

Real Estate Risk Assessment Commercial Real Estate and Appraisal

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Today's Agenda

- **What is an Appraisal?**
- **History of Appraisal**
- **“Old Days”**
- **FIRREA**
- **Ordering Appraisals at Bank of America**
- **Common Appraisal Issues (nuts and bolts)**

What is an Appraisal?

- **An estimate of Value**
- **It can be written or verbal**
- **There are different Types of Value (examples):**
 - **Market Value**
 - **Fair Value (legal term for sale within 12 months)**
 - **Investment Value**
 - **Value in Use**
 - **Insurable Value**

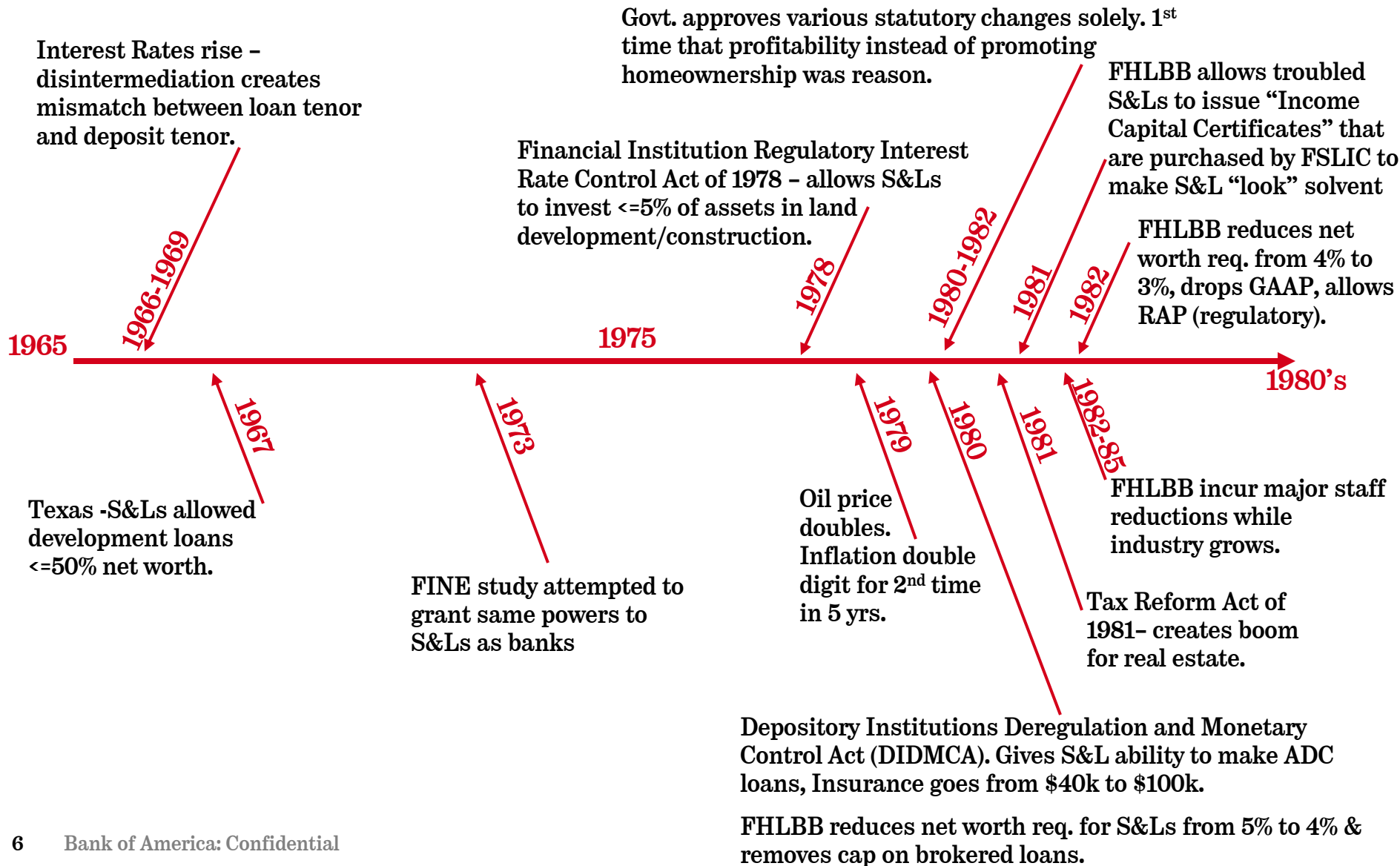
History of Appraisal

- **First Recorded Appraisal – for Acquisition of a lot**
 - Abraham: “I will give the full value of the field....” for the cave of Machpelah to bury his wife, Sarah. He purchased the cave and field from Ephron, son of Zohar the Hittite for 400 shekels of silver. Approximately 1800 BC
- **First mentioned Bank of America appraisal – 1903 Earthquake**
 - A.P. Giannini sets up loan of boardwalk near wharf with two barrels and a plank for a desk. He provided cash loans. Un-named local broker/appraiser gave “thumbs up/down” for value of collateral.
- **Oldest Appraisal Co. in U.S.**
 - Elam & Funsten, Richmond, VA – founded in 1868
- **The “Appraisal Institute” is the organization that provides the MAI designation, was formed in 1932. The current organization resulted from the merger of the American Institute of Real Estate Appraisers and the Society of Real Estate Appraisers which occurred in 1990.**

