

## **A Neutral Appraisal Provides Accurate Valuation to Fairly Divide Marital Equity**

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In marriage dissolution cases, real estate tends to be the largest joint-owned asset. Whether a homestead or other type of real estate, it is very important to both parties that there is an accurate valuation. The use of a neutral appraiser can save a considerable amount of time and money and ultimately result in a mutually understandable way to fairly and equitably divide real estate equity.

### **I. What is a Neutral Appraisal?**

A neutral appraisal is a well-written and documented appraisal report completed for parties with opposing interests by a neutral third-party real estate appraiser. A neutral appraiser typically has experience being appointed by courts, or is agreed to by both parties, and has had a high success rate facilitating party consensus related to the opinion of market value. Neutral appraisers will agree that their reputation as a neutral appraiser is their most valuable asset. As neutral experts typically have significantly more experience, fees may be somewhat higher than that of non-neutral appraisals, but a few hundred dollars more for a more accurate valuation of an asset worth many hundreds of thousands of dollars, is almost inconsequential. But, agreement and confidence by opposing parties relying on an accurate valuation to divide marital equity is priceless.

Neutral appraisers and appraisals are held to a high ethical standard by their clients, typically beyond that required through appraisal licensing. Ethically, all appraisers have to certify:

- 1) The value is not in any way contingent upon the development or reporting of a predetermined value or direction in value that favors the cause of a client;
- 2) That the value is not subject to the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of the appraisal; and
- 3) That the appraiser has no personal interest (or bias) with respect to the parties involved.

Appraisers must also complete the appraisal in conformity with the Uniform Appraisal Standards for Professional Appraisal Practice (USPAP), and appropriate state laws, regulations, policies and procedures applicable to an appraisal. USPAP is essentially the national ethical standards that appraisers must adhere. When appraiser licensees are subject to investigation by the licensing board, USPAP is used by the investigators to support whether or not an ethical violation occurred. Appraisers are the only real estate professional, that due to their licensing requirements, “certify” the value of their appraisals. Other real estate professionals do not “certify” the value, and are not bound by USPAP or appraisal licensing law. An appraiser, when performing as a neutral appraiser, has a greater duty to the clients to ensure accuracy as well as a clearly written report that lay people can use to understand the methods, analysis and logic used to support an opinion of market value.

A good neutral appraiser should be able to provide a list of referrals from attorneys and judges. Additionally, besides being qualified as a neutral appraiser by way of specific neutral experience, the neutral appraiser should be competent in the geographic location as well as the property type. Certain property types, such as lakefront, upper price bracket, acreage with or without subdivision potential, hobby farm, etc., may require a neutral expert with specific experience in those property types. Appraiser competence is necessary as also addressed within USPAP.

A neutral appraiser's testimony as an expert witness in trial is invaluable. It is also worth noting that hiring a neutral appraiser for a non-neutral appraisal is also beneficial, as courts are generally aware if an appraiser does a significant amount of neutral work, and could deem them more qualified and therefore more accurate in their opinion of value, knowing that they do not want to risk tarnishing their well-deserved reputation.

## **II. The Importance of Following Neutral Protocol**

It is important for a neutral appraiser to explain, define, and follow their neutral protocol. Although it may vary from appraiser to appraiser, generally a few things are expected from neutral appraisal protocol, including an invitation for both parties to attend the inspection and obtaining information from both parties. If one party does not attend the inspection, it is important for a neutral appraiser to talk with the non-attending party to receive and consider their information as well. The information requested should be the same for each party, and may generally include: understanding what improvements, if any, have been made, if there are any problems or maintenance issues to note, or even if an insurance claim is pending.

It is important that the neutral appraisal is written and communicated in a way that lay people can understand. This could include, but is not limited to things such as fully explaining the market conditions; fully exploring the concept of highest and best use; fully explaining the search criteria used to obtain suitable comparables; explaining why certain comparables were selected for adjustment analysis; explaining the reasoning and adjustment for differences between the subject and each comparable; cross-valuation checks (if necessary); and finally, adequately reconciling the data to arrive at a well-supported opinion of value that a lay person can follow and understand. The idea is that the methods, analysis and logic should be easily followed throughout the appraisal so that lay people can fully understand the ultimate reasoning for the valuation opinion.

