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Diversif

is the key to success in today's ever-changing marketplace

The valuation and consulting world is continuously evolving. Appraisal Management Companies (AMCs) are doing what they do best. Automated valuation models are advancing. Our clients have more access to data than ever before. And now, the COVID-19 worldwide pandemic is upon us. In addition to all of this, fees are being compressed for conventional mortgage financing work, forcing many appraisers to consider what the future holds in an ever-changing marketplace.

What should appraisers do? The answer is obvious. We must adapt to change or become obsolete. This is not only true in real estate valuation and consulting, as there are numerous industries and professions that are being affected by technological advancement and a changing business landscape. Will the traditional 'real estate appraiser' be needed in the future? My answer is yes, although we need to adapt our thinking to better serve the market. Diversification is the key.

Conventional mortgage financing appraisals are what most of us are used to, and it is the largest segment in valuation. As such, it attracts the most appraisers, which, in turn, increases competition, exerts downward pressure on fees, and creates a price-taking rather than a price-setting environment. Financing work should certainly represent the largest portion of an appraisal company's revenue, however, the question is what that percentage should be? If it is 100%, it is certainly going to be a decreasing revenue stream into

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the future, especially in a competitive market. Financing work also contains some degree of homogeneity, creating complacency in our professional development and learning curve. No doubt, this work is the easiest to get, but easy does not always correlate with compensation.

To give appraisers credit, our clients rely on our impartial value estimates every day, and we need that conventional work, but to what end? Do you want to expand your scope, grow your revenue stream, and/or develop a new niche? In my opinion, the appraiser of tomorrow will need to continuously adapt to the evolving environment.

Conventional financing appraisals

As a residential appraiser, are you doing single-family homes, lots, or condominiums? Are you a commercial appraiser who only does standalone buildings or condominium-style units? What types of clients do you serve: public sector, private sector, banks, lawyers, brokers, AMCs? The type of clients you service will dictate if you are a price taker or a price setter in the market.

In financing work, it is my opinion that the first and easiest step to diversification is to get new types of clients. Consider developing a well-articulated Curriculum Vitae and approaching law firms in your area to do litigation work. In current COVID-19 times, you can pick up the phone, speak with a lawyer and forward your information. Litigation work requires strong attention to detail, a willingness to look outside the box, and an ability to implement critical thinking. With the right experience, you will become an expert witness, defined as, *"a person whose opinion by virtue of education, training, certification, skills or experience, is accepted by the judge as an expert."*

Court or arbitration experience by itself sets you apart. The best part of expanding your client base to include lawyers is that there is a diverse range of real estate related issues that can arise, many of which require an appraiser's expertise. This does not mean only foreclosure work or typical matrimonial matters. With our legal clients, we have been involved in a range of Right of Way (ROW) issues, including encroachments and easements. The valuation of going concern assets forced us to look at businesses as going concerns with real estate, e.g., hotels, car washes, gas stations, bowling alleys, movie theatres, etc. Then there are partial interests in real estate, where you have to consider the market value of a 50% partial interest in a property. We have done the valuation of real estate corridors for private landowners, utility companies, First Nations, and oil and gas companies. We have consulted in the valuations of long-term lease lands, or the value of prepaid leases as it would relate.

Feasibility studies

"A Feasibility Study Report (FSR) is a formally documented output that summarizes results of the analysis and evaluations conducted to review the proposed solution and investigate project alternatives for identifying if the project is feasible, cost-effective, and profitable. It describes and supports the most feasible solution applicable to the project."

In 2015, our firm did its first major feasibility study. The previous seven years were spent establishing our experience and competency to get to that point. There is no easy path to becoming an expert. There is no easy path to becoming competent in a skill. But once you have the skill, there is a high probability it will translate into a revenue stream, especially when you can articulate your skill.

More specifically, a very specialized field is ROW valuations. This is *"the legal right, established by usage or grant, to pass along a specific route through grounds or property belonging to another."* This can result in easements, which is *"a legal right to use another's land for a specific limited purpose."* An example of a ROW valuation could be that the local gas company wants to purchase a 20-foot strip of land from a landowner to run its utility lines to provide energy to consumers. An example of an easement is a neighbour needing access through an adjacent property to access his or her property. These alone are two specialized fields of valuation and consulting that can set you apart from the rest. In other cases, expropriation can occur, which is, *"the action by the state or an authority of taking property from its owner for public use or benefit."* The amount of work available in this realm alone is astonishing.

With experience and education, you can become an expert in these fields. Outside of our own Appraisal Institute of Canada (AIC), the International Right of Way Association (IRWA) is a separate organization that specializes in ROW consulting and valuation and offers its own IRWA certification. Yes, all these certification initials after your name result in better compensation because of education and demonstrated competency. We need to become price setters, not price takers.

