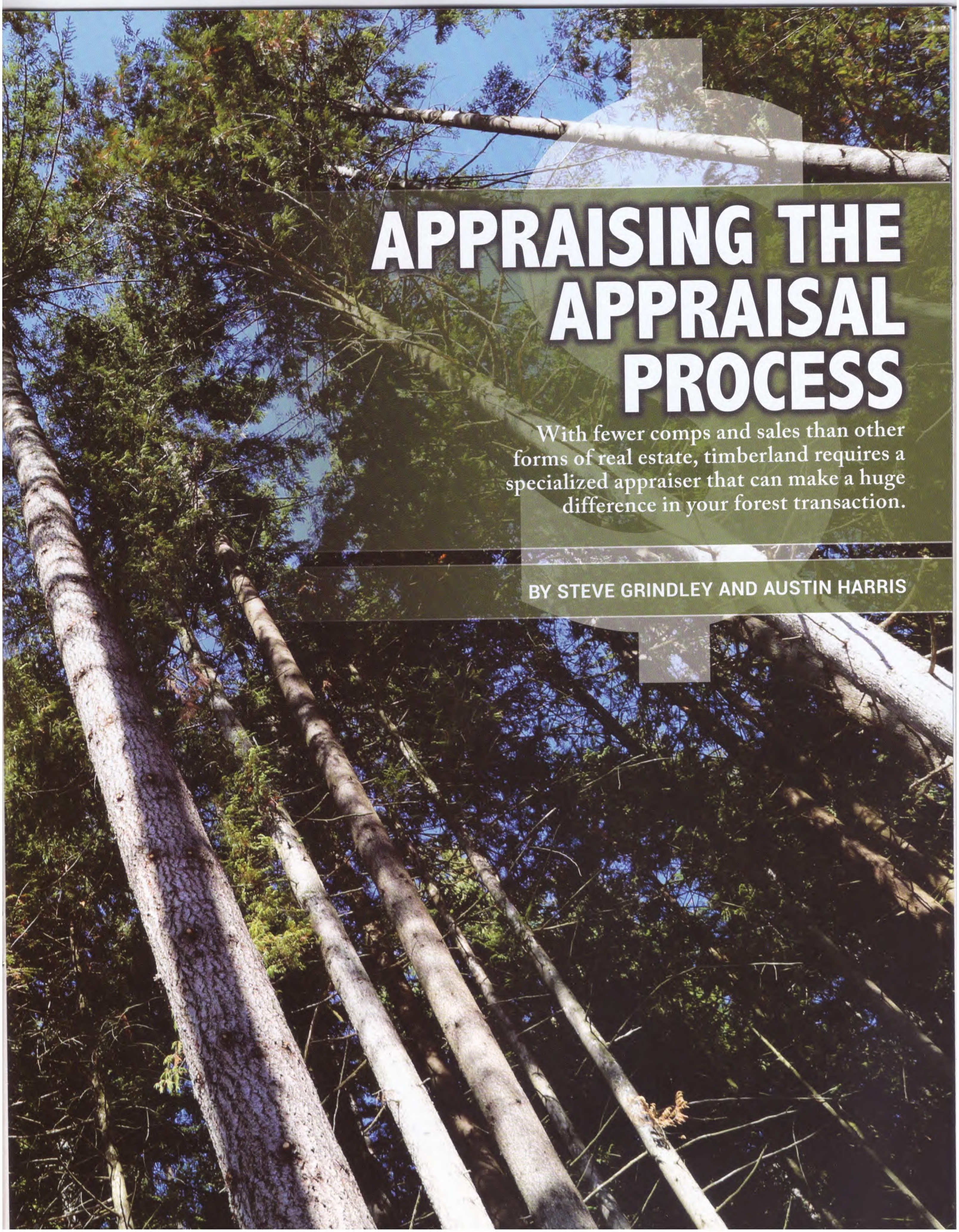

APPRAISING THE APPRAISAL PROCESS

With fewer comps and sales than other forms of real estate, timberland requires a specialized appraiser that can make a huge difference in your forest transaction.

