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Rules of thumb don't measure up!

"Rules of thumb" are somewhere between a mathematical computation and a guess.

"The use of a 'rule of thumb' when valuing one's property or business," says Anthony F. Mollica, MAI, ASA, "can lead to erroneous conclusions."

Most industries and professions have their own parlance and parameters which are used as a starting point to estimate value. These parameters or "rules of thumb" are the most generally used formulas for the valuation of real estate or business. The "Rules" appeal to many because of their simplicity and also because they can be repeated with authority.

When investments or businesses become the topic at business luncheons or cocktail parties, everyone wants to be an "expert." Thus, repeating formulas such as "so and so" sold his property for so many dollars per square feet or "so and so" sold their business at three times book value makes the speaker seem like an expert, but can lead the listener into taking the "rules of thumb" as gospel.

The applications of "rules of thumb" when valuing real estate or businesses do not take into consideration the location or the trends in the area of the property or business. Further, they do not consider the age or condition of the assets. A property could be rented below the market rate (rentals) in the neighborhood; therefore a "rule of

thumb" would not properly reflect its value. On the other hand, a property could also be rented at market rates but may be in need of major repairs which would have an impact on its value that would not be reflected by a "rule of thumb."

A qualified real estate or business appraiser will analyze each aspect of the property or the business before giving an opinion of value or preparing an appraisal.

The Uniform Standards of Professional Appraisal Practice of the Appraisal Foundation dictates that an appraiser consider the three traditional approaches to value: the cost approach, the sales comparison (market approach) and the income approach. If these approaches are not considered, a detailed explanation should be presented as to why they were omitted.

The Sales Comparison (market approach) is based upon a comparison of prices paid for similar properties or businesses that have sold in the recent past. The Income Approach involves an analysis of the net operating income potential and an appropriate rate of capitalization. The Cost Approach is the appraisal procedure which estimates the reproduction costs new of a property or a business' assets and deducts accrued depreciation

All of the value approaches are market driven. That is, they are based upon the activities of typical buyers/sellers/owners/lessees or lessors in the marketplace.

Before hiring an appraiser for a real estate or a business valuation, ask for their qualifications and recommendations from attorneys, bankers, brokers, or investors. The details of an appraiser's background, including their professional designations and education, should be carefully examined and an inquiry made as to the experience the appraiser has in the type of appraisal you require.

State Certification for appraisers requires considerably less education and experience than the qualifications for most professional designations. A consumer should seek full-time appraisers with "earned" professional designations. Personal interviews and a review of sample appraisals can give a consumer a better level of confidence. Fees for appraisal services tend to vary; however, most qualified appraisers charge in the same general price category.

When you need a business, real estate, or any other kind of appraisal, it is wise to shop first for a qualified appraiser and second for a competitive fee. *Beware of the lowest bidder and the minimum requirements as that kind of an appraisal may not be a bargain. An inaccurate appraisal is always "expensive" and,*

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