The clients for neutral appraisals are typically the parties' legal counsel. This keeps an arm's length distance from the parties who each have opposing interests regarding the value of the marital real estate. It is also important that the appraisal is delivered during business hours and at the same time to both attorneys. There is nothing worse than when it comes time to exchange the kids on the weekend that one spouse is aware of the appraised value while the other is not. Finally, if either party has any questions, the neutral valuation expert should be able to help, but usually for an additional fee. It is important that the questions get directed through the legal counsel, but with the answer/response copied to both attorneys to then share with their clients.

### **III. Types of Appraisals/Valuations**

Based on various circumstances, other valuations and related appraiser qualifications may be necessary. It is important to seek an appraiser who is competent in the specific type of valuation necessary, as that will insure a credible opinion of value. The following are examples of different valuations or report formats which may apply.

Narrative Reports: While a form report may be appropriate to value a residence, the flexibility a narrative report offers may be appropriate for commercial, industrial or investment real estate.

Partial Interests: Sometimes partial interests are owned in real estate and they must be valued separately. Partial interest valuations need to consider a wide variety of information to conclude the opinion of market value for the partial interest. Most of the times, the partial interest valuation is not equivalent to the actual percent of interest owned.

Marital (Dorweiler) Claims: Sometimes it is important to quantify the non-marital interest. When a property has a non-marital interest, but during the marriage improvements were made, the “increase in value” created by the improvement, and its related contribution to market value, must be quantified. Sometimes there can be multiple-valuation dates necessary. Understanding what Dorweiler claims are and how multiple valuations may be necessary is a wide-ranging topic deserving of its own article, currently under authorship and yet forthcoming.

Different Effective Dates of Value: Sometimes it is necessary to have the value of the real estate as of the date of marriage, or a forensic (or retrospective) valuation, as well as a current valuation, in order to estimate pre-marital equity. It is important that the appraiser was licensed as of the retrospective date to properly understand market conditions and relative magnitude of adjustments applied.

Construction Defects, Partial-Completed Projects, Pending Insurance Claim or Deferred Maintenance: Known construction defects, partial-completed projects, insurance claims for damage or significant deferred maintenance can have a significant effect on market value. Proper assessment and understanding of the defect, partially-completed project, insurance claim or deferred maintenance and related cost to cure (if feasible) is important to quantify as it will typically have a significant effect on market value.

### **IV. How To Determine A Quality Appraisal**

Whether a neutral appraisal or not, the quality of an appraisal can often be observed through a few items or sections: highest and best use, market conditions, comparable search criteria, adjustment analysis, additional approaches to value, cross-checks to value (if necessary), and the final reconciliation. More detail on each follows:

The Highest and Best Use: The highest and best use is the basis of all real estate valuations. It considers what is physically possible (e.g., size, shape, topography, presence of utilities, easements, etc.); legally permissible (current use versus zoning or guided land use); financially feasible (all uses that are physically possible AND legally permissible); and finally, maximally productive (of those uses that are financially feasible which use(s) would garner the highest market value). If the highest and best use is not fully explored and then justified, the related value conclusion is likely inaccurate. This is more important for commercial, industrial or investment properties or for instances when there may be an older and modest single family residence on land that is zoned and guided commercially or for residential subdivision, and where there is a higher value for redevelopment than its existing residential use.

The Market Conditions: Real estate markets are ever-dynamic, sometimes the market appreciates (goes up) and sometimes it depreciates (goes down). It is important to understand the current market conditions, to know the reliability of older market data and any related adjustment applicable for passage of time. For residential properties, it is easy to find market statistics online or through the MLS, yet rarely do appraisers go to this level. To know the magnitude of a positive or negative adjustment for variance in market conditions between the comparables' sale date and current date is important, and if not properly supported and applied, could affect the opinion of market value. This is a very important adjustment to quantify and properly use to ensure an accurate valuation.

Comparable Search Criteria: Fully explaining the search criteria used to obtain suitable comparables lets the reader know the entire universe of data considered. The search criteria should not be so limiting that only a small sampling of comparables are obtained. This will also tell the reader what was not considered in the search criteria, such as if the geographic area was too limited; if the search criteria is exclusionary of styles, sizes, and other important physical characteristic; or even if there is an ample amount of recent market data.