BY STEVE GRINDLEY AND AUSTIN HARRIS

If you own timberland, or any other type of rural real estate, you likely have dealt with an appraiser to determine the value of your property while buying, selling, or estate planning.

Despite a common misconception, these professionals are not there to slow down the process or to disrupt a potential land purchase. Instead, they provide impartial and unbiased valuations designed to ensure trust in financial transactions. An appraisal report can be intimidating and forest landowners often are bewildered with the effort, requirements and the basics of appraisal practice.

In order to better understand the process, let's examine what an appraisal is and the three approaches of valuation; the difference between a timber valuation and a timberland appraisal; the background on the qualifications of appraisers (including typical credentials); why appraisals might be necessary, how much they cost, and finally, how to locate and engage an appraiser.

THE APPRAISAL PROCESS

An appraisal can be defined as the act of judging the value, condition, or importance of something. The appraisal process is the same for all types of property. The process begins by determining the property to be appraised and the scope necessary to develop credible results. Scope refers to the type and extent of research and analysis that will be needed. Next the appraiser will determine highest and best use (H&BU) for the property and begin the research phase of the assignment. H&BU can be defined as a reasonable, well-supported use that supports the highest value for the property. For example, farmland might have a H&BU for commercial development, depending on location.

The appraiser will use one or more approaches to determine value: sales comparison, cost, or income. Each method has strengths related to various types of properties; one might be better suited than the others in determining value, but performing

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the other two might support the results from the first approach, or render one of the three approaches less meaningful. As a final step in this process the strengths and weaknesses of each approach are reconciled and assessed for validity in forming an opinion of value.

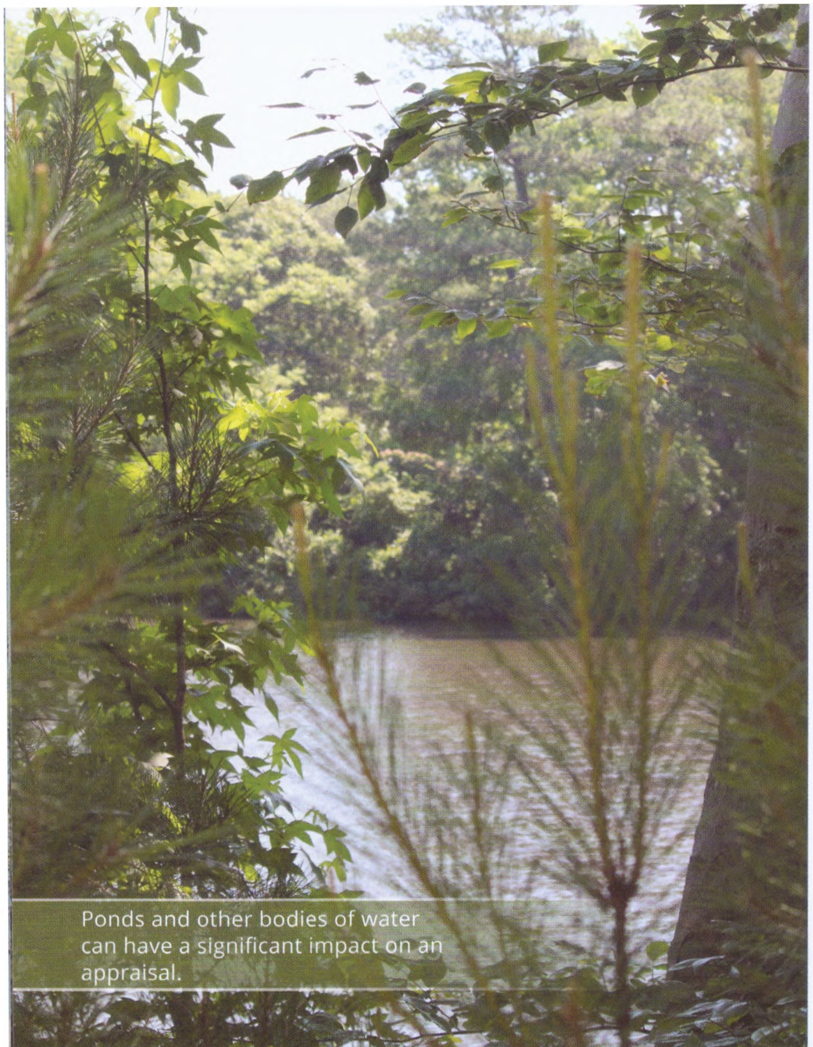
Of the three approaches, the sales comparison approach is most commonly used for timberland tracts and is based on local land sales from the nearby subject area. The appraiser will search local courthouse records, sales listing services, and other sales databases for comparable sales that are similar to the subject property.

