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Conceptualising the Influence of Clients on Valuations

Deborah Susan Levy

A thesis submitted in fulfilment of the requirements for the degree of
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Abstract

The review of property-related literature pertaining to valuer behaviour, valuation bias and smoothing all indicate that there are many behavioural issues that may affect valuation outcomes. Evidence suggests that heuristics may be one explanation for such phenomena, but a growing literature suggests that the role of the client within the valuation should also be considered.

The main aim of this study therefore is to construct a framework of client influence in order to achieve an in-depth understanding of the commercial valuation process and the role played by the client within this process. Previous research in the area of behavioural property research has been undertaken utilising a quantitative research approach, however by introducing a qualitative approach a richer and more in-depth understanding of the topic was achieved.

The research question addressed in this study was established as “How do clients influence valuation outcomes?”. Constructionism identified the underlying assumption about reality governing the research; based on the premise that different people construct meaning in different ways in relation to the same phenomena. The theoretical perspective was determined to be interpretivism which was guided by the study’s goal of assessing the nature of reality for both valuers and clients regarding the valuation process.

The research process consisted of four stages, the first being the literature review and the construction of a preliminary framework of client influence. The second stage incorporated one-to-one interviews with valuers and the compilation of an updated framework. Stage 3 consisted of one-to-one interviews with clients and the compilation of a revised framework; and Stage 4 collected feedback from a number of experienced valuers and sophisticated clients in order to enhance the trustworthiness of the findings.

The framework of client influence highlights eight main factors with the potential to affect the type and amount of client influence and power over the valuation process. These are described as the type of client; external pressures; valuer traits; the type of client valuer relationship; the characteristics of the valuation firm; the valuation process; the purpose of the valuation and finally technical valuation. In addition to the formulation of a framework of client influence the results provide a comprehensive understanding of the valuation process and specifically the incentives, power and opportunities clients have to influence valuations.

The results of the study suggest that there are a number of specific influences not previously documented in the property literature that appear to have the potential to affect valuation outcomes and the valuations that are ultimately reported to stakeholders. In particular the strong influence the client has over the whole valuation process was uncovered. The main findings of the research suggest that clients possess not only the incentives and the ability to influence valuation outcomes, but the valuation process itself is largely governed by the client and provides opportunities for them to exert their power over the valuer. This influence does not only exist within the formal valuation process, but informally before the valuation has been commissioned.

The study concludes by identifying scholarly contributions and contributions to the property profession. These suggest that the knowledge gained from the research can assist the property profession in understanding the role of both client and valuer in the valuation process and the tension that may exist between valuer independence and customer satisfaction. This knowledge can be used to effectively educate both valuers and clients of their roles in the valuation process together with areas where a valuer may be potentially vulnerable to undue influence.
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I am very aware that without the support of mentors, colleagues, family and friends that finishing this thesis would have been impossible. I would like to acknowledge three academics who have been instrumental in inspiring and assisting me through the research process. Firstly, Dr Gerald Brown who encouraged me in his roles of supervisor and friend until only a week before he passed away. His dedication to academia and faith in me kept me going through all those dark early mornings. Secondly, my supervisor and friend Dr Christina Lee who has guided me so proficiently with wisdom, a sense of humour and most of all patience. Thirdly my co-supervisor Professor Alastair Adair who gave of his time and helped to steer me through to completion with realistic expectations and support.

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CHAPTER 1 INTRODUCTION

1.0 BACKGROUND TO RESEARCH

Estimates of the market values of real properties are obtained frequently by commissioning the services of a professional valuer. Information on the market values of assets is required for financing and investment decisions and the measurement of historic investment performance. In capital markets, the market values of securities may be imputed quickly and easily from the prices at which identical assets trade in active secondary markets in which transaction prices are easily observed. In contrast, the procurement of market values for real property assets is much more difficult to ascertain. This is due to the heterogeneity of properties, the infrequency with which they are traded, the difficulty in observing transaction prices and the high proportion of private information that is relevant to the pricing of properties. These complexities create opportunities for the commercial provision of market valuation services. These opportunities arise as a result of the ability of parties to develop competitive advantages in the areas of information gathering, the interpretation of market value data and valuation technology.

A natural issue of concern in this context is the degree to which valuations are accurate and unbiased estimates of a property's unobservable 'true' market value. Anecdotal and survey evidence suggest that industry practitioners believe valuations contain random error and lag true market values. They also believe changes in valuations are generally understated (biased toward zero), with the consequence that time series of capital returns exhibit volatility that is 'smoothed' in comparison to that of true returns. The serial correlation observable in time series of empirical returns is frequently cited as further evidence of this phenomenon. There is a growing weight of literature that indicates valuations are not accurate estimates of market value as they contain random and systematic error. Crosby, Lavers and Murdoch (1998), demonstrate a two in three chance of valuers reporting values within 10% of each other and Brown, Matysiak and Shepherd (1998) conclude a one in five chance of valuers getting within 10% of the sale price of an individual asset.

Valuation smoothing and lagging have been alleged to result from valuers not documenting all price movements identified by the market. Quan and Quigley (1991) propose that valuers may attribute less than full weight to more current market information given a market characterised by price dispersion. Blundell and Ward's study (1999) suggests that valuations fall behind prices by about 3% when markets are rising. Studies in the UK, US and Australia conclude that valuations are higher than prices when markets are falling and lower than prices when markets are rising (Matysiak and Wang, 1995; Webb, 1994; Newell and Kishore, 1998).

Theoretical research concerning the issue of valuation bias has been primarily concerned with identifying sources of bias and quantifying their effects with the aim of developing models that can be
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used to unsmooth returns. Attention in this context has been based on methods of return calculation and index construction, and the methods used by valuers to estimate values.

With respect to valuation methodology, research has generally sought to model the valuation exercise as a black box process, where valuers combine a previous estimate of value with signals (hedonic process of property characteristics) extracted from transaction data in order to estimate the market value of a particular property. Geltner (1998) suggests that the placing of weight on a previous valuation may be the result of a valuer's lack of confidence in what may be an accurate estimate of value. The lack of confidence may therefore induce the valuer to turn to the last valuation that was accepted by the portfolio manager.

Quan and Quigley (1991) advance a counter argument that the placing of weight on a previous estimate of value is consistent with optimal practice in the face of poor information. In a world of noisy transaction data, a rational valuer’s best estimate of a property’s current market value \( P_t \) is a weighted average of a previous forecast of \( P_t \) at a time \( t - 1 \), a previous valuation and new transaction data.

This and subsequent research tend to take a normative view of the valuation process, which can be graphically depicted as a signal processing system (Figure 1.1). The valuer’s task involves the filtration and interpretation of property market information (including a property’s previous valuation) to produce an estimate of value. The transfer function that characterises the process within the black box assumes that valuers act rationally and (for the most part) objectively in their interpretation of this information.

FIGURE 1.1. THE NORMATIVE MODEL

![Diagram of the Normative Model](Source: Levy and Schuck (1999))

Many authors have explored the theory of valuation bias from a methodological perspective, but most of the work is based on anecdotal evidence and speculation. None has fully explained the phenomenon, leaving the debate unresolved (Geltner, 1998).
In the late 1980s, a desire to develop a more in-depth understanding of the valuation process led to some important work being carried out into the behavioural aspects of valuation. This perspective recognises that valuers are neither entirely objective nor completely rational and have a need for cognitive efficiency to overcome natural processing limitations (Diaz, 2002), (for example Gallimore, 1994; Diaz, 1990; Diaz and Wolverton, 1998; Diaz, 1997; Diaz and Hansz, 2001; Diaz, Gallimore and Levy, 2002; Diaz, Gallimore and Levy, 2004; Hansz and Diaz, 2001; Gallimore and Wolverton, 2000). (Chapter 2 provides a more in-depth discussion). Research in this area seeks to develop a fundamental understanding of the process through experiments and reference to the psychology literature. Issues include the effect of prior valuations in familiar and unfamiliar geographical areas, valuers' use of heuristics, prior knowledge and experience, and the selection of comparables.

An important contribution of these studies has been to highlight implicitly the role that certain factors and information play in determining the specification of the transfer function. These manifest themselves as a control signal that affects the parameters of the transfer function, or even the form of the function itself (Figure 1.2).

### FIGURE 1.2 THE DESCRIPTIVE MODEL

![Diagram](Image)

Source: Levy and Schuck (1999)

A shortcoming of these two lines of research is their failure to recognise sufficiently the true complexity of the valuation process: specifically, reference to the roles played by other parties and the potential for their influence to act as a source of bias. There are therefore many opportunities for research in this area of potential bias which have been identified explicitly in the smoothing literature, (for example Cole, 1988; Ibbotson and Siegel, 1984; Geltner 1989a and 1989b; Diaz and Wolverton, 1998; Clayton, Geltner and Hamilton, 2001, discussed in more detail in Section 2.3)
Conceptualising the Influence of Clients on Valuations

Placing the practice of valuation in its commercial context facilitates the identification of potential sources of bias. The roles of interested parties and the flows of information and compensation are illustrated in Figure 1.3 as set out in Levy and Schuck (1999). Valuations are an output of a service offered to clients on a contractual basis and it is frequently the case that this is done in order to obtain independent opinions of value for the consumption of third parties as lenders or shareholders.

FIGURE 1.3. VALUATION WITHIN THE COMMERCIAL ENVIRONMENT

Fletcher and Diskin (1994) note that clients and stakeholders enjoy an agency relationship in which conflicts of interest can arise due to an incongruence of objectives. Clients have economic incentives to influence valuations in order to maximise asset-based fees or loan-to-value ratios. These conflict with the desire of stakeholders for accurate and objective valuations.

Furthermore, valuers themselves face economic incentives to act in ways that conflict with the interest of stakeholders. Although valuers face obligations to provide independent and informed opinions of value, they are also interested in satisfying their client in order to avoid conflict over fees and enhance the probability of repeat business. As a result, clients and/or valuers are in many cases motivated to influence the outcome of a valuation to the potential detriment of a stakeholder. This may be done intentionally or unintentionally, implicitly or explicitly.

The potential for client-related bias is demonstrated by the valuation industry's concern for its mitigation. This manifests itself in codes of practices globally. For example, Article 1.7b of The Code of Ethics of the New Zealand Institute of Valuers (NZIV) (as amended in April 1996) states that:

"A member must maintain the strictest independence and impartiality in the performance of the member's professional duties. To this end no member shall
allow the performance of that member's professional duties to be **improperly influenced by the preferences of clients or others as to the result of their professional work;**” (emphasis added).

Investigation of client influences is warranted not only on account of their potential to affect the "involved parties", but as Kinnard, Lenk and Wozala (1997) observe, client pressure and its effect on valuer independence also has wider implications for the credibility of reported values of listed companies and ultimately confidence in related capital markets.

The topic of client influence has been researched before, but this study adds to the body of literature by examining the subject holistically both through the eyes of the client and also the valuer. The majority of the studies that have been carried out to date have focused on specific issues or scenarios using anecdotal evidence or quantitative methodology (see for example Wozala, Lenk and Kinnard, 1998; Kinnard et al., 1997; Roberts and Roberts, 1991; Smolen and Hambleton, 1997; Rushmore, 1993; Gallimore and Wolverton, 1997; Gallimore and Wolverton, 2000; Hansz and Diaz, 2001).

This study demonstrates that by constructing a holistic framework of client influence many of the shortcomings of previous research in the area may be overcome. The utilisation of a qualitative methodology has permitted an in-depth understanding of the commercial valuation process and the effect of client influence.

The aim of this study, therefore, is to add to the body of literature by providing an in-depth understanding of client influence. In order to achieve this aim and to assist in building theory this study sets out to construct a theoretical framework of client influence. The construction of such a framework seeks to allow an in-depth understanding of the valuation process and the potential influence of clients.

