Effective Commercial Appraisals For Banks

Society of Chief Appraisers & Credit Officers

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Aon Center

707 Wilshire Bl., LBL Auditorium

Los Angeles, CA 90017

Part 4 – Providing Effective Appraisals and Reviews

This is a portion of a course provided the Society of Chief Appraisers.

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Part 4 – Providing Effective Appraisals and Reviews

Writing an Effective Report for the Client, i.e. "The Real World of Appraisal":

- Understand the client's desired Scope of Work for an Appraisal
- Understand the client's desired Level of Detail for an Appraisal
- Make the report(s) Error Free
- Understand the client's desired Scope of Work for a Review
- Understand the client's desired Level of Detail for a Review
- Recommendations

Appraisal Scope of Work

Understand What is Expected – Common Issues

- The provided information is often missing rent rolls, leases, other agreements (e.g. cell tower / billboard leases), entitlement status, plans, budgets, etc., which may warrant Extraordinary Assumptions.
- Do not use Extraordinary Assumptions as a form of laziness. Too often, that is the case.
- Communicate with the Client regarding missing information. Communicate! Communicate! Communicate!

- More on Extraordinary Assumptions after lunch

Appraisal Scope of Work continued

Client's Desired Scope (low) vs. Credible Report
- Do not allow the Client's desired scope result is something that is less than a USPAP-compliant credible report. You are the Appraiser!
- Alert the Client if their desired scope results in excessive Extraordinary Assumptions.

Appraisal Scope of Work continued

<u>What if the Client's Desired Scope is Higher?</u>
- Understand the Scope before Accepting the Assignment.

  - War Story – 1990's Bank of America

Appraisal Scope of Work continued

Common Issues with Scope of Work
- Building Area – Do they require the appraiser to measure the building?
- What other sources are available for Building Area, assessor, leases, building plans?
- Report what you did, and report what you used.
- Google Earth Pro allows you to measure things (e.g. lengths of walls, site dimensions, anything that needs a distance measured), use it!

Highest and Best Use & Market Analysis – Does the Market Analysis support the HBU conclusion?

Appraisal Scope of Work continued

Common Issues with Scope of Work
- Rent Rolls and Leases – Some clients demand you have the actual leases. Other may accept verbal information from the borrower.
- Income / Expense History – Tax returns vs. financial statements. Audited on non-audited statements. Audited are normally required with government lease that have percentage clauses, such as a restaurant in a Marina, e.g. all the restaurants in Los Alamitos Bay, Marina Del Rey, Gladstone's, most of the "Dukes" chain, etc.

Appraisal Scope of Work continued

Verification
- <u>What is Expected?</u> – Some clients allow public records, others are fine with CoStar, others want the appraiser to personally speak with a party to the transaction, e.g. buyer, seller or broker(s), some want it to be the buyer and / or the seller.

Additional Sections – Know What's Required
- Market Participant Survey
- Cap Rate Sustainability
- Reliance Language
- Insurable Value, RCN, Actual Cash Value

Appraisal Scope of Work continued

Inspection

- What is Expected? – For a large shop, is the "client contact" who signed the engagement letter (often the MAI in the office), expected to inspect the property? Can a lead or junior person be the sole inspector? Can an outside vendor be used as the inspector? Do the comparables need to be inspected? Can the report include photos of the comparables taken from CoStar, LoopNet, Google Maps (which have watermarks) or another source. If the property is a multi-tenant property, what percentage or number of units must be inspected?

Appraisal Scope of Work continued

<u>What Content and Analysis is Expected</u>
- <u>DCFs</u> – Understand when the client expects a DCF, and what type of DCF. Contact the Client whenever in doubt. Understand if a Client allows a "home made" Excel cash flow, or they expect Argus. If they Expect Argus, is Argus DCF acceptable, or do they want Argus Enterprise? Argus DCF is no longer sold, and support is no longer provided. Argus Enterprise was made for Portfolio, is more than double the cost of old Argus DCF, is more than double the complexity and requires much more training to become proficient. https://argus.altusgroup.com/products/argus-enterprise/

Appraisal Scope of Work continued

<u>What Content and Analysis is Expected</u>
- <u>Techniques used in Each Approach</u> – What techniques are included in a Sales Approach. For example, with apartment, do they just want a Price per Unit analysis (most commonly true) or do they want $$ per Unit, $$ per Room, $$ per SF, all with a standard adjustment grid, GRM, EGIM, and a $$/Room, $$/SF and $$/Room analysis with a Revenue and NOI ratio analysis, then a with Gross Income. Punchline – Mirror the market!