Aspects that make sales comparable might include location, road frontage, size, utility, soil quality/site indices, proximity to city centers and recreational improvements. Once comparable sales have been selected, the appraiser typically analyzes the sales to break them down to bare land value and any contributory value of improvements and timber.

The subject property and the comparable sales are then examined. First, the necessary adjustments for differences between the subject and the comparable sales are identified (i.e. rights conveyed, financing, condition of sale, etc.). Qualitative or subjective adjustments might be necessary to make the sales comparable, depending on the properties characteristics. Finally, after considering relative strengths and weaknesses of the comparable sales, the appraiser typically reconciles the various adjusted values into a single value for the subject.

The cost approach is similar to the sales comparison approach and uses the process of extraction to determine the separate contributory values associated with land, timber and improvements of a comparable sale.

Simply put, the extracted value of bare forestland would be total value less the contributory value of timber and any other



Ponds and other bodies of water can have a significant impact on an appraisal.

improvements. In this approach timber value is fairly easy to determine as current stumpage prices (from sources such as Timber Mart-South) times the standing timber volume. Improvements are valued using a replacement cost approach that places value as the cost of completely reconstructing the asset from the ground up, less any depreciation. These values, land, timber and improvements, are combined to form a total property value opinion.

The third method, the income approach, is based on the cash flow or income generated by the property over time. It uses a process financial people call discounted cash flow (DCF), which is a fancy way of saying all the cash generated is brought to today's value at some specified interest rate.

DCF analysis tends to work best with large acreage timberland investment properties that generate regular income over time, but smaller recreational tracts can be valued based on cash rental income and estimated timber value growth. Cash rental scenarios determine a revenue stream from hunting leases, estimated timber growth, and other leasing opportunities associated with the property and apply an interest rate in order to make a value determination.

If two or more of the approaches are used, the appraiser will weigh the strengths and weaknesses from each approach to determine which is most applicable, and then provide an opinion of value. Depending on the reliability of the information in each of the approaches, the appraiser might place equal weight on the results of each approach, or might favor one over another.

Regardless of which approach or combination is employed, the reconciled value is an expression of the entire appraisal process, with the appraiser applying knowledge and judgment in reporting an opinion of value. Generally, a single dollar figure is expressed, but nothing precludes the appraiser from indicating a range of values.

Landowners and appraisers don't always agree on value, but the appraiser is there to report an unbiased opinion of value based on recent land transactions, timber sales, and market research. With federally regulated purchase transactions, landowners have limited options to discuss value concerns with the appraiser, as the lending institution will typically be the client and intended user. However, in other situations, such as estate planning, the landowner will likely be the client and intended user, and will have the opportunity to discuss concerns over value directly with the appraiser.

TIMBER CRUISES, CREDENTIALS AND COSTS

Timber cruises or valuations are sometimes referred to as a timberland appraisal but they are not technically an appraisal. They are merely an estimate of timber value and do not incorporate a scope of work, H&BU determination, the three approaches to value, or a reconciled value. However, appraisals can and should include the timber inventory and resulting valuation, and the forest landowner should provide the appraiser with any current timber cruise or existing management plans developed by a forester. For landowners that do not employ a forester, some timberland appraisers also are foresters and might be able to provide the timber inventory as well as the appraisal itself.