Chapter 1 sets the scene for the study and explores the contribution of the research to the property discipline. It is structured in the following way:

**Section 1.1** sets out the research aim, the question guiding the research and objectives of the study

**Section 1.2** sets out the research design

**Section 1.3** identifies the scholarly and professional contributions of the study

**Section 1.4** discusses the limitations of the study, and
Section 1.5 sets out the outline of the thesis

1.1 AIM AND OBJECTIVES

1.1.1 Research aim and question

It is important at this stage to emphasise that this study is not designed to produce outputs that are generalisable to the population of valuers and clients. The intention of the research is to build theory in order to achieve an in-depth understanding of the valuation process and the role of client influence. A major output of this study therefore is to help valuers and clients to understand the influence of the client in the valuation process and to provide researchers with a conceptual framework for future systematic investigation. To assist in theory building, a theoretical framework of client influence was constructed. This deeper understanding was permitted from an interpretation of data by way of transcripts taken from interviews with experienced valuers and clients.

Due to the breadth of understanding required from this study a hypothesis was not formulated. It was considered that a hypothesis would limit the ability of the research process to uncover all factors affecting client influence within the valuation process. As an alternative to the hypothesis a research question was derived to guide the research. The research question describes the specific query to be addressed, sets the parameters of the project and suggests the methods to be used for data gathering and analysis (Strauss and Corbin, 1998). A full explanation of this approach can be found in Chapter 4. The research question guiding this study is as follows:

“How do clients influence valuation outcomes?”

To assist in answering the research question a number of research objectives were identified, these are considered in the following section.

1.1.2 Research objectives

The research objectives identified by the researcher to assist in fulfilling the research questions are set out below:

i. To critically review the relevant behavioural real estate and valuation literature relating to influence and valuation outcomes.

ii. To examine the relevant auditing and marketing literature relating to “influence”.

iii. To compile a framework affecting client influence from reviewed literature.

iv. To assess the perception of valuers and clients as to the influence of clients in valuation outcomes.

v. To produce a theoretical framework synthesising the effects of influence on the outcome of reported values.
vi. To evaluate the implications of client influence on the workings of the commercial property market.

The following section outlines the research process followed in the study. An in-depth analysis of this design is provided in Chapter 4.

1.2 RESEARCH DESIGN

The choice of research design was guided by two main elements. Firstly, the research question as set out above and secondly, by the overall aim of the study to construct a theoretical framework of client influence. In order to justify the most effective design, the underlying epistemology and theoretical perspective were determined. Constructionism was identified as the epistemology which best described the underlying assumption about reality. Constructionism is based on the premise that different people construct meaning in different ways even in relation to the same phenomena. In addition to this, the theoretical perspective as guided by the research question was identified as interpretivism. This incorporated the study's goal of assessing the nature of reality for both valuers and clients regarding the valuation process. The interpretivist approach frees the researcher from the positivist approach (assumed in the majority of property research, Levy and Henry, 2003). This view holds that the world is external and objective and that observers are independent and that science is value free. It allows the research to focus on what is happening in a given context (Carson, Gilmore, Perry and Gronhaug, 2001). By embracing these concepts it is clear that the study does not intend to test but to build theory.

Taking into consideration the research's focus to achieve substantive meaning and an in-depth understanding as to how and why valuation outcomes may be influenced by clients during the valuation process a qualitative research methodology was chosen. In identifying this methodology, consideration was given to the previous limitations relating to client influence research. Within the qualitative methodology a grounded theory approach as promoted by Strauss and Corbin (1998) was utilised which acknowledges the importance of prior knowledge of published literature in the development of theory.

One-to-one interviews were identified as the most effective research method as they permitted the observation of the respondents and listening to what they had to say. Elements of case research were also incorporated into the design to assist in the systematic interpretation of the transcripts. An analysis of the themes emerging from these transcripts provided a rich source of data which enabled the construction of a framework of client influence.

The research process followed by the study is described in detail in Chapter 4 and consists of 4 distinct stages. A summary of these stages follow:
1.2.1 Stage 1 of the research process

In Stage 1, property-related literature that could shed light on the topic of client influence was reviewed. This was followed by a review of a number of academic studies in non-related areas such as professional services marketing, organisational decision making, family decision making and auditing. This research identified a number of useful factors which helped to determine pertinent issues to guide the research study (Bonoma, 1985; Hague, 1992; Miles and Huberman, 1994; Yin, 1989). The outcome of this Stage was the formulation of an initial conceptual framework reflecting client influence which can be found in Chapter 5, Figure 5.1.

From an examination of the initial framework it was clear that, to answer the research question, interviews with both clients and valuers should be undertaken. These interviews were undertaken in two stages: Stage 2 comprised the collection and interpretation of data from valuer interviews and Stage 3 the collection and interpretation of data from client interviews.

1.2.2 Stages 2 and 3 of the research process

Semi-structured, in-depth, one-to-one interviews were identified as the preferred method of collecting data. This method helped to create a climate whereby interviewees were able to speak openly and frankly, and the interviewer was also able to explore different areas with a large degree of freedom. The use of one-to-one interviews in situations of sensitive subject matter and complex decision-making concurs with the recommendations of Anastas (1988). Prior investigation indicated that valuers and clients would not be prepared to talk as freely within a focus group environment. Several other advantages of one-to-one interviews include the encouragement of personal thought, maintenance and attentiveness of respondents' questions and the interviewer's consequent ability to sense non-verbal feedback (Sokolow, 1985).

In-depth interviews with five experienced commercial valuers made up Stage 2 of the research process. Each of these interviews was audio taped and the transcripts interpreted. The results from this analysis assisted in identifying issues to be included in the second set of interviews with clients.

Stage 3 consisted of in-depth interviews with seven senior property executives (with at least 10 years experience) employed by institutional property investors. Each interviewee was personally responsible for commissioning valuations on a regular basis. These interviews were also audio taped, transcribed and the data interpreted to identify emerging themes. The themes from the two sets of interviews formed the basis of a revised framework of client influence. An in-depth discussion on these interviews can be found in Chapters 4, 6 and 7.
1.2.3 Stage 4 of the research process

In order to confirm the trustworthiness of the findings, three valuers and three clients were interviewed and feedback was collected relating to their perceptions of the revised framework. This feedback is discussed in Chapter 8. The next section briefly outlines the contributions of the research to the academic literature.

1.3 CONTRIBUTIONS OF THE RESEARCH

As highlighted in the previous sections, two fundamental contributions have been made to the academic literature. The first of these is the formulation of a conceptual framework of client influence. Secondly, the study demonstrates the usefulness of a qualitative methodology to property-related research and the ability in attain an in-depth understanding of the behaviour of participants in the valuation process.

In addition to these two general contributions the output of the study specifically makes a number of academic and professional contributions which are outlined in the following sections.

1.3.1 Scholarly contributions

This research makes a scholarly contribution by addressing the gap in the behavioural property literature. Despite anecdotal evidence indicating that the client has an impact on reported values of properties there has been little empirical research on the joint decision-making process and the influence of clients on valuation outcomes. Past empirical research has tended to take a quantitative approach and thus has been unable to reflect the complex nature of the client-valuer relationship and the joint decision-making process surrounding a valuation. This research gives insight by specifically looking at the incentives, the ability and the opportunities clients have to influence valuation outcomes. In addition, the formulation of a framework of client influence provides the opportunity for further systematic expansion to alternative markets.

1.3.2 Professional contributions

There are many stakeholder groups which have an interest in the valuation process and the client valuer relationship. Interested parties include professional bodies, educators, valuers, clients, financiers, investors, purchasers and vendors.

The concept of independent professional valuations is perceived as fundamental to the efficient working of the commercial property environment. By understanding the pressures that valuers, as professional service providers, may be placed under, advocates of professional practice such as professional bodies are in a better position to develop and enforce rules of ethical conduct and pro vide
relevant and effective guidelines for their members by educating them to recognise and resist inappropriate influences.

Educators of valuers and other property professionals will benefit from an enhanced body of knowledge in the field of valuer behaviour, the valuation process and more specifically the client/valuer relationship.

"Before valuation improvement can be engineered, valuation behaviour must be understood. The aim of behavioural studies into valuation therefore understand actual valuer problem solving (descriptive research) and thereby provide a solid basis for offering the community of practicing valuers' methods of improvement."

(Diaz, 2002).

It should be noted, however, that although the study has succeeded in making a number of important academic and managerial contributions, the research is limited in a number of ways and these are outlined in the following section.

1.4 LIMITATIONS

The underlying interpretivist theoretical perspective of the study is limited to the perceptions of experienced senior valuers and property executives in the Auckland region. It is not intended to reflect the perceptions of a wider market. The clients sampled were made up of senior property executives from institutional property trusts and therefore describe only the valuation process relating to larger commercial property portfolios.

The study was also limited in geographical area. For practical and cost reasons all valuers and clients interviewed were working within commercial property in New Zealand's largest city. The results, as with other qualitative research are not intended to be directly generalisable to other geographic locations.

Another limitation to the study was the absence of information gathered from the additional participants in the valuation process. Feedback from clients and valuers highlighted the important role of the banks in the valuation process. Further research is therefore required to determine whether the revised client influence framework describes accurately the perceptions of financiers in the process. The next section provides a summary of this chapter.

1.5 SUMMARY

This opening chapter has introduced the study by outlining the background to the research and presenting the research question and the objectives required in order to fulfil the requirements of the research question. It also outlines both scholarly and managerial contributions. The chapter identified
a number of methodological issues and discussed the study's limitations. It has demonstrated that a gap exists in the academic property literature regarding client influence within the valuation process. The aim of this study is to go someway towards addressing this shortcoming by constructing a theoretical framework of client influence.

Taking into account the theoretical perspective and epistemology underpinning the research a qualitative methodology guided the research design. A research question was formulated and in-depth one-to-one interviews undertaken with a sample of experienced valuers and clients. Each of these interviews was transcribed and audio taped in order to identify themes and factors to be incorporated into a revised framework of client influence. Feedback was also sought on the final framework from a number of valuers and clients.

The organisation and structure of the research is set out in Figure 1.4. Within this structure is an outline of the content of each chapter. The next section gives a brief outline of the following chapters.

1.6 THESES OUTLINE

The organisation and structure of the research is set out in Figure 1.4. The topics covered in each chapter can be viewed on the right hand side of the page and the research stages and objectives on the left hand side. Outlined below is a summary of the chapter contents.

Chapter 2 reviews the property-related literature including published papers related to behavioural property research, client influence and feedback, valuation accuracy and bias and valuation smoothing.

Chapter 3 reviews a number of non-property related literatures. These include the following subject areas: concept of influence, auditor independence, joint decision making within the consumer business-to-business environments, services marketing and professional services marketing.

Chapter 4 describes the research design including epistemology, theoretical perspective methodology and research methods including data collection and analysis.

Chapter 5 describes the creation of an initial framework of factors affecting client influence in a professional services context.

Chapter 6 presents an interpretation of the data collected from the interviews with valuers. It discusses the findings and presents an updated conceptual framework of client influence.
Chapter 7 presents an interpretation of the data collected from the interviews with clients. As with Chapter 6, it then discusses the findings and presents an updated conceptual framework of client influence.

Chapter 8 contains a summary and discussion of the results, followed by an analysis of the scholarly and professional implications, limitations and suggestions for further research.
STAGES OF RESEARCH

AIMS AND OBJECTIVES
Research Question
Ho do clients influence valuation outcomes?

