

## Appraisal: Introduction

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The American Real Estate Society (ARES), Hal Smith and I wish to thank the American Institute of Real Estate Appraisers for their financial support of this Special Issue of the *Journal of Real Estate Research* on appraisal. Appraisal, as an academic area of research has received, at best, residual attention. This, in part, can be attributed to its interdisciplinary origins (which combine elements of both financial and land economics), and its eclectic nature (per Paul F. Wendt, who states it involves both theory and application resulting in a broad array of investigated topics). All of these characteristics, and the fact that much of the appraisal research in the past has been done by practitioners, has been sufficient to place it on the back burner of the academy until recently. However, probably the greatest problem of the appraisal discipline is that it has not proposed a general equilibrium theory of property values or urban land structure. By its very nature, appraisal is an ad hoc decision tool. In the hierarchy of academic order, ad hoc models are on the lower rungs of the prestige ladder.

But, as the classical literature on "value versus utility" has shown, a lack of prestige does not exclude a high level of utility. In fact the ad hoc nature in which appraisal is used is a direct result of the structure of real estate markets, the heterogeneity of the real estate markets, the heterogeneity of the real estate product, and the related problems.

The fact that appraisal is applied in an ad hoc context, however does not mean that the appraisal process cannot be viewed as a *generalized model*. That is the essence of the process. There is a growing body of literature identifying general economics as a process relating initially perceived unrelated topics, in a specific manner, to reach a conclusion.<sup>1</sup>

Appraisal, as an academic endeavor, is not just limited to the checklist of topics to be communicated in a report; it can be divided into three theoretical components. The components are value theory, valuation theory and appraisal theory. Value theory is concerned with the reasons and basis for worth in an asset. Valuation theory addresses the techniques and procedures used to estimate asset worth. Appraisal theory is concerned with the logic and procedures by which the valuation techniques are linked to the value premise for a specific land use parcel.

Surveys of the literature show that the bulk of appraisal research in the past has addressed valuation concerns, to the extent that academics and professionals tend to label all appraisal research as valuation. Although the majority of the articles in this special edition offer insights to valuation techniques, a balance between appraisal theory, value theory and valuation theory is achieved. A separate section on specific problem-solving and decision models is also included. The specific applications tend to be valuation oriented, although many contain elements of value and appraisal theory.

The section addressing specific problems is not intended by the editors as a catch-all category, but is used to illustrate the basic ad hoc application of the appraisal process, and

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still emphasize its generalized nature. The generalized appraisal process illustrated in these articles is flexible, to the extent that it can be altered to fit the myriad range of real estate problems and decisions that must be dealt with by appraisers on a daily basis. The process itself is a combination of self-styled fundamental and technical analysis techniques that are integrated with decision tools from various disciplines.

Because no general equilibrium model of realty valuation has yet been developed, the ad hoc approach has continued to dominate real estate appraisal research. In addition to the reasons mentioned earlier, ad hoc dominance continues because of the heterogeneous nature of realty, the unequal flow of information, the disparity between parties' bargaining positions, and the spatial and residual nature of the real estate product and its demand. The continuance of the ad hoc tradition does not necessarily require a continuation of this perspective in the future. Several of the articles in this special edition establish the foundation for a more formal and unified theoretical development.

The first article by Diaz is a survey/decision science investigation of appraisal theory. It quantitatively investigates the logic and processes by which components of the appraisal process are carried out in the valuation of residential properties. Diaz finds that formal adherence to the appraisal process is contingent upon the appraiser's knowledge of the property and area. The second article, by Dotzour, Grissom, Liu and Pearson, is an in-depth investigation of the highest and best use paradigm. The proposed model is a constrained optimization technique that incorporates the cost of capital into the traditional constraints of physical, legal and market criteria. This article emphasizes the value theory component of appraisal analysis and focuses on the flexible basis of worth for realty.

The next few articles are concerned with valuation theory. This set of articles emphasizes the process or techniques by which worth or value is measured. The techniques encompass the sales comparison, cost and income approaches. However valuation theory is not just limited to measurement techniques, as emphasized in the Kuhle and Moorehead article on the application of bootstrapping for the statistical analysis of comparable sales. This section also considers the theoretical analysis required to develop measurement/valuation's models per Epley's market extraction of effective age. Epley illustrates the importance of economic life to value estimation and offers a method of measurement that combines both value and valuation theory. In addition, his article sets up a procedure for abstracting an estimate of effective age via market information. The technique combines elements of the sales comparison and cost approaches.