Timberland appraisers tend to be forestry professionals with years of in-woods experience and training. Many of these foresters have professional affiliations, such as the Society of American Foresters and/or the Association of Consulting Foresters, or hold a Certified Forester (C.F.) designation and/or a state license or registration (R.F.) in conjunction with their appraisal credentials. A majority of these professionals have at a minimum, a combined 10 to 15 years of appraisal and forestry training, and extensive knowledge in both disciplines.

Forest landowners should seriously evaluate the credentials of any appraiser. The savings and loan scandal of the early 1980s made it clear that use of poorly credentialed appraisers can lead to problems with financial transactions. As a result of that scandal, Congress passed the Financial Institutions Reform and Recovery Act of 1989 that strengthened educational and experience requirements for appraisers and established higher appraisal standards.

For most real estate transactions that involve loans from federally insured banks an appraisal is required and must be performed by licensed appraisers who have the proper credentials.

Three credential levels are generally recognized: licensed, certified residential, and certified general appraiser. The size or value of the transaction determines the type of credential required. For example, timberland appraisers have the highest credential level and can perform appraisals regardless of transaction amount, but a licensed appraiser could not perform an appraisal for a timberland property where the transaction value exceeds $250,000, nor would it be in your best interest for a licensed appraiser to perform a timberland appraisal in the first place.

As a landowner, it is important to realize that situations outside of the federal requirements might still need an appraisal. Appraisals can be valuable in buying and selling land even when a loan is not involved and are especially useful in establishing a value for estate planning. Land acquisition is by far the most common reason for appraisals. Outside of getting a good interest rate, buyers typically fight to reduce fees, often including the appraisal fee.

It is important to recognize the fee, as it relates to the purchase price of the property, is typically minimal. For example, on a property purchase of $250,000, the appraisal fee could be as much as $1,500, but in terms of percentage, it is 0.6 percent of the total purchase price. This is a small sum to pay to avoid overpaying for the property, or to determine that you have found a property with instant equity.

On the other hand, if you are in the market to sell, an appraisal prior to listing can help generate a listing price and ultimately determine if you are receiving fair market value for your investment. Many landowners choose to transfer their property as a whole or in parts to their family as part of the gifting process, and like to know that all of the gift and inheritance tax benefits are consumed based upon the appraised value. Appraisals also can be useful following unfortunate events such as wild fires or bug infestations, when they are covered by insurance. Having the appraised value prior to the loss could assist in filing claims with your insurance.

HOW TO LOCATE AND ENGAGE AN APPRAISER

Forest landowners often face challenges in identifying an appraiser capable of assisting with their valuation needs. It's easy to search the Internet to locate appraisers, but often it is most effective to get referrals from fellow landowners.

Organizations such as Society of American Foresters, Association of Consulting Foresters, and Society of Farm Managers and Rural Appraisers all have local chapters throughout the United States, and in addition to offering local expertise relating to timberland, they can assist in finding the ideal timberland appraiser for you. Your local and state forestry offices are excellent sources as well. Most of the larger forestry-consulting firms offer appraisal services and have the most qualified timberland appraisers.

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Appraisers provide a service that many forest landowners have a hard time understanding. The reason is that most private landowners are involved in land transactions infrequently, so interactions between the two are minimal. However, when these transactions do occur, large sums of money are involved, and the forest landowner often is not the person in the room with the most information.

If you have hired an appraiser, you have a client relationship with that appraiser as a forest landowner. The appraiser attempts to ensure the forest landowner has the most accurate information as it relates to values, recent market transactions, and any other information which could be pertinent to the pending land transaction.

A forest landowner can save the cost of an appraisal by having better information to negotiate with, or information to prevent them from making a serious mistake by overpaying for a tract of land.

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