LITERATURE REVIEW
Theories and concepts

- Objective 1
  - To review the behavioural real estate and valuation
    literature relating to influence and valuation outcomes
  - To review literature from auditing and marketing
    relating to "influence" and decision making

RESEARCH DESIGN

ANALYSIS AND FINDINGS
Qualitative Analysis
In-depth one-to-one interviews
Client and valuer feedback

- Objective 2
  - To compile a framework of factors affecting client
    influence from extant literature

CONCLUSIONS
Conclusions from research findings
Further research

STAGES OF RESEARCH

STRUCTURE OF RESEARCH

CHAPTER 1
Introduction
Aims and objectives
Structure of the thesis

THEORETICAL AND CONTEXTUAL FRAMEWORK

CHAPTER 2
Behavioural real estate
Client influence and feedback
Valuation accuracy and bias
Valuation smoothing

CHAPTER 3
Influence
Auditor independence

CHAPTER 4
Methodological Design
Grounded Theory
One-to-one in-depth interviews
Data Collection
Valuer and client feedback

CHAPTER 5
Creation of an initial conceptual framework of client
influence

EMPIRICAL KNOWLEDGE

CHAPTER 6
Valuer interviews
Analysis and Results
Creation of an updated framework

CHAPTER 7
Client interviews
Analysis and Results
Creation of an updated framework
Feedback Interviews

CHAPTERS 8
Principal findings
Conclusions
Areas for further research

FIGURE 1.4. ORGANISATION AND STRUCTURE OF THE RESEARCH

Conceptualising the Influence of Clients on Valuations
Chapter 1 References

Anastas, M., (1988), 'For sensitive research studies, one-to-one interviews work best', Bank Marketing, 20(7), pp 18-22

Blundell, G.F. and Ward, C.W.R., (1997), The accuracy of valuations – expectations and reality (unpublished), University of Reading

Bonoma, T.V., (1985), Case research in marketing: problems and opportunities and a process", Journal of Marketing Research, XXII, pp 199-208


CHAPTER 2 LITERATURE REVIEW – PROPERTY RELATED

2.0 INTRODUCTION

The concern that exists over valuation uncertainty and valuation bias is well documented in the real estate literature. A summary of many of the issues can be found in Brown (1992 and 1997). Brown et al. (1997) state that there is approximately a 1 chance in 10 that valuations will lie within 5% of the mean. This increases to 1 chance in 5 if the range is increased to 10%. Much of the focus of the debate has involved questioning the statistical validity of interpretations of the regression equations of the valuation-price relationship (Gallimore, 1994) and identifying errors which may arise through the use of poor information, or poor valuation practice (Brown et al., 1997).

A desire to understand these issues more fully has led to recent interest into behavioural studies examining the valuation process, as opposed to concentrating solely on the valuation outputs. As part of this investigation a review of the property literature reveals a small number of studies explicitly addressing the client's influence on valuations and its relationship to valuation accuracy and bias specifically. In order to understand the context of these studies and assess the opportunities available to contribute to the body of knowledge, a number of relevant subject areas are explored. These areas cover both property specific and non property specific literature (set out in Chapters 2 and 3). The review presented in this chapter outlines the property-related literature in four main topic areas:

Section 2.1 examines behavioural property research by introducing a relatively new perspective to the study of property. This perspective proposes that economic activity constitutes human behaviour which necessitates an understanding of decision-making behaviour within a property activity.

Section 2.2 discusses specifically the literature pertaining to client influence and feedback including a discussion relating to both anecdotal and empirical observations.

Section 2.3 explores the area of valuation accuracy and variation and examines possible reasons for valuations not accurately reflecting market values.

Section 2.4 reviews the literature pertaining to valuation smoothing and lagging where appraisals used as substitutes for transaction information exhibit reduced variability.

Section 2.5 provides a summary of the property-related literature.

It was evident from examining this literature that there were only a small number of studies relating specifically to client influence on valuations. By expanding the review to include behavioural property
research a deeper understanding of the valuation process was achieved together with an appreciation of the effect external influences on valuation outcomes. More specifically, a summary of the behavioural property-related literature helps to demonstrate how decisions are made within the context of the valuation process. This understanding helps to provide a deeper appreciation of the valuation process and proves useful in recognising the client's role and influence on valuation outcomes. The review of a number of studies pertaining to valuation accuracy, variation, smoothing and lagging clearly show that valuations are not always an accurate estimate of market value. In trying to explain such a phenomenon a number of authors are looking to the valuation process, valuer behaviour and more specifically client influence. The property-related literature reviewed has thus proved invaluable in providing property-specific background material used in the formulation of the initial conceptual model of client influence as set out in Chapter 5, Figure 5.1.

In addition to literature specifically related to property a review of extant literature in a number of other subject areas relevant to the topic of client influence on valuations was also undertaken. Chapter 3 incorporates this review which is set out in the following sections:

Section 3.1 reviews the literature pertaining to auditor independence. This identifies many parallels between the appraisal and auditing industries, in particular in the areas of economic independence and ambiguity. The behavioural literature in the auditing area is more extensive than in the property area and thus provides invaluable insights into the auditing process which it is argued can be transferred to a property context.

Section 3.2 examines the concept of influence within the marketing literature (more specifically within the context of family and organisational decision making). This literature greatly assists in clearly defining the term influence as used in this study and identifies potential influence strategies available to clients in the context of the valuation process.

Section 3.3 seeks to understand decision making within the business-to-business context and provides useful insights into client influence within a commercial environment.

Section 3.4 further explores decision-making literature pertinent to the valuation process, more specifically within the context of professional services marketing. An analysis of this literature permits a fuller understanding of the unique features of services marketing and the importance of the role of the client in the delivery of such a service.

Section 3.5 provides a summary of the non-property related literature.

In summary, in order to gain a deeper understanding of the decision-making process relating to client influence and valuations together with an appreciation of the implications of such behaviour a review
was undertaken relating to both relevant property-related and non-property related literature. The information gained from this review was invaluable in providing background material used in the formulation of an initial conceptual model of client influence as set out in Figure 5.1. It must be emphasised at this time, that there are many other literatures capable of assisting in further understanding decision-making processes relevant to client influence but the literature outlined was utilised to provide an initial understanding of the topic, supplying information for the formulation of an initial model and demonstrating the need to undertake further research in area of client influence on valuation outcomes.

2.1 BEHAVIOURAL PROPERTY RESEARCH

Until the late 1980s the academic property literature related to valuations, was based on the assumption that valuation formulation was rational. As outlined in Chapter 1, at this time valuation research took a normative view, where information relating to the specific property and the property market was received by valuers who would then act in a rational manner to interpret this information and formulate a valuation outcome.

In 1990 Julian Diaz III published two articles (Diaz, 1990a; Diaz 1990b) which introduced a new perspective to the study of property. As other authors followed, the approach was given the label of "behavioural property research". The main difference between this approach to research and the traditional approach was that Diaz recognised that human behaviour is fundamental to property (Diaz, 1999). The traditional approach which came originally from the economic and finance disciplines had dominated research in the USA and much of the world (Diaz, 1999). This research approach is theoretically underpinned by the construct of the rational man and the efficient market hypothesis. Diaz and other property authors proposed that economic activity constitutes human behaviour and called attention to the necessity to view and understand the decision-making behaviour within property activity. In order to achieve such an understanding, research techniques not commonly used in property research were utilised. These included controlled experiments, process tracing protocols, field surveys and, more recently, more qualitative research techniques. These approaches are able to give more insight into valuer behaviour and the valuation process which the more traditional statistical methodology had been unable to achieve.

On the theory side the behavioural approach abandoned the economic constructs of the infallible rational man and efficient markets, and began to use such approaches as human information processing and problem solving (Newell and Simon, 1972; Diaz, 1999). Newell and Simon viewed the mind as having limited information processing capabilities and that therefore seeks efficiency when solving problems (Newell and Simon, 1972). In order to achieve this efficiency, research has shown that human beings use cognitive short cuts or heuristics and the use of such short cuts can cause errors and biases in judgement. Heuristics can be defined as rules or patterns which help to reduce
the complexity of decision-making (Wofford, 1985), Tversky and Kahneman (1974) identified three heuristics used by humans when making judgements as:

**Representativeness** evaluates an uncertain probability by the degree to which sample characteristics are similar to key features of the parent population (Tversky and Kahneman, 1972). The representative heuristic has been compared to stereotyping, where a decision maker classifies an event or object with others of a type they are familiar with. Lessons are learned from experience and assumptions are made that the subject in a task is the same as that seen elsewhere (Havard, 2001a).

**Availability** uses ease of recall of past occurrences or correlations to assess event probabilities (Tversky and Kahneman, 1973). The decision is therefore framed according to the experience the decision-maker has had in the past with the type of problem or situation (Havard, 2001a).

**Anchoring and adjustment**, is usually employed in numerical prediction when a relevant value is available, or "starting from an initial value that is adjusted to yield the final answer" (Tversky and Kahneman, 1974).

An additional heuristic was added by Evans (1989) as: **Positivity**, this was identified after it was noted that humans have a fundamental tendency to seek information consistent to their current beliefs. They have strategies that are designed to confirm, rather than refute beliefs (Havard, 2001a, Hardin, 1999).

Given that the valuation process can be described as a numerical prediction, the anchoring and adjustment heuristic has attracted a number of studies by behavioural property researchers.

Valuation has been used as the main focus of behavioural property research to date. Diaz (1999) explains that this is because valuation formation is one of the critical issues confronting the property discipline.

"The lack of transaction information which characterizes property markets makes value estimation all the more critical" (Diaz, 1999).

Valuers are also a comparatively easy target for study as they form a well classified and accessible group, they have well defined normative models and it is relatively easy to define what they are taught to do and compare this with what they actually do. Behavioural investigation however is now emerging in other areas such as investor behaviour.
Diaz (Diaz 2002 and Black et al 2003) when reviewing the behavioural literature relating to valuation identified four main themes, these can be summarised as:

Departures from normative models (overall methods of valuation)
Comparable sales selection
Biases and heuristics, and
Feedback and client influences

The outcomes of research into all these areas suggest that valuers working in the market are not behaving in the rational manner as assumed by traditional property research. Their findings are essential in understanding the complexity of the valuation process and how valuers actually behave when undertaking valuations and the effect of this behaviour on valuation outcomes. The first three themes will be considered in this section and client influence and feedback in the following section.

2.1.1 Departures from normative models

It was one of Diaz's first papers addressing behavioural property research that initially compared the normative valuation model with descriptive processes (Diaz 1990a). Diaz found with the use of experiments that the processes utilised by expert residential valuers from the USA when carrying out routine, residential valuation tasks differed significantly from the normative model. He established that the process they followed was fundamentally different from what they were taught. More recently these results using US valuers were compared with the behaviour of UK and New Zealand valuers (Diaz et al 2002; Diaz et al 2004). The findings from these studies support the belief that the US normative model is cognitively demanding and that greater departure from it results in reduced cognitive effort. In addition to this, the processes of New Zealand valuers were closest to the US normative model, the US process less normative than the NZ processes and the UK process significantly less normative than those of US valuers.

These results therefore, reflect cultural differences in the valuation process, which may be explained by a number of reasons, the first of these being the way that valuers are taught to carry out residential valuations. US and NZ expert valuers were clearly influenced by the way they have been taught to undertake valuations even though they did not follow the process strictly. In the UK, valuers do not undergo such normative training and therefore they are not influenced by it to such an extent. There was also evidence that cultures requiring disclosure (USA and New Zealand) examined a significantly greater number of sales than from the UK where disclosure is uncommon (Diaz et al 2002; Diaz 2002; Diaz et al 2004). Culture and training were found not only to influence the process adhered to by valuers but also "time on task" (Diaz et al 2002). The more valuers followed the normative approach the more time they took to complete a residential valuation. New Zealand valuers tended to take the longest time, followed next by US valuers (although the difference was not significant) and UK valuers spent significantly less time on task.
Adair et al's 1996 study also found a departure from normative valuation models. By utilising a survey they investigated the property characteristics that residential valuers consider to be critical and compared these with those characteristics that motivate buyers. They concluded that valuers and buyers perceive differently the relative importance of price/value influencing factors. Diaz (1999) suggests that these findings not only question the appropriateness of normative valuation methodologies but challenge the whole understanding of value formation. The results of this study have specific relevance to client influence as they may suggest that clients who perceive the value of a property differently from that of the valuer may be inclined to encourage a valuer to produce a valuation outcome which accurately reflects their alternative opinion of the value of a property.