The Adjustment Process (including overall gross and net adjustment amounts): The comparability and hence applicability of each comparable can be observed and demonstrated through the adjustment process. The **gross** adjustment amount reflects the overall dissimilarity between the subject and comparables and is the sum total of all positive and negative adjustments. There is greater similarity if overall gross adjustments are low. However, it is often the case that unique properties or valuation in slow or declining markets may require higher gross adjustment amounts. In such case, the reasoning for the limited pool of comparable data and high gross adjustments should be explained.

The **net** adjustment reflects the positive adjustments less the negative adjustments and is the total used to add or subtract from the comparable's sale price. It would be desirable to see some comparables having negative net adjustments and others having positive net adjustments, as that would bracket the subject value with comparables which overall are both superior and inferior. When comparing more than one appraisal, likely the more reliable report is the one which has the least comparable manipulation, or lower overall gross adjustments.

Additional Approaches to Value/Cross-Check Valuation: The three most common approaches to value are the sales comparison approach, cost approach and income approach. Usually, most appraisals include the sales comparison approach, because the best suggestion of value is what similar properties have sold. Many times, this is the only approach applicable and therefore is the only approach used. The cost approach and income approach are two types of additional approaches to value. In certain instances, a cross-check to the valuation via the improved (land and improvements) sales comparison approach lends more credence to the report and related opinion of market value. For instance, in cases where the land represents a greater-than-typical contribution to overall market value, it may be important to objectively estimate the market value of the land, through a land sales comparison approach. It can also be used to support an adjustment for site differences between the subject and other improved comparables. If the improvements are newer, the cost approach may apply, and the depreciated in-place replacement value, when added to the estimated market value of the land, can provide a very meaningful cross-check to the opinion of market value from the sales comparison approach. In markets where there is limited sales data, or in instances where the property is unique, comparison of the opinion of market value to current list prices of comparable properties may also provide a valuable cross-check to the opinion of market value. For commercial, industrial or investment types of real estate, the income approach may additionally be meaningful and applicable. Any additional approaches to value and cross-check valuations should be reconciled with the opinion of improved market value.

Final Reconciliation: The final reconciliation process is very important. It should reconcile the approach(es) to value, cross-check valuations, and data used to arrive at the well-supported opinion of value. It should be thoughtful and logical, and easy for the reader to follow and understand. The methods, analysis and logic should be able to be easily followed throughout the appraisal, and reiterated in the final reconciliation, so that the reader of the report fully understands the logic behind the valuation opinion.

## **V. Difference Between an Appraisal vs. Other Types of Valuation Evidence**

There are many other types of “valuation” reports that should be defined and described. These include competitive market analysis, broker price opinions, assessed market value for taxation, and even other appraisals completed for other purposes. There should be little reliance on these as current suggestions of market value due to the use of the report and (purpose), the timing (difference between effective date of valuation and current date), and limitations of the work product itself.

Competitive Market Analyses and Broker Price Opinion: The majority of homeowners are aware of “free” competitive market analysis offered by Realtors, or broker price opinions offered by brokers. It is important to understand that these documents and opinions are completed in order to estimate a current list price, which is often rarely the same as the current real market value, and therefore these reports should not be relied upon for an estimate of market value. Appraisers are historians, and look at actual closed sales that have occurred as proof of current valuation. Listing prices are typically more than market value, as sellers many times expect and anticipate appreciation (positive market movement) and factor that into list price. Additionally, appraisers are licensed only after significant education and experience, typically taking a few years to acquire.

Certified General Appraisers, the highest of four levels of licensing, require at least four years to accumulate the specific education and experience necessary, after a college degree is obtained. Sales agents and brokers have no college degree requirement, and less than 200 hours of education, with no experience requirement. Appraisers are licensed and are paid for their valuation opinions. Brokers are licensed to sell and are paid for their brokerage (sale) services.