Old Days

- **Borrower (or Developer) brought in appraisal. Banks did not (or rarely) ordered the appraisal directly**
- **“Approved Lists” were eventually developed**
- **MAI became premier professional designation**
- **Bank reviewed appraisals**
 - **changes to value were rare**

FIRREA – History Behind the S&L Crisis, by E.A. Greer



FIRREA - History Behind the S&L Crisis, by E.A. Greer

FHLBB drops restrictions on minimum number of S&L stock holds. Was 400 total w/ 125 local and no controlling group >25% stock. All rules gone. Sparks buying/selling of S&Ls.

1982
1982
1983

In response to Garn - St. Germain, many states loosen rules to match federal S&L rules, California, Texas & Florida are "Big 3" that loosen rules.

New FHLBB chair Edwin Gray reverses much of deregulation.

Board raises net worth req. to 7% for newly chartered S&Ls.

1985

FHLBB limits brokered deposits to 5% & limits real estate (et al) to greater of 10% of assets or 2x net worth.

Chrmn Gary transfers federal examiners from OMB to FHLBB.

Gray fails to convince congress to recapitalize FSLIC - \$4.6B fund vs. \$20B losses.

Examiners "classify" loans.

1987
1988

Competitive Equality Banking Act of 1987 - \$10.8B (\$3.75B/yr.).

FHLBB rolls "Southwest Plan" - 205 S&Ls, \$101B

Bush elected President. S&Ls not in campaign.

Financial Institution Reform Recovery and Enforcement Act of 1989:

- 1- Abolished FSLIC & FHLBB
- 2- Insurance shifted to FDIC
- 3- Created OTS for S&Ls
- 4- Created RTC
- 5- \$50B in funding
- 5- Crime Control Act of 1990

1982

1983

1984

1985

1986

1987

Garn - St. Germain Depository Institutions Act of 1982 for Federal S&Ls - Eliminates rate ceilings, eliminates LTV caps, allows 40% of assets in commercial mortgages.

"Land Flips" take down 1st S&L - Empire Savings of TX.

FHLBB & FDIC fail in their attempt to eliminate insurance for brokered deposits.

FHLBB requires S&Ls to manage interest rate risk.

Lower rates help S&Ls. 35% sustain losses. 9% insolvent by GAAP Stds (10% based on \$\$).

Failures cause Ohio to clos state-chartered S&Ls. Maryland loses state deposit fund.

Board raises net worth req. to 6% for all S&Ls with 2% credit for interest rate risk mgmt.

GAO declares FSLIC insolvent.

Gray ends his term. 5 senators grill Gary about Lincoln Savings...they become known as the "Keating 5". Lincoln cost = \$5B.

RAP gone for GAAP / New Chairman Wall

Appraisal Regulations

- Global Risk Policy Manual – Commercial Real Estate link available from various sources – extremely long
- Corporate Appraisal Policy** - applies to all lines of business
http://crprdniisd1:8099/Notice_Appraisal_Policy.html
http://crprdniisd1:8099/Notice_Appraisal_Policy.html
- Appraisal Regulations – Internal site covers “major” regulations
http://reraweb.bankofamerica.com/documents/app_Reg/appraisal_Regs.html
http://reraweb.bankofamerica.com/documents/app_Reg/appraisal_Regs.html

** Note: The first 1 ¼ pages of the Corporate Appraisal Policy are directly from the Code of Federal Regulations. When the policy states “exceptions not allowed”, it’s due to Federal Regulations.

Appraisal Process at Bank of America

- **CM / RU submits appraisal request via RERA's on-line ordering platform (aka RIMS). <http://reraweb.bankofamerica.com>**
- **CM/RU/Borrower have no input in appraiser selection process.**
 - **RERA is the sole selector of the appraisal.**
 - **Let RERA know in advance of anyone to exclude, e.g. prior bad experience with a specific appraiser.**
- **Reports ordered by the borrower can NOT be used.**
- **Reports ordered by another bank must be reviewed by RERA before they can be used.**
- **The ordering entity must be “unbiased.” Mortgage broker reports will be decided on a case-by-case basis.**
- **Readdressing appraisals (e.g. from borrower to a bank) is illegal!**

Appraisal Ordering - RERAWeb

Real Estate Risk Assessment - Microsoft Internet Explorer

Address: <http://reraweb.bankofamerica.com/>

Enterprise Credit Risk Global Risk Management

Real Estate Risk Assessment

Feedback Site Map

Bank of America

Links

Order Services

- Order Services Online (RIMS)
- RIMS Training
- RIMS Updates

About RERA

- Offices Map
- Office Directory
- Description of Services
- Dictionary
- News

Forms & Documents

- Appraisal Services
- Environmental Services
- Reports
- White Papers

RERA SERVICES

Appraisal
Environmental
Real Estate Research
Valuation Technology

Committed to providing reliable, efficient and innovative services to business partners.