This review illustrates that studies examining behavioural property processes have abandoned the economic constructs of the infallible rational man and inefficient markets and have begun to use such approaches as human information processing and problem solving. The results of these studies indicate that the way valuers behave when carrying out valuations does not necessarily correspond to the normative models as assumed in much of the property literature. This has led to a stream of research investigating specific elements of the valuation process. The results of this research have led to a deeper understanding of how valuers carry out valuations. These studies are now discussed.

2.1.2 Comparable sales selection

Diaz's second work in the area of behavioural real estate research (1990b) examined the sales selection process used by experienced US appraisers and students. Before this time little was known about how valuers chose comparable data and yet the selection of such sales can have a great impact on value judgements. Different sales can result in different value estimates. Diaz (1990b) found that students typically examined many sales before making judgements about comparability. Experts generally, however, began selecting one or two criterion sales and used these sales to screen other candidates until an acceptable number were selected. Several experts chose not to examine all available sales. Students with some property experience used a mixture of approaches suggesting that they were moving from novice-like behaviour through to expert behaviour as they gained more experience and sought greater efficiency. These results indicate that experienced valuers use a form of heuristics in a systematic and efficient process, whereas novices tended to use a more cognitively demanding selection process.

Diaz (1999) highlights that the expert comparable sales selection process could produce sub-optimal or biased results. This potential has also been recognised by Gallimore and Wolverton (1997), who conclude that knowledge of a subject property's transaction price could bias comparable sales selection as well as final judgement. Gallimore and Wolverton (1997) found both US appraisers and UK valuers susceptible to these biases but to differing degrees which may be explained by variations in valuation culture. British valuers seemed less susceptible to comparable selection bias due to
transaction price knowledge, but the value estimates of British valuers seemed more susceptible to transaction price knowledge than the value estimates of US appraisers. Diaz (2002) puts these cross-cultural differences down to rigid disclosure requirements in the US which make the valuation and adjustment processes transparent.

Familiarity with certain markets has also been found to affect comparable sales selection. Intuitively one would suppose that valuers would increase a search of comparables when valuing in unfamiliar markets, but a multicultural study carried out by Diaz et al. (2004) found that the number of sales examined by US and UK valuers when moving from familiar to unfamiliar geographic settings did not increase, and New Zealand valuers significantly decreased the number of sales examined when operating with unfamiliar markets.

The findings of this stream of research examining comparable sales selection, as with other behavioural property studies, also suggest that departures from the normative model are consistent with the common human need to find cognitive efficiency and reduce cognitive effort (Diaz, 2002). A desire to understand more fully the cognitive short cuts commonly used by valuers has encouraged an increasing number of research projects in this area. The outcomes of these are examined in the following section.

2.1.3 Biases and heuristics

As alluded to earlier, there has been extensive work that clearly shows that humans, when assessing probabilities and making other estimates, resort to using decision strategies known as heuristics (some examples include Fischoff and Beyth-Marom, 1983; Ashton and Ashton, 1988; Tubbs et al., 1990; Northcraft and Neale, 1987). The work of Tversky and Kahneman (1972, 1973 and 1974) on heuristics was instrumental in inspiring a stream of valuation literature, with the anchoring and adjustment heuristic receiving particular attention. Northcraft and Neale (1987) examined both students’ and real estate agents’ pricing decisions relating to properties and found that knowledge pertaining to the listing price of residential properties significantly biased estimates of both amateurs and experts. They concluded that experts were susceptible to decision bias and are less likely than amateurs to admit (or perhaps understand) their use of heuristics in producing biased judgements. Although this study is significant and useful in identifying the possibility that heuristics are used in assessing value, it is argued that the employment of real estate agents as “valuation experts” reduces the strength and validity of the results as sales agents, although familiar with pricing techniques, may not necessarily be familiar with residential valuation techniques (Hardin, 1999). Northcraft and Neale’s work however has been followed by a number of studies specifically using valuers and their tendency to utilise the anchoring and adjustment heuristic, more specifically the use of reference points in valuation judgement. These include Diaz (1997) who found no evidence that expert valuers (or novice valuers) operating in familiar markets are influenced by the previous value judgements of anonymous experts. It was highlighted though that while the group mean differences were consistent with the
existence of anchoring, the differences were not statistically significant. Diaz and Hansz (1997), however found that experts outside the bounds of geographic familiarity were influenced by the valuation opinion of an anonymous expert ('unsanctioned reference point' (Diaz and Hansz, 2001)). They concluded that:

"... increased uncertainty of geographic unfamiliarity may trigger the use of reference points which would otherwise be given little or no credence" (Diaz and Hansz, 1997).

Diaz and Hansz (2001) extended their research into valuers working in unfamiliar geographic locations by examining 'implicitly sanctioned' reference points comprising uncompleted contract prices on the property and uncompleted contract prices on a comparable property. The results of this study provide further evidence that unfamiliarity with the market has a role in evoking reference point anchoring. Under conditions of geographic unfamiliarity, valuers appear to rely on 'unsanctioned reference points' as well as 'implicitly sanctioned reference points'. The study also provides evidence that 'implicitly sanctioned reference points' exert a stronger influence on valuation judgement under geographic unfamiliarity than 'unsanctioned reference points'.

The tendency for appraisers to be affected by knowledge of the contract price was also considered by Ferguson (1998). With information supplied to him by two savings and loans associations and two savings banks he concluded that most residential valuations undertaken for lenders are not in fact appraisals but instead justifications for the amount of loan applied for by the purchaser. Thus, he argues, the knowledge of the loan amount being applied for will ultimately bias a valuation outcome.

The evidence of appraisal smoothing by a number of authors (e.g. Ibbotson and Siegel, 1984; Cole, 1988; Geltner 1989a; Geltner 1989b; Quan and Quigley, 1991; Matysiak and Wang, 1995; Webb, 1994) prompted Diaz and Wolverton (1998) to examine the effect of valuers' previous value judgments on subsequent valuation outcomes (see section 2.3 for a more in-depth discussion on appraisal smoothing). Their experiment required a group of expert property valuers to value a property and revalue that same property approximately 8 to 10 months later given certain market and property changes. At the same time another group of expert valuers were asked to value the properties only on the updated information. The results indicated that the expert valuers made insufficient adjustments from a self-generated prior anchor. These results suggest one possible explanation for the existence of appraisal smoothing which will be discussed in more depth in section 2.3.

The use of the anchoring and adjustment heuristic was also examined by Havard (1999) in an experiment designed to explain the way valuers adjust a self-generated anchor point. More specifically it looked at whether novice valuers (students) have a greater tendency to adjust a low previous valuation upwards or a high previous valuation downwards. The results confirmed the hypothesis that student valuers have a greater tendency to adjust a previous valuation upwards than to adjust a previous valuation downwards. Evidence of anchoring to previous valuations was also found in a study
carried out by (McAllister et al, 2003), from which they concluded that the anchoring heuristic was central to price and appraisal formation and that not only do current appraisals influence pricing decisions, but they also act as anchors for subsequent appraisals.

The presence of anchoring and recency bias (a tendency in certain circumstances, to overweight information received most recently), was also examined by Gallimore (1994 and 1996). He (Gallimore, 1994) found that valuers appeared to give greatest weight to more recent information. From his results he concludes that in circumstances where valuers do not have total confidence in a current valuation there will be a tendency for it to be moderated towards valuation conclusions produced in the (recent) past. He suggests therefore that valuers when producing a valuation take notice of information available from prior work. This information may be valuation figures themselves and/or evidence used to arrive at these. There was also a suggestion (as in Havard (1999)) that valuers adjust less to negative evidence than evidence which supports existing views. This outcome could also be viewed as an illustration of the positivity heuristic as described previously. In addition to these results, the study suggests that valuers may not only anchor on information available to them, but also utilise an internal anchor which is dependent on the type and length of their experience. In his 1996 study Gallimore investigated the tendency for valuers to seek out positive evidence (confirmation bias), and although he concluded that the case for the presence of confirmation bias remains 'unproved' the findings do reveal the presence in isolation of potentially biasing behavioural characteristics.

The existence of confirmation bias was also found by Havard (2001a) when investigating the behaviour of valuers working within a commercial environment. He found that not only do valuers employ heuristic processes in the development of the final valuation opinion by anchoring on previous valuations, but they may also anchor on their own opinion of value before the commencement of the valuation. His conclusions suggest that the valuation process in the UK sees the valuer relying heavily on their store of prior knowledge and experience which become dominant factors in the evaluation of a subject property. Havard (2001a) concludes that when undertaking a valuation, valuers adopt a strong initial anchor based on their knowledge and experience and then ‘test’ that opinion by gathering additional market evidence. This leads to the conclusion that confirmation bias leads a valuer to seek to confirm an initial opinion and not challenge it. Where valuers were working in relatively unfamiliar markets (even when working with a common set of data) they produced high levels of variance in their valuation outcomes. This may be explained by their inability to draw on previous knowledge of the market.

Another area of potential bias was investigated by Havard (2001b) utilising experiments with student valuers. He looked at whether the mode of data presentation can affect the bias attributed to valuers making early value judgements. In this experiment the early value judgement was encouraged through knowledge of the transaction price. The results indicate that the addition of a tabulated summary of the evidence did counter the potentially biasing effect of the price knowledge, although not all of the bias was corrected as some participants were still affected by the price knowledge. Despite this significant
result, further research still needs to be undertaken to identify whether such heuristics would be used by expert valuers in the same situation or whether they only reflect novice behaviour. As Havard suggests,

"it is likely that experts use heuristics for reasons of efficiency whereas novice valuers use a known anchor through lack of market knowledge to support their opinion. It is possible that experts might not have displayed the same reaction to the tabulated data." (Havard, 2001b).

Cypher and Hansz (2003) have more recently examined other information that may result in the utilisation of the anchoring and adjustment heuristic. Their research specifically examined the potential influence of assessed value in the US. They define assessed value as:

"...a value set on real estate and personal property by government as a basis for levying taxes" (Cypher and Hansz, 2003).

The results of their study indicate that knowledge of the assessed value does influence non-appraisers' market value judgements, but not expert valuers. The authors of the study conclude that expert appraisers most likely realised the inappropriateness of assessed value as a reliable market value proxy and therefore did not depart from their normative training.

The susceptibility of expert valuers to the effect of market feedback is another stream of research carried out by behavioural property researchers. Hansz and Diaz (2001) specifically asked:

'How do appraisers respond to transaction price information on properties previously valued when they are not working for a client who has a clear interest in one direction or the other?' (Hansz and Diaz, 2001).

Their results revealed an asymmetrical response between three groups receiving transaction feedback. The first group were given feedback indicating that their current judgement was 'too low', the second 'too high', and the third received no feedback. Their study suggested that the group receiving transaction feedback indicating that current judgements were "too low" responded in subsequent, unrelated valuations with values that were significantly higher than the group that received no feedback. The authors conclude that clients generally will be less concerned with valuation judgements that are too high than with valuation judgements that are too low. These results concur with the results of Havard (1999) who found that valuers have a greater tendency to adjust a previous valuation upwards rather than downwards. Other reasons postulated for these results is that appraisers may tend to share a subconscious optimism about real estate values which leads them to overreact to positive information and under react to negative information. Alternatively it may be that appraisers have a tendency to appraise conservatively due to uncertainty and if they receive transaction price information that reduces that uncertainty then such conservative bias may be reduced. The existence of such behaviour could also be explained within the concept of agency-related bias, where valuers are motivated to meet the expectations of their clients. Diaz (2002)
suggests that this type of anchoring may in fact be subconscious, learned management of cognitive limitations.

