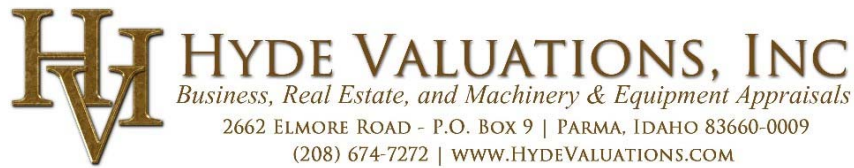




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## **Hypothetical & Extraordinary Assumptions**

The user of an appraisal report must be careful when relying upon an appraisal that is based upon a condition or assumption that may invalidate the opinion of value for the appraisal purpose required.

Occasionally, there is a need to value a business entity or piece of real estate using facts contrary to what are known to exist, i.e. a hypothetical appraisal. There are many reasons why this might be necessary or desirable. Some of these reasons include the following:

- Appraisal of a gas station with known soil contamination “as if” not contaminated in order to evaluate potential options
- Appraisal of land “as if” built out with various types of improvements to determine its highest and best use
- Valuations and fairness opinions for pending merger and financing transactions
- Appraisals of potential capital investments (such as a new manufacturing facility)
- Feasibility studies of Employee Stock Ownership Plans (ESOPs)
- Discount studies for pass-through entities (such as family limited partnerships)
- Appraisal of a business assuming a return to the boom conditions in 2006

A Hypothetical Condition is defined by the 2018-2019 edition of the *Uniform Standards of Professional Appraisal Practice* (USPAP) as “a condition, directly related to a specific assignment, which is contrary to what is known by the appraiser to exist on the effective date of the assignment results, but is used for the purpose of analysis.” USPAP goes on to comment that “hypothetical conditions are contrary to known facts about physical, legal, or economic characteristics of the subject property; or about conditions external to the property, such as market conditions or trends; or about the integrity of data used in an analysis.”

A similar sounding condition, yet a very different situation, is an Extraordinary Assumption. An Extraordinary Assumption is defined by the 2018-2019 edition of the *Uniform Standards of Professional Appraisal Practice* (USPAP) as “an assignment-specific assumption as of the effective date regarding uncertain information used in an analysis which, if found to be false, could alter the appraiser’s opinions or conclusions.” USPAP goes on to comment that “Uncertain information might include physical, legal, or economic characteristics of the subject property; or conditions external to the property, such as market conditions or trends; or the integrity of data used in an analysis.”

A few examples of Extraordinary Assumptions are:

- Valuation of a gas station with the Extraordinary Assumption that no soil contamination exists; i.e. none is known to exist, however if the property were found to be contaminated, it would change the opinion of value.
- Valuation of a shopping center using proposed leases with the Extraordinary Assumption that the leases will actually be executed.

- Valuation of a proposed office building with the Extraordinary Assumption that the building will be constructed according to the plans and specifications provided to the appraiser.

To make things even more confusing, appraisers typically include in each appraisal a list of “standard” assumptions and limiting conditions. Here are a few examples:

- The sources of information used to prepare this report, its estimates, forecasts, and projections, including those given to us by the company and others associated with the company, are considered to be reliable but cannot be guaranteed to be accurate. Information supplied us, including financial statements and information relating to adjustments to financial statements has not been audited or verified for accuracy.
- This valuation is valid only for the valuation date specified herein and only for the valuation purpose and use specified herein. No other purpose is intended or should be inferred. It is not to be used or relied upon for any other purpose. No events subsequent to the effective date of appraisal have been taken into consideration except as noted in the report.
- Title is assumed to be good and marketable. We have not investigated titles to assets or searched for liens against assets.

The user of an appraisal report needs to pay particular attention to the assumptions and conditions upon which the opinion of value expressed in the report is based as they may affect the proposed use of the appraisal or present an opinion of value which is not useful in helping with the problem for which the appraisal was prepared. This is particularly true when an appraisal is used later on for a purpose and use not contemplated when the appraisal was prepared and not specified in the appraisal report.

Valuations play a part in all strategic transactions, tax, and many litigation matters. For additional information or advice on a current situation, please do not hesitate to call. **We value real estate, businesses, and personal property including livestock and machinery & equipment.**



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