-Frank Wall Street Reform and Consumer Protection Act, passed by Congress in 2010, has released a tidal wave of change on the valuation profession. Many of these changes impact smaller, niche areas such as higher-risk loans and manufactured housing. Others, however, are much more significant, affecting the Real Estate Settlement Procedures Act, Equal Credit Opportunity Act, Customary and Reasonable Fees and appraiser independence. The profession is still seeing a shake-out and we expect more to come, particularly concerning demographics.

When appraisers think about changes to the valuation profession, they needn’t look further than big data and technology to see just how rapidly things evolve and how crucial it is to remain up-to-date on current best practices.

**Big Data and Technology**
The history of the valuation profession can be broken down into four categories, all measured on how data is used.

The Data Rummage Era, which spanned the 1920s–1970s, focused on data collection, with appraisers “owning” the data.

The Market Analysis Era (1980s–1990s), brought in the availability of data in competitive market segments, and the use of three to six comps.

The Data Discarding Era (1990s–2000s) provided large electronic data sets. Along with useful information, there was also miss-used data and “junk” science. Using three to six comps remained the norm.

Finally, the Data Optimization Era (2010s–present) focuses on optimal sets of large datasets, and the analysis of all the data– not just sampling.

Appraisers used to focus on the collection and verification of data; those who were the best at this were often well rewarded. But today data is widely available, so appraisers must focus on the analysis of that data to bring value to their services. While automated valuation models are unlikely to completely replace a human appraiser, they will nevertheless continue to evolve into an alternate form of valuation that competes with traditional appraisal services. Appraisers will increasingly be expected now and into the future to adopt big data analytical techniques into their product.

**Stale and Limited Product**

As key participants in residential and commercial real estate transactions, appraisers have been subject to certain negative feedback. However, as always, the role of the appraiser is simply to provide a credible opinion of value as an independent, third-party expert.

Who among us has not heard one of these complaints?

* “Over-valuation by appraisers was a key reason for the housing crisis.”
* “Low appraisals are holding back the housing market.”
* “Appraisals are too high.”
* “Appraisals are too low.”
* “What good are appraisals if they don’t protect us from market cycles?”

While some of these complaints are unfounded, the Appraisal Institute hears the concerns and is responding by further developing its body of knowledge. Is an appraisal that only provides an estimate of value on one date still adequate for today’s needs, or has it become stale and limited in its usefulness?

The Appraisal Institute’s “Guide Note 12: Analyzing Market Trends” addresses to what extent appraisers are responsible for recognizing changes in market conditions, and what steps appraisers must take to ensure due diligence is done regarding the analysis of market trends.

The Guide Note states, “Analyzing current and anticipated market conditions is more complicated – and more critical – when a market is rapidly changing, either upward or downward.” Adequate market analysis must be completed before highest and best use analysis, and the determination of highest and best use is critical to an appraisal assignment when market value is the objective, according to the Guide Note.

The Uniform Standards of Professional Appraisal Practice (USPAP) include rules that address the steps appraisers must take to ensure due diligence is done regarding the analysis of market trends. According to the Guide Note, “Reconciliation is an important step in the valuation process, especially when market conditions are such that good quality, current data is lacking.”

Signs of a changing market are symptoms, as opposed to causes, according to the Guide Note. An appraiser observes the symptoms, but must understand the underlying cause or causes in order to properly analyze market trends. For appraisers and market participants, a “bust” market is usually relatively obvious. However, it can be difficult to spot a “bubble” market when in the midst of one. Further, it can be difficult to tell when a bust market has started to turn and improve, or when a bubble market has begun to decline.

**Future Trends**

While no one has a crystal ball, there are certain things that can reasonably be expected to impact the valuation profession in the coming months and years, including:

* More commoditization;
* Consolidation of valuation firms;
* Specialization and true expertise;
* Alternate valuation products;
* A growing divide between commodity appraisal and consulting appraisal; and
* The principle of change.

**Obsolete Business Model**

In the world of rapidly changing technology, adaptability is a key to viability. Clinging to obsolete business models can spell doom to companies and entire industries. Kodak was sunk by the “creative destruction” of the digital camera. However, Apple rose on the wave of change and evolved from the maker of small personal computers to the iPod and ultimately to mobile devices like the iPhone.

Changes in demographics, regulations and technology all present challenges to the valuation profession. However, an improving housing market and increasing business and growth opportunities have appraisers feeling optimistic about their futures and that of the profession. The Appraisal Institute is dedicated to assisting appraisers in adapting to these changes, and to the future viability of the valuation profession.

 **About the Author**

M. Lance Coyle, MAI, SRA, of Dallas, is the 2015 president of the Appraisal Institute, a global professional association of real estate appraisers, with nearly 21,000 professionals in almost 60 countries throughout the world. He has been involved in the real estate appraisal profession for 30 years. He is principal of Coyle Realty Advisors, a Dallas-based real estate services firm engaged in fee-based investment property valuation, analysis, research, expert witness testimony and counseling. He currently concentrates on providing support in real estate litigation cases, and has been a guest lecturer and author for several eminent domain conferences.

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