A feasibility study is an advanced report, advanced scope of work, and a customized response to a client's need. In most cases, it is a consulting report and appraisal report under the *Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP)*. It requires time, experience and competency. In a typical feasibility study, supply and demand fundamentals are used to support the highest and best use of a property/site, then various highest and best use probabilities are tested to determine the use that offers maximum profitability. We use stabilized income statements, discounted cash flows, absorption variables and operating cost calculations. Feasibility studies can also be customized for a client's specific needs. This, in turn, will result in a new revenue stream, enhanced confidence, and diversification. Feasibility study fees can range from $10,000 to $30,000, depending on the scope.

Machinery and equipment valuations

This is the latest AIC initiative to keep our members engaged and diversified. The AIC is the preeminent appraisal leader in Canada, and we were a logical fit for the appraisal of machinery and equipment. Machinery and equipment follow chattels and not real estate, and there is a separate standard within *CUSPAP* for this competency. As per CUSPAP, "A term that describes the physical

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facilities available for production, including: the installation and service facilities, together with all other equipment designed or necessary for manufacturing purposes, regardless of the method of installation. It also includes those items of furniture and fixtures necessary for the administration and proper operation of the enterprise."

Examples of conventional equipment valuations are appraisals of restaurants. In these types of valuations, we are typically responsible for all the equipment related to the going concern of the business operation. Examples are pots, pans, freezers, condensing units, stoves, tables, chairs, POS systems and signage, to name a few. In addition to this, we will typically appraise the leasehold improvements affixed to the real estate. So, the valuation is a mixture of chattels and affixed real estate related components. Equipment assignments our company has completed range from Subways, Pizza Huts, convenience and liquor stores, to all types of mom-and-pop restaurant sales/refinances. Other examples are landscaping or concrete companies, where we appraise a variety of vehicles and specialty equipment including backhoes, dozers, wheel loaders and crib cages. We have appraised farm equipment including plows, seeders, generators, combines and irrigation pivots.

All these assignments are challenging and unique, with each having its niche. For example, the appraisal of leaseholds requires us to review the legal aspect of the lease agreement and ensure that the term of the lease and options to renew are long enough to support the loan amortization. Machinery, equipment and leaseholds are logically amortized at much lower amortizations than real estate. Leaseholds are typically up to 10 years, where most equipment loans are 5-10 years.

Examples of machinery valuation are quite evident, generally defined as *"Physical facilities available for production, or equipment designed or necessary for manufacturing purposes."* Examples of machinery valuations range from manufacturing facilities to production facilities. Our firm has been involved with the valuations of carwashes as well as all types of fabrication facilities.

In conducting these types of valuations, we need to follow the *Machinery and Equipment Standard* in *CUSPAP* to create the template to meet the minimum requirements. Most importantly, you must prove competency. This can be developed by using a mentor and by taking courses related to machinery and equipment valuation. Like the IRWA designation, there is another organization in the United States called the American Society of Appraisers (ASA). The ASA is a certification given to those who meet the education requirements of the program. This certification can be considered the premier level of machinery and equipment certifications both in North America and globally.

It is also important to consider the types of values that are required in machinery and equipment valuations. It becomes increasingly important to specify the type of market value required by the lender, especially for chattels and non-real estate related items. The definitions of value vary relative to typical real estate valuations: fair market value – removal; fair market value – installed; value in continued use; orderly liquidation value; forced liquidation value; liquidation value in place; salvage value; scrap value; insurance cost new; or insurable value depreciated. Value in continued use is a typical estimate that we apply, although each lender has their own underwriting guidelines and value requirements.

A variety of factors must also be considered, including shipping rates, installation rates, currency conversions and potential duties charged. For approaches to value, we generally apply the Direct Comparison Approach, although we also use the Cost Approach to correlate the values via depreciation. In certain circumstances, the Income Approach can be used with specialty equipment, although it becomes hypothetical in some cases.

The outlook for the future

What does the future hold for the AIC and appraisers in general? Technology is advancing faster than ever, and the current pandemic has taught us that we need to be resourceful in getting information in the absence of a physical inspection. In my opinion, conventional financing work could become more automated. Niche work will always require experienced appraisers who can not only produce a value but defend it in a court of law. Niche work allows an appraiser to become a price setter and not a price taker. It is not easy. You need to take risks and move outside your comfort zone. There is a delicate balance to adding new types of work to your repertoire and balancing opportunity costs (time) to obtain the competency and limit liability. In the future, I can see us expanding into business valuations, which is another very in-demand market segment.

As an organization and individually, we must continuously grow and evolve with technological changes. We must be aware of what the market wants from us, and equally important, the gaps in the market that AIC can fill. One thing is certainly true: if you stand still for too long, you will always be a price taker. If you take some small risks to educate yourself, ask questions and get mentorship, you can begin the path to become a price setter. The latter of which should be the ultimate goal of any professional.