A recent addition to the property behavioural literature (Havard, 2005) is a study providing empirical evidence of commercial valuation behaviour in the field. By utilising structured interviews via a questionnaire Havard found that the sequencing of tasks which occurs during a typical commercial valuation process has common features, but is by no means uniform between different organisations. He also concluded that the personnel carrying out tasks were significantly different in the central part of the valuation process for small, medium and large firms. Finally he concluded that consultation by the valuer tends to be internal to the firm and the main external consultation is with the client they receive instructions from. The results of this investigation confirm the complexity of the valuation process and the need for further study of the impact to the valuation process of the delegation of valuation tasks.

This review of the literature relating to heuristics and resulting bias has identified a major area of interest by property academics in recent times. There is growing evidence that experienced valuers commonly make use of a number of different heuristics in order to complete valuations, the most common one identified being the anchoring and adjustment heuristic. The literature also indicates that the amount of experience may affect the valuation process undertaken by valuers. This section again suggests that valuers are susceptible to behavioural responses when carrying out valuations and the presupposition of the behaviour of the rational economic man may be too simplistic to explain the valuation process.

The results of the behavioural property literature discussed here therefore supplies overwhelming evidence that valuation is far from a simple normative process, and that valuations are carried out by human beings who are prone to the use of heuristics which may result in valuation bias. A summary of results is provided in Figure 2.1, together with the research methods utilised by the research. It is significant that to date the primary research into this area does not include any qualitative enquiry. This omission highlights future opportunities of using such approaches to generate a greater understanding of the valuation process.

**FIGURE 2.1 SUMMARY OF BEHAVIOURAL PROPERTY RESEARCH**

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<td>Adair et al (1996)</td>
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<td>Valuers and buyers perceive differently the relative importance of price/value influencing factors. (UK)</td>
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<tr>
<td>Diaz (1990b)</td>
<td>Experiments</td>
<td>Students tend to consider many comparable sales. Experts use one or two and then compare others against them. Experts using a form of heuristics. (US)</td>
</tr>
<tr>
<td>Gallimore and Wolverton (1997)</td>
<td>Experiment</td>
<td>Knowledge of the transaction price biases comparable sales selection as well as final judgement. US and UK cultural differences</td>
</tr>
<tr>
<td>Diaz et al (2004)</td>
<td>Experiment</td>
<td>The number of sales examined by US and UK valuers when moving from familiar to unfamiliar markets did not increase, NZ valuers decreased the number of sales in unfamiliar markets</td>
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<tr>
<td>Diaz (1997)</td>
<td>Experiment</td>
<td>No evidence that expert or novice valuers operating in familiar markets are influenced by the valuation opinion of anonymous experts</td>
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<td>Ferguson (1998)</td>
<td>Empirical</td>
<td>Most residential evaluations done for lenders are not appraisals but justifications for the amount of loan applied for by the purchaser (US).</td>
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<td>Havard (1999)</td>
<td>Experiment</td>
<td>Student valuers have a greater tendency to adjust a previous valuation upwards than adjust a previous valuation downwards. (UK)</td>
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<td>Gallimore (1994)</td>
<td>Experiment</td>
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<td>Experiment</td>
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<td>The mode of data presentation could influence students in making early value judgments (UK).</td>
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Conceptualising the Influence of Clients on Valuations

<table>
<thead>
<tr>
<th>Cypher and Hansz (2003)</th>
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</tr>
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</table>

One area where qualitative enquiry together with a more quantitative approach has assisted in a deeper understanding of the valuation process and valuer behaviour has been evident is in the area of client influence and feedback. A realisation by academics of the existence of a close relationship between the client and valuer and the reliance of the valuer on the client to provide information and in some cases even to act as a 'consultant' to the valuation process has prompted such research. The research reported in Chapters 6 and 7 have been a result of such an enquiry. The literature has also been informed by a number of authors reporting on anecdotal evidence pertaining to client influence. This need for a deeper understanding of valuation accuracy and bias has led to the fourth theme of behavioural property research, feedback and client influences.

The next section discusses the current research available in the area of client feedback and influence and makes the argument for additional research to be undertaken in this area in order to understand more fully the motivations and opportunities that clients may have to influence valuation outcomes.

2.2 CLIENT INFLUENCE AND THE VALUATION PROFESSION

The previous section suggests that client influence may implicitly and explicitly affect valuation outcomes. As stated in Chapter 1, Fletcher and Diskin (1994) note that clients and stakeholders enjoy an agency relationship in which conflicts of interest can arise due to an incongruence of objectives.

The volume of research in the academic property literature relating to client influence is limited although growing in more recent times. Researchers have tended to focus on the nature of specific types of influence and the implications of such influence. Surveys and experiments together with anecdotal evidence have been a dominant approach in the investigation of the subject although Levy
and Schuck (1999 and 2005, which draw on chapters 6 and 7 of this thesis) and Baum et al (2000) have utilised more in-depth interviews.

Anecdotal evidence as to the existence of client influence is common with articles such as Peterson (2001) noting:

"Real estate appraisers nationwide complain that they are under increasingly heavy-handed pressure from brokers and lenders to help get mortgage applications approved. They say they are being forced to inflate property valuations in order to "hit" the values needed to finance the prices on sales contracts. And should they decline to do so, they claim that their invoices go unpaid. And then they are blackballed from further assignments" (Peterson, 2001).

Client influence or the influence of someone who has an interest in a particular value conclusion is also noted by Roberts and Roberts (1991), they suggest that such influence is probably the most frequent cause of variance in value conclusions. They give examples of differences in valuations being encouraged by clients explaining why their property may be a "financial loser" or as having "tremendous potential". They also note that clients may hold back certain information that may detract from the value they would want to be reported on the property.

In addition to these, a number of authors have looked at the ethics and ethical behaviour of valuers and the appraiser's role in making decisions that have ethical implications. These discussions tend to acknowledge the dilemma appraisers find themselves under when balancing the service required by the client and independent accurate valuations. For example a client may wish for a valuation that is fast, cheap and high enough to do the deal and an appraiser who impedes closing the deal will be viewed negatively (Hurley, 1996). Hurley (1996) when examining the potential influence of clients suggests appraisers ask themselves "To whom and to what do I give my loyalty as a person and as an appraiser?", he concludes that appraisers not only have an obligation to their client but also to the public and other third parties.

Martin (1997) also considered the notion of ethics in the context of valuation, he states that modern theory regards property value as being created by four interdependent value factors: "utility, scarcity, effective purchasing power and desire". He suggests that choices are made on the fourth factor "desire" which is very subjective and therefore can vary from one individual to another and is most obvious when considering the difference between how much a vendor wants to receive and how much a buyer is willing to pay. This subjectivity can cause a valuer an ethical dilemma as it creates an opportunity to value a property according to the desires of an individual (the client) rather than to the principles of value rationale, which Martin (1997) describes as unethical conduct. This dilemma is increased as valuers are made aware of the guiding principles of business success which states that the client is always right and "his needs (or desires) must be satisfied". Martin (1997) concludes that
the fundamental dynamics of the real estate market and the relationship amongst individuals who make them up are why ethical standards for appraisal are required.

Fletcher and Diskin (1994) also expressed concern that agency relationships between the client and valuer could potentially affect the accuracy of valuations, and interfere with the process of appraising properties for institutional asset managers. Agency relationships occur when one party, the principal, hires another party, the agent, to perform a service on behalf of the principal. Jensen (1994), states that agency theory maintains that:

"... because people are, in the end, self interested, they will have conflicts of interest over at least some issues any time they attempt to engage in co-operative endeavours." (Fletcher and Diskin, 1994).

They note that before the development of agency theory, it was assumed that agents acted in a strictly professional manner in performing their services, without regard for the economic consequences for their actions (this may be compared with the normative model as described by Diaz 1990a). Possible conflicts of interest between parties have been noted, however, described as agency problems, these problems arise because of conflicting economic incentives between a principal and an agent. Molho (1997) maintains:

"..... if the agent's objectives differ from those of the principal then the former may take advantage of the unobservability of actions to pursue his/her own ends" (Molho, 1997).

Fletcher and Diskin (1994) highlight two potential problems in this context, firstly the performance based fee received by asset managers which is typically calculated as a percentage of the appraised value of the assets under management and secondly, the financial dependency of appraisers on the client. Kinnard et al (1997) gives as an example of such agency problems as evidence of "tacit collusion" between appraisers and loan originators as reported by Horne and Rosenblatt (1996).

Other authors who have identified potential agency problems include Rushmore (1993) who outlines personal experiences of appraisers within the hotel industry. He explains that a hotel appraisal is generally used to justify an investment in a hotel project and the appraisal should be carried out as an independent verification of preconceived conclusions of the professional operators. Specifically the appraisal is carried out to satisfy the needs of lenders and less sophisticated investors. He depicts graphically the pressure an appraiser may be under as follows:

"You can imagine the stress involved in this process. The developer or purchaser has spent thousands and sometimes millions of dollars on research, legal fees, broker expenses, professional time, and so forth. The prospective lender or equity investor has been identified and shows interest. The fate of the entire deal rests on the appraiser. If there is going to be a breakdown of ethics, it will probably occur at this point". (Rushmore, 1993).
The various types of pressure exerted on appraisers from the client can be subtle and indirect or obvious and abusive. Rushmore (1993) identifies loss of fees as the most common threat but also mentions the potential of more work or loss of work, the threat of being sued and threats of physical bodily harm. In addition to this he explains the complexities of the hotel valuation process and the opportunities this complexity offers appraisers to apply their analyses to inflate the final estimate of value to produce a client a valuation they require.

Rutledge (1994) also considered agency related problems between the client and valuer and described these as “conflicts of interest”. He included in his list of potential conflicts “the valuation of assets by a manager in a way to improperly affect fees”. He again highlights a manager’s financial incentive to influence the appraisal process and states that an appraisal with an upward bias has a direct and favourable bearing on reported investment performance and investment performance in turn is critical to the success of a manager’s future business survival and growth.

Concern that appraiser independence may be subverted by client pressure prompted Smolen and Hambleton (1997) to undertake a survey to gauge the views of 292 appraisers on their: “experience with client pressure, sources of pressure, type of threat or coercion used, and awareness of other appraisers complying with clients’ demands” (Smolen and Hambleton, 1997).

They found that 78.8% of appraisers surveyed reported clients as behaving aggressively, sometimes pressuring them to alter their values. From a typical list of appraisal clients including commercial banks, S&L, mortgage banker, credit union, private investor and consultants, the results show that there was a perceived difference in the amount of client pressure between different clients with over 63% of respondents identifying mortgage bank clients as being most likely to apply pressure. With regards to the source of client threat or coercion used by a client was the threat of a decrease in the number of assignments, followed by the threat of being removed from the approved appraiser list. Finally 81.5% of respondents suspect that some local appraisers may be accommodating client demands to produce unrealistic valuations. They concluded that appraisers are: “... the target of a shocking amount of client pressure and that this pressure can place the independence of appraisers in grave doubt” (Smolen and Hambleton, 1997).

