

PRICE GUIDES—FRIEND OR FOE?

Bill Hofer, GIA GG, FGA

How convenient it is to use a price guide to retrieve prices for diamonds and colored stones. Merely adding a markup to determine a value seems too easy. Some gurus of valuation theory are emphatic that price guides should be banned. Other experts embrace price guides as a key part of the process.

So, can you use a price guide or not? Well first, we need to review some basics.

Comes in Threes

Fundamental appraisal theory offers three basic value approaches, namely the market data approach, the cost approach and lastly the income approach. Regarding the latter, unless one rents jewelry or gemstones, the income approach will not be a method considered by you. On the other hand, the *market data approach*, which has been renamed the *sales comparison approach*, is a method that appraisers are more familiar with. Or are they?

The sales comparison approach sounds great but then again appears limited to only actual sales. This may have led some valuation makers-and-shakers as well as some leading appraisal societies to teach that value is strictly limited to reliance on accomplished transactions or the prices of items for sale.¹ And, by default, everything else is the cost approach.

You will learn...that may not be the case. One of the drawbacks with relying solely on actual transactions or price tags occurs when you depend on price guides or call wholesale dealers for estimates. Rather than redefine established terms, let's use a new phrase to replace both the "market data" and "sales comparison" approach. The accurate descriptor is the *market activity approach*.

¹ The Sales Comparison Approach, as defined on the American Society of Appraisers (ASA) website is "A procedure to conclude an opinion of value for a property by comparing it with similar properties that have been sold or are for sale in the relevant marketplace by making adjustments to prices based on marketplace conditions and the properties' characteristics of value."



FIGURE 1. This Colombian emerald ring with diamonds was custom made, although an exceptionally crafted piece, that alone does not make it unique. Courtesy of Philip Zahm Designs, Photo Jeff Mason.

Push Back

Some specialists openly state that a price guide is really "someone else's opinion as to value." Thus, one must only research the market for transactions to determine a value conclusion. If you have been on any internet appraisal forums, this will sound familiar. Another facet of their argument, besides the sales comparison approach terminology, is that the Internal Revenue Service (IRS) does not accept the cost approach. This however, is not true.

We have all heard it said that price guides can only be used for the cost approach. Is that true? Let's examine what the cost approach rules are.

Cost Approach—Most Misunderstood

The cost approach is based on determining the cost to make an item. But when can one apply the cost approach? It can be applied if one of these three situations exist: (1) the item is unique, (2) data in the market-

place is limited, or (3) there is no market activity.² Looking at some examples of the conditions is helpful.

First, custom items are not unique. Figure 1. Unique means that the value elements of an item are unique in the market. If I have a brass ring made from metal extracted from a spent artillery shell recovered from a World War II battlefield on Okinawa—that is unique. If I make a custom mokume-gane wedding band—that is custom but not unique.

² Remember that I stated that the IRS accepted the cost approach? It was decided that for the cost approach, if one of the stated three situations existed, it is proper for determining fair market value [839 Fed.2d 420].

If I put the brass ring up for sale with a price tag of one million dollars, you might agree that since the data is limited as well as misleading it therefore it is not useful.

If you were a real property appraiser and were given the task of determining a value for obtaining insurance for the capital building of Utah, how would you do it? Has any state capital building been sold? Thus, there is no market for state capital buildings. You would have to determine what it would cost to buy the land, build the buildings, etc. "Keep in mind that although you are adding the costs, such as parts and labor, each of those costs requires research," explains Joel Hassler, instructor for the Certified Gemologist Appraiser (CGA) courses offered by the American Gem Society (AGS). "Hence, the cost approach is really a subpart of the market activity approach."

Price Guides—Cost Approach or Market Activity Approach?

Some valuation theory resources state that using a price guide and a markup is the cost approach. Is it? It should be clear that the three situations stated above in which the cost approach is proper to use do not exist for your standard jewelry item seen in everyday appraisals. Clearly then price guides would be unthinkable. But wait; are they really?

Let's take a step backwards and first tackle whether a price guide is unacceptable since it is hearsay. Both in the federal and state evidence rules, there are exceptions to the hearsay rule. Here is what the federal rule says. "Market quotations, lists, directories, or other compilations that are generally relied on by the public or by persons in particular occupations"³ are an exception to the hearsay rule. A price guide used by dealers as well as appraisers is on solid ground in the legal arena as evidence!

Take a commonplace item such as a modern solitaire diamond ring with no special marks on the gold ring, no custom work. The diamond is a one carat round brilliant of average quality. Can you check your semi-mount catalog, then retrieve a price from a price guide and add some markups to determine a retail replacement value?

If you are going to be challenged on your approach, it will be when your appraisal ends up as evidence in litigation. Once again, we can reference a legal precedent-setting published court case that embraced the use of markups.

As a general rule, current price lists and catalogues from wholesale dealers may be used to establish the cost of articles sold to retailers; and where the selling price by the retailer is cost plus a percentage of that cost as profit, such cost price as shown in lists and catalogues may be used to aid in determining the retail market value of the articles.⁴

Firstly, are the catalogs and price guides used by the trade? That sounds like the exception to the hearsay rule we mentioned earlier. Has the appraiser adjusted the wholesale catalogs and price guide to reflect the actual wholesale market? If a markup is applied, does it reflect actual markups used by the trade? And does the resulting retail value hold up to be real world? In all these steps, the appraiser is mimicking how those in the trade buy and sell jewelry. That is to say, they are setting a retail price from a wholesale price, is that not true?

Since the cost approach involves reproduction or reconstruction to determine value, then using a price guide and adding a markup is not the cost approach but belongs in the market activity approach category.

And, that's a lot of work! "I reverse engineer markups using a price guide," advises Geoff Nelson, an adjunct professor, seasoned gemologist-appraiser specializing in gemological laboratories, jewelry grading techniques, and appraisal clinics. "Take sales receipts, lookup the gems in a price guide, and then calculate the markup, thus avoiding adjustment of a price guide or messing with markup research."

Mimic the Trade

Although researching actual transactions is hands down the best way to determine value, if data is available. You are on safe ground if you determine value the same way retailers determine their prices.⁵ And, a reliable price guide is an invaluable addition to your value research arsenal. ♦

Bill Hoefler is an independent appraiser, author and educator. He has served as an expert witness in a number of high-profile jewelry valuation cases. He also hosts a web-based resource for appraisers at www.appraiserunderoath.com

³ Federal Evidence Code, Rule 803 (17) Market Reports and Similar Commercial Publications.

⁴ Evidence Price Lists of Wholesale Dealers Admissible to Determine Value of Articles Stolen. As a general rule, current price lists and catalogues from wholesale dealers may be used to establish the cost of articles sold to retail dealers; and where the selling price by

the retailer is cost plus a percentage of that cost as profit, such cost price as shown in lists and catalogues may be used to aid in determining the retail market value of the articles [Hoffman v State, 218 P. 176 headnote 4].

⁵ Embracing this logic, using markups to determine auction transactions would not work.

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