Lipscomb and Gray compare and contrast the benefits of multiple regression analysis to the traditional grid models used in the sales comparison techniques. They provide several useful insights for both academics and practitioners. It is suggested that this article be especially considered by practitioners, along with Kuhle's and Moorehead's bootstrapping technique, which enables the development of useful statistical data from a limited data set.

Dotzour investigates the possibility of bias in the cost approach, given the theoretical and formatted structure of the cost analysis process. He uses a national residential property data set. Gilley and Pace continue the theme of integrating the cost and market (sales comparison) approaches by developing a hedonic model for valuing properties using transaction information and cost data. Their application addresses mass appraising concerns, but the theory easily can be expanded to individual property appraisal issues.

The impact of financing on residential markets is illustrated by Mooney. Of interest is Mooney's delineation of dichotomous markets as a result of financial options (or limit-

ations). Mooney's research contributes to the valuation theory components of comparison and income analysis techniques.

The last of the valuation theory papers by Wang, Webb and Cannon offers an absorption model application to subdivisions (or multi-tenant properties). It is a combination of discounted cash flow analysis and sales (lease) comparison models. The emphasis of the paper is on integrating the issues of economic analysis (supply and demand) directly into the valuation process. Of interest in the valuation series is that, overall, the articles provide an inter-relationship between the three traditional approaches to value. This is contrary to the general perceptions in the literature that treats each technique as separate and equal.

The final section offers specific topics or problem areas that are currently of concern or are expected to become increasingly important in the near term. The first paper is by Colwell. It employs a hedonic model to address the effect of power lines on encumbered and surrounding land values. This in-depth study illustrates the contributory value of components to the overall property value and then indicates alterations attributed to the introduction of transmission line easements as a market perception. Colwell's paper combines value and valuation issues.

The Shilling, Benjamin and Sirmans paper addresses an issue that has caused much concern in the Southwest and will be receiving attention nationwide. They develop a framework for adjusting distressed real estate properties for liquidating discounts. The technique provides a process for predicting the average rate of offers in specified time intervals. It also allows an estimate of net realizable value. Next, the Sirmans, Sirmans and Benjamin article on rental concessions and property values illustrates that rental concession can have a positive impact on the value of apartments. Rental levels are also illustrated to be associated with varying amenities and services. The Alvaay and Baen article on wetlands emphasizes the impact of extensive wetland legislation and regulation, in general, on markets and thus the appraisal process. The paper addresses the impact of regulation enforcement on the wetland market structure, with specific emphasis on the economic value of services possibly not capitalized in the market price.

Finally, the Fisher and Lentz article on business enterprise value in shopping malls discusses the economic basis of business enterprise value and entitlements, in addition to the leased fee-leasehold property estate. The work addresses value and valuation issues as they relate to realty and intangible and tangible personalty. The separation of these issues is relevant to business strategy and ad valorem property taxation.

Overall, the special issue offers insights to value, valuation and appraisal theory. As in past research efforts, the emphasis of the research is on the valuation techniques. It is hoped that future research will increase the emphasis on appraisal and value theory issues. Of interest to the editors was the limited number of articles received using the income approach. This is a change from the past and may indicate the overall acceptance of the discounted cash flow model within the academy and in professional practice.

The general theme of appraisal as an ad hoc decision tool was evident in all of the articles submitted. It is hoped that development of more general models may occur in the future with an emphasis on value and appraisal theory research. This evolution may be necessary, as well as desirable, given the economic trends of the country, the transition in institutional structures and the apparent economic restructuring of the national and world economies.

Hal and I want to thank all participants; those being published, those who submitted articles, and especially the reviewers. The response far exceeded the anticipated partici-

pation, with over 120 reviews required and a limited number of experts available. The importance of volunteer effort cannot be overemphasized in any professional organization, and ARES can claim many active, diligent and enthusiastic participants. A task of this magnitude is always a team effort. Special thanks go to the Appraisal Institute for its interest and financial support and the Real Estate Center at Texas A & M University for its contribution of time, facilities and materials. Much thanks to our secretary Lois Carter. Also the guidance, advice and efforts of Don Epley and James Webb were greatly appreciated. It is hoped that the final product closely approaches expectations.

## Note

<sup>1</sup>Institutional and evolutionary economists have viewed general economic analysis as a process influenced by the institutions and cultures of a society. This is incorporated in neoclassical models in part as agency theory. An example of such institutional literature is Richard N. Langlois, *Economics as a Process* (Cambridge: Cambridge University Press, 1986).