Kinnard et al (1997) and Worzala et al (1998) compiled the first major academic studies providing evidence as to whether commercial and residential appraisers react to client pressure. More specifically the goal of Kinnard et al’s (1997) research was to identify whether non-appraisal factors influence the valuation decisions of commercial appraisals. The two appraisal factors they concentrated on were the fear of client loss and the size of the valuation adjustment requested by the client. To investigate these they employed a behavioural experiment design with a scenario of a client requesting a last minute increase in the valuation (owing to a purported new comparable sale). The intention was to test whether client size or value adjustment size affects the likelihood of commercial
appraisers agreeing to client-requested valuation adjustments. Overall, 41% of commercial appraisers revised their valuation estimates, without having supportive documentation, when requested to do so by their client. Client size was found to significantly and directly affect the valuation decisions of commercial appraisers. The appraisers' revising behaviour was not significantly related to the size of the valuation adjustment requested by the client, nor the interaction between client size and valuation adjustment size.

Wozala et al (1998) identified and measured the impact of client pressure in the context of the residential appraisal industry. As with their previous study in the commercial setting respondents were asked to describe how they would react to a scenario in which the client is pressuring them for an immediate change to the original value estimate. The two factors measured were the importance of the client to the respondent's firm and the size of the adjustment requested; 599 appraisers responded to the residential case. The respondents could be classified into three categories. Those who chose to leave the report as is, those who chose to revise the report, and those who would not make either of the two choices. Of those who made one of the two choices (68% of respondents) were classified as making the decision to turn the report in as is and less than 33% chose to revise the report. In addition to this, the study found that for residential appraisers client size does not matter and they are no more likely to revise a residential report if the client represented 30% of their business than if the client represented only 5% of their annual revenue. Another conclusion was that the size of the requested change makes no difference to the appraiser's decision.

An important observation in both these studies was that 73% of the respondents provided detailed comments on their returned survey form or made them orally to one of the researchers. The comments related to the question asking whether they had experienced client pressure. These observations suggest the presence of a significant amount of client pressure in both the commercial and residential appraisal industry. Respondents also highlighted the possibility of omitted variables. This suggests that further work utilising qualitative methodology would be beneficial in that it would allow valuers to express their experiences and opinions as to client influence which would in turn identify further variables and allow for a more in-depth understanding of the process. Wozala et al (1998) also concluded from respondent observations together with the high response rate that the topic had "hit a hot button for real estate appraisers in the United States". Their study also identified the practice of opinion shopping as being relatively common in the real estate industry and creating a major source of pressure on a real estate appraiser. Comments directed specifically at the industry and the existence of client pressure were identified as having six major themes:

i. "Clients often threaten to opinion shop and sometimes the client shops for a value before hiring an appraiser.

ii. Appraisers lose clients or payment when they stand by their values.

iii. Many clients believe the appraisal is just a necessary evil and they know more than the appraiser."
iv. Some appraisers are leaving the profession due to client pressure.

v. The commission-based fee structure of mortgage brokerage and the mortgage banking industry creates a conflict of interest and a rubber stamp attitude towards appraisals.

vi. Pressure appears to be most common for appraisals for refinancing and divorce settlements" (Wozala et al, 1998).

It was also noted that the frequency of pressure experienced by valuers could range from one to two assignments per year up to daily. Respondents revealed that not succumbing to client pressure resulted in not accepting certain assignments and a number were specifically refusing to accept appraisal work from mortgage brokers. They did however suggest that appraisers prepared to take on these assignments did exist and appeared to be more “adaptable” to client wishes.

The results of these two studies form the first rigorous empirical study into client influence and provide an invaluable base for further research. The use of an experimental research design did however prove to be limited, for example one fifth of respondents wanted a third choice that allowed the appraiser to wait and verify the data before either revising the report or turning it in. This may indicate that respondents may be influenced by something other than client size or the magnitude of the value adjustment, this was further emphasised by respondents written comments. A study using more in depth interviewing techniques would be an effective way to allow respondents to voice their experiences and provide an opportunity to identify further variables and context for client influence.

Yu (2002) utilised a similar behavioural experiment as Wozala et al (1998) in order to determine the likely impact of client pressure on an appraisal within the Singapore residential market. His study was based on 34 respondents and found 85% of valuers surveyed agreed with the statement that valuers are sometimes pressured by clients to modify their valuations. He found that the pressure is most likely to come from groups of clients comprising lending institutions, including banks, finance companies and the HDB, besides private individuals. It was speculated that the reason for this was clients' ignorance of professional regulations. About half of the respondents could not cite any actual threats, although about one third of them had experienced threats to reduce future assignments or engage their competitors. 85% of respondents suspect that some valuers in the profession are yielding to client demands to modify their valuations. In addition to these findings 79% of respondents decided to turn in the original valuation report and 21% would revise the report. However neither client size nor the amount of adjustment has a significant effect on the decision of the valuer. Overall Yu (2002) concluded that the study had produced empirical evidence to suggest that client pressure does exist in the valuation of residential properties for mortgage loan purposes in Singapore. In the words of one of the respondents

“... being very rigid and inflexible will only cause valuers to lose business. It is therefore a balance between keeping your clients and maintaining your professionalism.” (Yu, 2002).
Other authors that have found the impact of client feedback and pressure worthy of study include Wolverton and Gallimore (1999) who expressly investigated the relationship between real-world experience and perception of the appraisal problem by expert appraisers. They based their research on the theoretical foundation on social judgement theory (Hammond et al., 1975) which stems from the lens model of perceptual theory (Brunswick, 1956). The experiment was designed in three parts. The first part requested clients to rate the degree to which they would expect to experience three forms of client feedback when carrying out an appraisal for a client and the market value is too low to justify the loan amount. The three forms of client feedback can be summarised as follows:

"Environmental perception feedback", which includes the client asking if the valuer is comfortable with the value or requesting consideration, is given to other comparable sales.

"Coercive feedback" which includes pressures to increase the appraised value, mentioning the work they provide the valuer, threats to send less work or remove them from their appraiser list, and the actual removal of the appraiser from the list.

"Positive reinforcement" includes clients not contacting a valuer regarding a valuation, sending them more of their work and thanking them to control risk.

Secondly respondents were asked whether they saw their role as validating the pending sale price when carrying out mortgage appraisal work. Finally they were asked whether a client when instructing an appraiser to undertake an appraisal for a purpose of a loan was more concerned about objectivity or more concerned about supporting the sale price. The experiment was administered by way of a survey and provided 377 usable responses from US appraisers. They concluded that appraisers exposed to above average levels of client feedback tend to define the valuation objective differently than do other appraisers. They also found that client feedback had a significant effect on appraisers' role perceptions. The appraisers who receive a great deal of environmental perception feedback and coercive feedback are more likely to perceive their role as validating a pending sale price, whereas appraisers exposed to positive reinforcement of the normative performance criterion are more likely to view themselves as providers of objective opinions of market value. A similar survey of UK valuers was carried out by Gallimore and Wolverton (2000), but the results of this study were quite different. A significant minority of UK valuers appeared to view the valuation objective as validating the sale price and these respondents were not subjected to greater client pressure than those valuers who categorised the valuation task as an objective market estimation. The valuers, who did perceive their task as price validation, were found to be specialists in residential valuation and did not tend to provide any other professional property services.

In a report completed for the Education Trust of the Investment Property Forum, Jones Lang LaSalle and the Royal Institution of Chartered Surveyors, Baum et al (2000) sought to identify how valuations may influence the operation of the commercial investment market. They explored the use made of valuations by investors, the degree of independence between valuations and investment transactions
and identified specific circumstances where valuers are perceived to influence market activity and prices. This was an extensive report that utilised a qualitative approach through in-depth one to one interviews. In their findings they found, as did (Levy and Schuck, 1999), that valuations do not stand above the market, but are an integral part of it and that there is evidence that client influence does exist and is used in the commercial valuation environment. They concluded that valuations may be affected by the influence of clients as well as by the procedures which form the valuation process. Their work also revealed a widespread practice in the UK in which valuations undergo a process of negotiation with clients. They conclude that:

"This may lead to improved valuations bolstered by enhanced information quality; but may also lead to biased and less valid figures. If the latter is the case, valuations may be far from independent of the market. The lack of independence between valuation and achieved sale prices means that a natural lag would appear to be built into monthly and quarterly indices in an upswing" (Baum et al, 2000).

As highlighted in previous experimental research Baum et al (2000) also conclude that such findings question the common assumption that valuations and prices are independent of one another (the debate over valuation accuracy will be discussed further in section 2.3 of the literature review).

In conclusion, client influence and valuer independence has been a topic of discussion and concern within the property academic literature. These concerns and in particular the findings of the research project undertaken by Baum et al (2000) have also been noted by certain professional bodies. The Royal Institution of Chartered Surveyors (RICS) in the United Kingdom was concerned about the effect of the results of the study on the professionalism of their members and this in turn prompted the commissioning of the Carsberg Report (2002) to:

"...consider and make recommendations in respect of valuations that are prepared for a client but may also be of use to third parties and relied upon by those third parties" (RICS, 2003).

The working party commissioned to produce the report highlighted a number of specific issues relating to client influence and recommended that:

"The RICS should undertake an examination of the influences and pressures on valuers who are instructed to undertake valuations for secured lending, and of those parts of the valuation process particular to this context, with a view to establishing Practice Statements designed to ensure public confidence in the valuation process in this area" (RICS, 2002).

Within their report they identified five main areas worthy of review these were, "the accuracy and currency of valuations", "the structure of valuation production", "independence and objectivity" and "valuation reporting". Their recommendations have resulted in alterations to the Appraisal and
Valuation Standards in the UK and also the way in which the RICS carries out its regulatory role in the UK.

This chapter has a discussed a number of research outcomes derived from the property-related behavioural literature. It has also highlighted the range of research methods utilised to date in the study of client influence and valuations. Although there has been an emphasis on personal reflections and anecdotal evidence, the empirical work undertaken (consisting of surveys and experiments and the single study utilising in-depth interviews) recognises the existence of client influence. These studies provide insights the motivation of clients to influence, the behaviour and ethics of valuers and the way such influence can occur. None of the studies reviewed, however, attempt to construct an holistic theoretical model of influence based on empirical research. A key aim of this study therefore is to provide such a model and this will be discussed in the following chapters.

One of the main reasons that property researchers have studied the valuation process has been to understand a number of wider issues affecting the integrity of the valuation profession. These include areas of valuation accuracy, valuation variation and valuation smoothing. An overview of the research into these areas is provided in the following sections.

2.3 VALUATION ACCURACY AND VARIATION

As indicated previously, valuers have been accused of not accurately reflecting market values and that their valuations contain random and systematic error. Research into valuation accuracy and valuation variation has highlighted some of these errors. Valuation accuracy studies attempt to measure the difference between a value determination or group of value determinations in relation to a subsequently realised sales price (Boyd and Irons, 2002), or as defined by Crosby (2000):

"... the ability of a valuation to correctly identify the target. If the valuation basis is market value, this is the ability of the valuer to identify the sales price of the property (or rent on letting if market rental value). In accuracy studies, this target is usually taken as a subsequent sale price transacted in the market place" (Crosby, 2000).

Whereas valuation variation studies measure the difference between value determinations provided by different valuers (Boyd and Irons, 2002), and as explained by Crosby (2000):

"... the ability of two or more valuers to produce the same valuation on the same basis at the same time. Variation is therefore, measured as this difference" (Crosby, 2000).

These two concepts, together with that of valuation uncertainty being:

"... the inability to determine a single point correct value because of the indefinite, and often subjective assumptions, inferences and opinions inherent in, and integral to, the valuation process" (Boyd and Irons, 2002).
are relevant for the study of client influence on valuations, as they further question a valuer's ability to accurately identify a pinpoint value for a property.