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ORDER APPRAISAL

UPDATES

- 08/01/06** [RERA Cost Increase for SIR, Effective Aug 1, 2006](#)
- 06/22/06** [OCC 2006 Revisions to Uniform Standards of Professional Appraisal Practice: Joint](#)
- 05/01/06** [RERA Appraisal Quality Assurance Process \(Review Sampling\), Effective Oct 2004](#)
- 04/07/06** [RERA Leadership Team Announcement - Dan Kuehl Promotion](#)
- 02/01/06** [Appraisal Ordering - Zions Bank Referrals](#)
- 01/11/06** [RERA Valuation Products Quick Guide](#)
- 01/11/06** [GCIB Credit Services / BCS - ONE FORM and Property Data Sheet](#)
- 01/11/06** [RERA Property Data Sheet for Commercial Bank and Other Lines of Business](#)
- 09/08/05** [New Joint-Agency Regulatory Statement Issued - 2005-32](#)
- 03/28/05** [Appraisal Fees - Overview of Internal & External Fees](#)
- 03/22/05** [Joint-Agency Regulatory Statement Issued - 2005-6](#)

Note: Contact Everett (Allen) Greer for RIMS Training

09/01/04 [Business Credit Services Rolls New Procedures for Southeast and Mid-Atlantic](#)

Local intranet

Appraisal Volume through RERA

- **Nearly 8,000 appraisers in database**
 - **Roughly 2,000 active**
- **13,000 to 15,000 appraisals per year**
- **\$100 to \$125 billion annually**
- **7,000 to 8,000 alternative valuation products**

Appraisal Issues

- **Defining the Property**
 - **Ground Leases**
 - Subordination is #1 issue
 - Payment / Term / Escalations / Cancellation Clauses
 - Participation in Income
 - **Leased Properties**
 - Audited vs. non-audited financials
 - Exit clauses, strength of tenant, is “parent” on hook or SPE/LLC
- **Highest and Best Use**
 - Four tests - “legally permissible” is more than just zoning, it encompasses what would be “blocked” by special interest groups
- **Information**
 - Lack of documentation can impact the valuation process.
 - Missing leases, missing “side letters”, missing agreements
 - Tenant-by-tenant Arrear Report, CAM Reconciliation, Effective Rent(s)
 - Property history drives expense forecast, Expense Comps crosscheck
 - Property history drives reimbursement forecast

Land and the Cost Approach

- **Development Rights**
 - “By Right” (zoning) is non-existent in most communities
 - Discretionary approvals - city/special interest groups/review boards/etc.
 - Negotiated Development Rights are the “norm”
- **Land Sales**
 - What did they buy, land, development approvals, approved plans?
 - What were their terms?
 - When did they close (i.e. before or after development rights)?
 - Most developers agree to a price based on receiving “approvals,” and wait to close until they receive “final” or “near-final” approvals
- **Costs**
 - Construction costs have skyrocketed in recent past
 - Cost DOES NOT equal value / When was the contract signed?
- **Profit - What is “reasonable” entrepreneurial profit**

Sales Approach

- **What is similar**
 - Beauty is in the Eye of the Beholder, especially for location
 - Parking - how much, where, convenience?
 - What impacts value? - location, L:B ratio, amenities, income, etc.
- **Data Quality**
 - Are they the best comps / most similar comps / most recent sales?
 - What was “verified?” What is unknown about the sale(s)?
 - What concessions / conditions / motivations impacted the price(s)?
- **Pull Data:**
 - <http://research>

Income Approach

- **What are the rents? What are the effective rents, post concessions?**
- **Are the leases accurate, complete, or missing parts?**
- **What concessions were offered at the competition / subject?**
- **What are the expenses? What is actually being reimbursed?**
- **What is expected vacancy, renewal probability, likely downtime?**
- **What are the cap rates? What were they based on?**
 - **Trailing v. Forecast.**
 - **Common Mistake is Trailing R_0 applied to Forecast Income**
 - **Seller provide NOI guarantees**

Valuation Conclusions

- **RERA is the sole selector of the appraiser**
- **Appraisal is an Art not a Science**
- **Information is not perfect**
- **RERA is responsible for the appraisal function**



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