3.1 Introduction

In the past decade or so, there has been growing attention paid to the question of appraisal, or valuation, accuracy. Studies that encompass this question have principally been driven by concerns over how appraisal inaccuracy may adversely affect the validity of appraisal-based real estate indices and of the portfolio management policies that draw inferences from them. Such studies have been pursued in the US (e.g. Webb, 1994; Fisher, Miles and Webb, 1999; Clayton, Geltner and Hamilton, 2000), the UK (e.g. Matysiak and Wang, 1995; Blundell and Ward, 1997; Drivers Jonas/IPD, 1997) and Australia (Parker, 1998; Newell and Kishore, 1998). Given the nature of the concerns, these studies have generally focused on commercial appraisals, especially of
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institutional grade real estate, although accuracy is a wider issue that surrounds all forms of appraisals.

This wider view is reflected in a different, somewhat subsidiary, strand of enquiry that encompasses the more general question of the degree of accuracy that may be expected of appraisers by the public. Investigation from this perspective has centred on situations where court actions have been taken against appraisers for arguably substandard professional behavior leading to client financial loss. Work taking this angle is confined largely to the UK (Crosby, Lavers and Murdoch, 1998; Crosby, 2000).

Both these kinds of study involve not only the concept of appraisal accuracy: i.e. the extent to which valuation differs from actual market values; but also the concept of appraisal variance: the extent to which appraisers differ amongst themselves, as might be observed when several appraisers value the same property. These concepts are analogous to those of validity and reliability in the design of research measurements. In the same way that reliability is a pre-condition to, but does not guarantee, validity; appraisal variance affects, but does not itself determine, the level of appraisal accuracy. The discussion in this paper encompasses both concepts but is directed at the larger issue of validity. It addresses the theoretical foundation for evaluating this, analysing what determines appraisal validity, using a framework that enables consideration of its constituent components. The paper suggests ways in which this analysis may contribute to improvements in appraisal accuracy.

3.2 Appraisal Accuracy and Real Estate Indices

In strict terms, appraisal accuracy cannot in practice be measured because true market values are unobservable. Empirical studies of appraisal accuracy therefore utilize comparisons of valuations against market prices, as proxies for underlying true market value. This practical and inevitable limitation has led investigators to adopt different criteria for deciding which market prices may be regarded as proxies for true value, most notably with respect to the limits of the acceptable time lag between valuation date and corresponding transaction date. When comparing findings from different studies, the presence of such differences must be borne in mind, as must the differing databases, periods of analysis and market conditions.

These studies give some general indication of the level of appraisal accuracy and of the way that it may vary in different market conditions. In the US, for example, Webb (1994), examining the period between 1978 and 1992, discovered average differences between sale prices and appraisals that were positive (7.8%) in the rising market phase but negative (3.3% and 4.9%) in falling markets; with mean absolute differences being about 10%. As Fisher et al. (1999) point out, it is the mean absolute difference that is important in evaluating the