2.3.1 Valuation accuracy

Valuation accuracy studies have identified differing likelihoods that valuation outcomes will fall within a certain range of the sale price. One of the earliest studies was undertaken by Brown (1985) who found that valuations do serve as a good proxy for market prices/values. His results indicated that 99% of the valuations of 29 commercial properties were explained by sale price. Crosby et al (1998), in their examination of the margin of error principle used by English courts suggest that there is only a two in three chance of valuers getting within 10% of a sale price, Brown et al (1998) found a difference between contemporaneous valuations and sale prices and concluded that there was a one in five chance of valuers getting within 10% of the sale price of an individual property. More recent evidence has been determined from an IPD report commissioned by the RICS. This report utilised 1216 property sales from the IPD databank and valuations carried out at least three months prior to the sale completion date (it is proposed that a valuer may become aware of the proposed sale price in a valuation any closer to the date of sale). The results of the report concluded that the average difference in 2003, irrespective of whether the sale was above or below valuation, was 9.9%, 78% of valuations were within +/- 15% of sale prices. These results were very similar to studies examining valuations for two previous years and suggest that price valuation differences have levelled off after a trend of gradual improvement through the 1990s. For example, in 1983 the proportion of valuations within 10% of the sale price was 40% and rose to over 66% by 2001 and has since stayed around that level. A further analysis of the results show differences between market segments with a continuing improvement in the office and industrial sectors, but a mixed picture for retail segments. The 2004 report also examined specific characteristics of 262 properties with valuations in excess of 15% from the sale price and they found that in all segments, properties with large price-value differences tended to be lower in value than other sales. The large differences between valuations and sale price tended to be associated with auction sales and sales to private investors.

Matysiak and Wang (1995) also examined valuation accuracy and the effect of market changes over time. They analysed a sample of 317 commercial properties sold from 1973-1991 (valuations had been conducted between 3 to 6 months prior to sale). The results suggest that the probability of a valuation lying within a range of +/- 10% of sale price will be approximately 30%, within +/- 15%, 55% and within +/- 20%, 70%. The results of this research were thus less favourable than the report commissioned by the RICS. Matysiak and Wang concluded that that valuers tend to undervalue property in bull markets and overvalue property in bear markets leading to a smoothing effect. This tendency was also confirmed in Newell and Kishore (1998).
Blundell and Ward (1997) as reported in Boyd and Irons (2002) also carried out a study into valuation accuracy, they used a database of 747 properties sold between 1974 -1990 (317 were incorporated into the database utilised by Matysiak and Wang). Their findings indicated approximately 80% of the valuations lay within +/- 20% of the sale price, and only 35% were within 10% of the sale price. These results reflect more favourable results in terms of accuracy than those reported by Matysiak and Wang (1995). Blundell and Ward also attempted to address the issue of ‘time lag’ between the valuation and sale price. Their results found that sale prices tended to be 3% above on average that of the valuation and that 85% of valuations would lie within the range of +/- 20% of the sale price and 55% would lie within the range of 10% of the sale price. They did note however some deficiencies in their analysis and thus their results should be treated with caution.

Within the Australian context Parker (1999) investigated the accuracy of valuations by utilising a case study of seven properties comprising, office, retail and industrial. His approach sought to address what he viewed as the practical limitations of previous studies by utilising real life/time data and "providing transparency through consistency and independence". Although the small sample size fails to provide a robust basis for statistical analysis it does allow consideration of the relativity between individual properties. Each of Parker’s subject properties was independently valued by one major national firm of valuers at the date of the close of tenders (November 1995). Offers were received for each property at the close of tenders and nominated by the seven potential purchasers. These remained unchanged to become the market price at which each property was sold. None of the valuations received matched the market price exactly. At the sector level the results indicated extremely high accuracy for retail property and commercial property, but substantially lower for industrial property. At the individual property level, a range of accuracy is exhibited from valuations exceeding market price by 8.8% to market price exceeding valuation by 14.3%, with the greatest level of consistency in accuracy being for the three industrial properties. The results indicate that 15% of valuations were accurate in the +/- 5% of the sale price, 85% were within a range of +/- 10% and 100% were within +/- 15% of the sale price. The overall correlation between the valuations and the market prices was 99.55%, with valuations exceeding market price by a dollar weighted average of only 2.5%. These results reflect a significantly higher level of accuracy than previous studies discussed. However it is difficult to compare them directly because of the different approaches and sample size.

Newell and Kishore (1998) also undertook an Australian study. They examined sale prices and compared them with the valuations for 101 commercial and 117 retail properties in Sydney over the period of 1987-1996. Their findings indicate that 65% of the valuations assessed were within a range of +/- 10% of the sale price and 91% lay within +/- 20% of the sale price. Boyd and Irons (2002) comment on these findings by conceding that they do provide some evidence of the accuracy of valuations in an Australian context but express concern over the absence of information regarding details of the statistical tests employed in assessing the data. Boyd and Irons (1998) also comment that the overall average absolute variation figure of approximately 9% is similar to the figures reported
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in a number of American studies. For example Coles, Guilkey and Miles (1986, cited in Boyd and Irons, 1998) provided a variance estimate of 9.5% and Miles, Guilkey, Webb and Hunter (1991, cited in Boyd and Irons, 1998) 10.7% and Webb (1994, cited in Newell and Kishore) 11%. However, Newell and Kishore also calculated the overall absolute variation figure between the sales price and valuation, adjusting for a time lag, as 5%.

In summary, the extant literature into valuation accuracy indicates a high level of variation in the results, with UK figures indicating between 30% (Matysia k and Wang, 1995) and two thirds (RICS 2005) probability of a valuation lying within a 10% of the sale price. Australian studies also indicate a variation between 85% (Parker, 1999) and 65% (Newell and Kishore, 1998). The studies also indicate that valuers are able to value different types of properties in specific types of market conditions more accurately than others. Overall however it is evident that there are will be a large proportion of valuations that lie outside the +/- 10% of the sale price. This again emphasises the imprecise nature of property valuation as confirmed from the previous sections in this chapter. This inability of valuers to report accurate valuations is also reflected through the valuation variance literature. An overview of a number of studies carried out in this area is set out in the following section.

2.3.2 Valuation variance

Interest by academics of valuation variation has resulted in a number of studies. The extent of the variation reported in these studies has been diverse and an overview is provided in Figure 2.2. This section discusses each of these studies in further detail.

**FIGURE 2.2 RESULTS OF VALUATION VARIANCE STUDIES, PROPERTY VALUATIONS WITHIN 10% OF THE MEAN**

<table>
<thead>
<tr>
<th>Study</th>
<th>Within 10% of mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hager and Lord (1995)</td>
<td>90% (office)</td>
</tr>
<tr>
<td></td>
<td>80% (shop)</td>
</tr>
<tr>
<td>Adair et al. (1996)</td>
<td>61% (rack rented)</td>
</tr>
<tr>
<td></td>
<td>69% (reversionary)</td>
</tr>
<tr>
<td>Brown et al (1998)</td>
<td>20%</td>
</tr>
<tr>
<td>Crosby et al (1998)</td>
<td>69%</td>
</tr>
<tr>
<td>Daniels (1983)</td>
<td>50% (complex)</td>
</tr>
<tr>
<td></td>
<td>95% (simple)</td>
</tr>
</tbody>
</table>

An initial UK study by Hager and Lord (1995) indicated that 85% of the valuations considered fell within a range of 10% of the control valuation. In this study a control valuation was carried out for two properties, a rack rented office property and a reversionary retail shop. Ten valuations were undertaken for each property. The highest valuations were 24% higher than the lowest for the office
and 45% higher than the lowest for the shop. For the office 40% of the valuations were within +/- 5% of the control valuation and 90% within +/- 10%, no office valuation was more than 20% different from the control valuation. For the shop 50% were within +/-5% and 80% were within +/-10% of the control. Only one valuation was more than 20% from the control. The limited number of valuations undertaken has received criticism (Brown, 1985), and the authors stressed the anecdotal nature of their survey, but the study does highlight the difficulties valuers have in valuing within a 5% range.

Adair et al (1996) also examined valuation variation within the UK commercial office market. They utilised a larger sample than Hager and Lord (1995) which comprised a hypothetical retail, office and industrial property in 14 main centres throughout the UK. Five valuers employed by national firms and five employed by local firms received instructions to value the hypothetical subject properties in actual locations. Certain limitations to the study have been identified (Brown et al, 1998 and Boyd and Irons, 2002) which include the disappointing response rate from the valuers of 56% which led to the receipt of only 446 valuations and an uneven sample size. The valuations were also hypothetical properties and the quality of the valuations could be questioned as they received no remuneration. Brown et al (1998) also contended that if the full range of possibilities based on the information set were considered in the valuations the variance between valuations would have been wider. Overall however their results provide useful information, giving a deeper understanding of valuation variance. Adair et al (1996), found a wide variation within the distribution of valuations received. The results also indicated a difference in the range of rack rented valuations as compared with reversionary valuations; 61% of rack rented properties fell within a 10% range of the mean of the valuation and 85% within a range of 20%; 69% of reversionary valuations fell within a 10% range of the mean, and over 90% of these valuations falling within 20% of the mean. The average absolute variation for rack rented properties was 10.5%, and 8.48% for reversionary properties. The absolute average over all properties was 9.53%. This again confirms the results of Hager and Lord (1995) that valuers are generally not able to value between 5-10% of the mean value (Brown et al, 1998; Boyd and Irons, 2002).

Brown et al’s (1998) study into valuation variance, attempted to eliminate many of the shortcomings perceived in previous studies (Hager and Lord 1995 and Adair et al., 1996). They approached their research not as ex ante tests (as in Hager and Lord and Adair et al) of how valuers interpret current information, but from the different perspective of estimating ex post uncertainty in mean values on the assumption that valuers are fully informed of market conditions. They argue that:

"This provides a benchmark against which the uncertainty in estimated valuations can be judged" (Brown et al, 1998).

The approach taken in the study was to assume that, over a given period, the total returns and rental value growth rates recorded for a property index in each period are representative of the market conditions that prevailed at the time. By utilising a 'bootstrapping' process the authors were able to obtain an unbiased estimate of the population returns and growth rate for the period. The study
covered the period from 1980 to 1995 and considered the three property sectors of retail, office and industrial from the IPD as of December 1995; the total number of properties included was 12,302. The results of Brown et al's study conclude that the uncertainty that exists in valuations is much higher than appreciated. They found that valuers have approximately a 10% chance of achieving values with +/-5% of the mean value, improving to 20% if the range is increased to +/-10%. These figures they contend will change with changes in market conditions. They also conclude that:

"Uncertainty in valuations is a normal part of an active market and is consistent with valuers having different views concerning market expectations. The fact that this will give rise to different views concerning valuations is important for an active market in property" (Brown et al 1996).

They do however indicate that it is not valuation uncertainty that is proving a serious issue, but the concerns that exist over errors in valuation.

Crosby, Lavers and Murdoch (1998) also examined the concept of valuation variation. They utilised data collected by Morgan (1993, cited in Crosby et al., 1998) which constituted valuations of eight different portfolios made up of 120 retail, office, and industrial investment properties. Two independent valuations were obtained for each property, one provided by one firm and the second by one of four other professional practices. The differences between the two valuations for each property was then analysed by sector. This difference was expressed as a percentage of the average of the two valuations. The results conclude an average variation of 8.6%, over 40% of valuations lay within +/- 5%, over 69% within +/- 10% and over 88% within +/-20%. A further regression analysis highlighted a standard error of around 12% for all the main property types.

In South Australia, Daniels (1983, cited in Rossini, 1999 and Boyd and Irons, 2002) conducted a small scale study to examine valuation variation within the residential property market. Two freehold detached properties, one more typical and "simple" to value and one more "challenging" property. Both properties were valued by 18 valuers on the same date. The mean absolute error was estimated at 5.3% for the "typical" property and 8.9% for the more complex property. For the "typical" property 50% of valuations lay within the +/-5% range from the mean, 95% +/- 10% of the mean and 100% within 15% of the mean. For the complex property 39% valuations lay within +/- 5% range from the mean, 50% +/- 10% of the mean and 95% within 15% of the mean. Although no definite conclusions can be gained because of the limited size of the study, it can be expected that the study would find a lower level of variance for a more straightforward property.