Estimated Market Value for Taxation: All homeowners are familiar with the annual estimated market value for taxation purposes. While it is true that assessors statewide are to complete sales ratio studies that overall prove to the Minnesota Department of Revenue that estimated market values are within 90-105% of real market value, it is typical to see a wide divergence of estimated market values for taxation purposes versus actual market value. It is not unreasonable to see an estimated market value for taxation purposes varying more than 10% of actual market value. As assessors utilize “mass appraisal” techniques to assign value to a certain classification of property, it is not a subject-specific valuation and should not be relied on as such. Complicating any reliance on the estimated market values for taxation purposes is a homeowner’s lack of understanding the effective date of valuation. In Minnesota, the effective date of valuation is January 2 of the year prior to the estimate of market value for taxes payable. It is therefore possible to have an estimated market value for taxation purposes that is almost two years old.

Other Appraisals Completed for Other Purposes: There are many reasons a homeowner may have an appraisal, including, but not limited to, new financing, estate purposes, and even just general knowledge. It is important to understand the differences in appraisals based on purpose. As of current, some appraisals done for lending are conservative, or less than market value. This is due in part to the significant liability the appraisers accrued due to the Great Recession and accompanying credit crisis. Appraisals completed for estate purposes or even general knowledge also may not be accurate based on the specific needs of the client. Reliance on any prior completed appraisal may also not be applicable due to the time which has elapsed from the effective date of value to current. In dynamic markets, such as is typical in the Twin Cities, appraisals with effective dates older than 6 months are likely not a contemporary reflection of market value.

## **VI. We Did Not Hire a Neutral Appraiser, Now What?**

Your neutral appraiser expert may be able to offer other neutral real estate services. This can include a technical appraisal review, a critique of one or more reports, or reconciling many types of reports that suggest a valuation, including, but not limited to, an appraisal done for lending or other purposes, a broker price opinion, a Realtor’s competitive market analysis, or even the assessed value for taxation purposes. Often times the suggestions of value range widely and are from various effective valuation dates. The different reports and suggestions of value are confusing to most, so many feel it important to have a neutral appraiser explain or reconcile the differences of the reports and related suggestions of value. Besides helping reconcile these differing reports and opinions of value, the neutral valuation expert can locate any additional and pertinent market data, and provide an opinion of value as of the specific date necessary. It is noted that this option is more costly and time consuming than hiring a neutral appraiser initially.

## VII. Benefits of Neutral Appraiser Services

Usually the most valuable asset a married couple owns together is real estate, and during dissolutions, it is important that both parties rely on a credible valuation to feel confident that the real estate equity has been fairly and equitably divided. Often a lot of money and court time is spent on dueling valuation experts, each armed, and equally convinced their opinion of value is correct, leaving the decision of valuation to the trier of fact, who is left to interpret and wade through the valuation evidence to extract their opinion of value, a significantly more expensive and time-consuming process than agreeing to and hiring a neutral appraiser initially. Ultimately, hiring a neutral appraiser will save money and time, and lead to a more accurate and fair basis to divide real estate equity.

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Ms. Schwartz is the sole-owner of Lake State Realty Services, Inc., founded in 1991. She has over 30 years of experience in the real estate industry as an appraiser and real estate sales broker. She has been providing appraisal and consulting services to the family law industry for over 25 years, including appraisals and “neutral appraisals”, often being appointed by a judge as a neutral appraiser, or agreed to by litigating or opposing parties. She has appraised a wide variety of property types, including commercial, industrial, investment, single- and multi-family, and special use. She has received awards, commendations, recognitions and honorariums and has been guest speaker or presenter at functions for engineers, bankers, appraisers, and attorneys, and has taught a CLE course. She has testified as an expert in neutral and other capacity on a wide variety of matters related to family law, estate planning, partnership disputes, eminent domain, construction defects, property disputes, and special assessment benefit analysis. Testimony has been completed for condemnation commissioner hearings, District Court, Federal Court, and Congress. She is on the Anoka and Washington County Condemnation Commissioner’s list, and is one of few neutral appraisers in the State of Minnesota that is regularly appointed by judges. Although most appraisal experience is in the Twin Cities, she holds the highest level of appraisal license (Certified General) in the states of Minnesota, North Dakota, Wisconsin, Michigan, and Ohio.



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