Studies considering valuation variance indicate that in different circumstances and for different properties the ability of a valuer to value a property within a +/- 10 of another valuer may differ substantially. For example in Hager and Lord 85% of the valuations were within the range of +/- 10% of the control valuation and only 5% of their valuations fell outside the 20% range. Adair et al (1996) found 65% to be within the 10% range and 90% within the 20% range. Crosby et al (1998) came up
with similar results of over 89% within +/- 10% and over 88% within a +/-20% range. Using a different approach Brown et al (1998) found figures substantially below these concluding that valuers only have a 20% chance of producing valuations that lie within 10% of the mean. In Australia, Daniel's small study reports more favourable results within the residential sector with 95% of the valuations completed lying within a range of +/-10% of the mean.

The results of these studies tend to indicate that many variables can affect the variance of valuations when undertaken by a variety of different valuers. These results further emphasise that valuation is not a science and that there are many factors that can affect a valuer's perception of value. The behavioural literature helps to explain this by a valuer's use of heuristics and the agency relationship between valuer and client, whereas other research points to the type of property and the complexity of the valuation as affecting valuation accuracy and variance. Another area of research related to the accuracy and variation of valuation is the phenomenon of valuation smoothing and lagging. The next section explores the literature related to valuation smoothing and lagging and explains its effect on valuer behaviour and the valuation process.

2.4 VALUATION SMOOTHING AND LAGGING

Unlike securitised investments the direct real estate market is where heterogeneous assets are traded infrequently in dispersed local markets; in addition, transaction price information is often confidential. This absence of information on price has meant that appraisals are used as the basis for performance measurement (Geltner, MacGregor and Schwann, 2003). When making an assessment of value, appraisers rely on fundamental variables including transaction prices of comparable properties, and, as Geltner et al (2003) state, it is the appraiser's role to extract the "signal from the noise in an efficient manner". Evidence shows that when real estate return series are constructed using appraisals as substitutes for transaction information they tend to exhibit reduced variability (Ibbotson and Siegel, 1984) which has been labelled 'appraisal smoothing'. Geltner's (1989a) definition of appraisal smoothing has been cited in many studies as the:

"... ratio of the standard deviation of true portfolio property values to the standard deviation of appraised portfolio property valuations" (Geltner, 1989a as cited in Diaz and Wolverton, 1998).

An extensive body of literature seeks to explain the low level of volatility of property returns which exist relative to other major investment classes. A major consideration is that they are based on appraised values rather than contemporaneous transaction prices. There are few analysts that accept that appraised-based indices reflect the true underlying performance of the property market (McAllister, Baum, Crosby, Gallimore and Gray, 2003). It is therefore becoming more accepted that valuer behaviour and response to external influences may increase the likelihood of biased figures (for example Geltner, 1989a and 1989b; McAllister et al, 2003; Diaz and Wolverton, 1998; Clayton, Geltner and Hamilton, 2001; Quan and Quigley, 1991).
Geltner (1989a and 1989b) suggest one explanation of valuation smoothing might be that appraisers may be forced to rely on past value estimates from lack of confidence of other evidence; they also identify smoothing as being the result of the timing of valuations. Quan and Quigley (1991) contend also that smoothing may occur because of the appraiser’s over reliance on previous value estimates in the face of greater market uncertainty. They argue that it is a rational strategy for valuers to put less than full weight to more nebulous current market-state information given a market characterised by price dispersion.

In addition to identifying the general phenomena of valuation smoothing, research studies have also shown that appraised values tend to lag the real estate price cycle in that appraisers tend to underestimate value in rising markets and overestimate value in falling markets. There have been different explanations for such behaviour; Matysiak and Wang (1994) argue that appraisers are “backward looking” because appraisal methodology is based on historical data, whereas other authors including Webb (1994), Quan and Quigley (1991) and Geltner (1993) see smoothing as a “function of appraisers rationally weighting previous value estimates against subsequent market information”.

The identification of the effect of the valuation process and valuer behaviour on valuation smoothing has led to researchers analysing the phenomenon from the viewpoint of the individual valuation and valuer behaviour. Diaz and Wolverton’s (1998) study is an example of such work. Their results support their hypothesis that valuers tend to make insufficient adjustment from previous value judgements. They suggested these results could be interpreted as a behavioural component which could contribute to the occurrence of appraisal smoothing. In addition to this, Crosby et al (1998) indicate that the court system may deter valuers from moving their valuations without hard transaction evidence, unless they have access to other compelling evidence.

There have been a number of other studies, demonstrating the existence of the valuation smoothing phenomenon. This review however concentrates on two recent studies which have contributed to an understanding of the impact of the valuation process on the valuation smoothing phenomenon. Both these studies have sought to understand the process and impact of smoothing at an individual valuation level. The first of these was a Canadian study carried out by Clayton, Geltner and Hamilton (2001), and a UK study published by McAllister et al (2003).

Clayton, et al’s (2001) study identified two main causes of smoothing at the aggregate level. One of these causes relate to the timing of valuations used at the index construction level. They explain that whilst many benchmark real estate return indices are quarterly indices, many of the properties tracked are not appraised at the end of every quarter. The second source which they identify is the evidence that indicates that individual appraised values lag “market values”:

"Appraisals are estimates of contemporaneous market values, and as such they will generally contain errors in the sense of differences between the
appraisals and the corresponding (unobservable, true) contemporaneous market values" (Clayton et al 2001).

Their findings give credibility to the proposition that appraisers place emphasis on previous appraised values (or at least old market information) and this emphasis tends to vary with the quantity and quality of information available to the appraiser. They conclude that the use of new market information shifts as the number of new comparable sales and/or dispersion of comparable capitalisation rates change over time. Clayton et al (2001) contend that this is rational appraiser behaviour. As the uncertainty about new information increases, less weight will be placed on this new information, and appraisers will tend to rely more heavily on older data already used in previous appraisal reports. Clayton et al (2001) also find evidence of anchoring behaviour where appraisers valuing the same property in consecutive periods appear to place more weight on older information.

The work of McAllister et al (2003) also examines valuation smoothing from an individual appraisal level and adds to the findings of Clayton et al and Diaz and Wolverton’s work. In order to achieve this, McAllister et al examined the smoothing phenomenon both from a qualitative and a quantitative perspective. They interviewed 20 fund managers and 11 valuers and reported on the use of appraisals in the transaction process and also the periodic appraisal process. They concluded that the appraisal formation process is more complex than simple weighted updating, with the timing of the appraisal, the terms of the appraisal ‘contract’ and the traits of the particular client and appraiser influencing appraisal outcomes. An important insight gained from the appraisers interviewed was an indication that valuers tend to carry out more extensive market analysis for quarterly appraisals than in any other months which in turn led to a reduction in anchoring to previous valuations on those dates. McAllister analysed the IPD Monthly index from January 1997 to April 2001 to investigate whether these effects could be observed. From this analysis they conclude that current appraisals influence price decisions and act as anchors for subsequent appraisals. They found that nearly 70% of appraisals remained unchanged and interpret this as clear evidence that previous appraisals are acting in some type of ‘default capacity’. Their empirical analysis of the IPD monthly index also finds that the appraisal process produces variation in the level of appraisals depending on when they are carried out. Annual valuations tended to be more responsive to change than quarterly valuations, which in turn were more responsive than monthly valuations. This again confirms the qualitative findings that the level of information and input sought by valuers may vary at different times of the year. McAllister et al also suggest that the client/appraiser relationship may impact on their findings as any client influence may change values and that the results of annual valuations may be influenced by the client.

The literature on valuation smoothing and lagging again indicates that an understanding of the valuation process and valuer behaviour is required in order to fully understand valuation outcomes. The work of McAllister et al is particularly interesting as it uses a qualitative approach to help explain possible explanations of valuation smoothing and follows this with a quantitative study measuring the different outcomes of valuations at annual versus quarterly valuations.
2.5 SUMMARY

This chapter has examined a range of published property literature in order to demonstrate that the valuation process does not necessarily reflect the rational process that has traditionally been assumed in property research. Questions surrounding the accuracy of valuations have proved to be of concern to many property academics over a number of years and have been well documented. In early 1990s Diaz introduced a behavioural approach to property research which has resulted in a deeper understanding of the valuation process and the behaviour of valuers within that process. Most importantly behavioural property research has demonstrated that valuer behaviour does not necessarily follow a rational normative process as suggested by traditional economic theory. There is substantial evidence to suggest a widespread use of heuristics by experienced valuers when carrying out valuations and making estimates of value. In particular studies have clearly demonstrated the use of the anchoring and adjustment heuristic in relation to a number of anchor points including knowledge of the contract price, previous value judgements and the recency of the information considered.

A search for literature addressing directly client influence within the valuation context identified a limited number of empirical studies. However a number of papers reported substantial anecdotal evidence suggesting that client influence affects valuer behaviour and valuation outcomes. These papers have identified the existence of performance-based fees received by asset managers and the financial dependency of appraisers to the client as potentially causing problems relating both to ethical issues and also the impact on valuation accuracy. In addition to anecdotal evidence, a number of experiments have demonstrated empirically that client feedback has a significant effect on the perception of the valuer’s role in the valuation process and that valuers lack independence when carrying out valuations. Other empirical studies also argue that client influence does exist and although they do provide a number of insights into the reasons and opportunities for such influence they do not attempt to provide an holistic theoretical model of influence. The recognition of such an omission has provided the key aim of this research study.

As commented on previously one of the main drivers for a research agenda examining the valuation process and the role of the client and valuer has been the outcome of research highlighting issues surrounding the ability of valuers to produce accurate and unbiased estimates of market value. Valuation accuracy studies have examined the differing likelihoods that valuation outcomes will fall within a certain range of the sale price. A summary of the literature indicates a high variation in results which again emphasises the imprecise nature of property valuation.

The difficulty valuers have to report accurate valuations is also reflected in the literature examining valuation variance, these studies conclude that valuers are not generally able to value between 5-10% of the mean value. The results of this research indicate that there are a number of variables affecting the variance reported between valuations. They further emphasise that valuation is not a science and that there are many factors that can affect a valuer’s perception of value.
The final area of research discussed in this chapter was the literature pertaining to valuation smoothing and lagging. Unlike securitised investments, the heterogeneity of property assets, the dispersion of local markets and the confidentiality of transaction information has meant that valuations are used as a basis for performance measurement. Analysis of such valuations has found evidence of a low level of volatility of property returns relative to other investment classes. It is becoming increasingly accepted by property academics that valuer behaviour and their response to external influence may increase the likelihood of biased figures and thus valuation smoothing. These external influences may include such behavioural issues as valuers relying on past estimates and making insufficient adjustment from previous value judgements and client influence.

In conclusion, the literature relating to valuer behaviour, valuation accuracy, bias and valuation smoothing all indicate that there are many behavioural issues that may affect valuation outcomes. Evidence suggests that heuristics may be one explanation for such phenomena, but a growing literature also suggests that the role of the client within the valuation process could also be a factor worthy of consideration. The review also highlighted the limited amount of qualitative enquiry into the role of the client in the valuation process and suggests that further in-depth analysis of client and valuer perceptions of the valuation process could help to identify how clients affect valuation outcomes. Insights into these area could also assist in explaining such concepts as valuation accuracy and smoothing.

In order to understand how clients may influence valuers and also to understand the relationship between a client and professional services provider, the literature in a number of other fields was reviewed including auditor independence, business to business/organisational decision making and decision making within professional services. The result of this analysis can be found in the following chapter.

Chapter 2 References


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