- War story time – apartment report & Zulauf story

Appraisal Scope of Work continued

Understand What is Expected – Common Issues
• When dealing with other income, explain it well, and perhaps call the client. Some reviewers expect all income to be subject to vacancy and collection loss. If the basis for the revenue category is historic collections, vacancy and collection loss might not be applicable. Be aware that NNN charges on multi-tenant properties rarely capture 100% of the expenses. That is a "pipe dream." In retail and office properties, when revenue is down, tenants run to the landlord to eliminate or reduce CAM and NNN charges.

Appraisal Scope of Work continued

Understand What is Expected – Common Issues
- Adjustment grids, quantitative vs. qualitative
- Support for adjustments, regression?, scalar?, paired data?
- Was the range reduced via the adjustment process?
- Is the adjusted range contained within the unadjusted range?
- Which comps were given most weight and why?
- Expense support, historic financials, survey data (e.g. BOMA, IREM, Penner), expense comps (sounds tough but is very easy)

Level of Detail of the Appraisal

Understand What is Expected – Common Issues
- Rarely, but sometimes, the client's desired level of detail is lower than what the appraiser normally provides.
- Do not allow the Client's desired level of detail result is something that is less than a USPAP-compliant credible report. You are the appraiser, it's your name & reputation on the line!
- If the level of detail is too low, consider communicating with the client and provide a restricted appraisal or don't accept the assignment.

Level of Detail of the Appraisal

Understand What is Expected – Common Issues
- Most often, if there is an issue, it's that the client's desired level of detail is higher than what the appraiser provided.
- Examples include: more or less rent/vacancy data, market participant surveys, data sheets, lack of photos of the comps, not enough subject photos, inclusion of a building sketch.
- Recommendation: Get a copy of the client's review template, and make certain everything they need is in the appraisal, preferably in the Executive Summary.

Level of Detail of the Appraisal

<u>Understand What is Expected – Common Issues</u>
- Addenda issues include: How many of the Argus printouts should be included? Should the purchase agreement, leases, rent roll, income/expense history, etc., or other pertinent legal, entitlement or zoning documents be included? Should a copy of State Certification, the Engagement Letter, clients other documents regarding scope of work, Statement of Qualification, etc. be included?

Scope of Work for Reviews

Understand What is Expected - Type of Opinion
- The first issue is what type of conclusion will be provided. Will the review conclude to a specific number, concur with the appraisal, conclude the value is high, OK or low, or conclude the report is credible? The first three result in the reviewer stepping into Standards 1 and 2. The last scenario, i.e. credible vs. not credible, is the only scenario where the reviewer stays in Standards 3 and 4, and has NOT stepped into the role for Standards 1 and 2.
- ASC Policy Statement – March 2018, page 10

https://www.asc.gov/Documents/PolicyStatements/2018%20March%20-%20Revised%20ASC%20Policy%20Statements.pdf

Scope of Work for Reviews

<u>Understand What is Expected – Scope / Work</u>
- While the scope of work for appraisals varies tremendously, the scope for reviews is much broader. Common issues include, will the entire report be read, will the math get checked (if so how much), will the reviewer search for more similar comparables, will the review verify the sales actually occurred, i.e. use CoStar, CoreLogic or another source (does the reviewer have the data services to do so), will the reviewer audit the DCF (does the reviewer have the software to do so) and many other similar issues.

Level of Detail of the Review

Understand What is Expected
- Review formats vary widely, from a one to two page document, to very long documents.
  - War story time – was report read vs long review?
- Many smaller community banks do not have the resources to create a template. They often do not have a Chief Appraiser or appraisal manager. Sometimes, the administrative staff for the CCO or CRO manages the appraisal process. The reviewer often uses their own review format.

Level of Detail of the Review

Understand What is Expected

- Large banks generally have sophisticated credit and underwriting departments that specialize in real estate; hence, their internal review templates are often very brief.

- Small community banks often have credit and underwriting departments where individuals work on everything, i.e. home loans, HELOCs, car loans, lines of credit, credit cards, auto leasing, equipment leasing, etc....one day this, next day that. They generally need much more detail in the review.

Make the Report Error Free

Consider Using one of the "Systems"
- Appraisal Writing Systems - Residential – Various companies provide form software for SFRs, apartments, and small commercial (UCIAR). Most of the Form software (e.g. a la mode, ACI, etc.) merely have you populate the form. They also provide Electronic Data Interchange (EDI) features to electronically upload the report in a digital file format.

Make the Report Error Free

Consider Using one of the "Systems"
- Appraisal Writing Systems - Commercial –Most of the commercial software consists of a multi-page Excel file (perhaps 30+ pages), a Database (usually hosted by the software provider), a Word Template which you can heavily edit and make it look like your existing template, and a lot of VBA code to make the Excel File, Database, and Word document talk to each other.
  - War Story Time – 50% time savings better report
- Digital File Formats are a dream for Commercial Reports. MISMO still has a lot of work to do.

Make the Report Error Free

Appraisal & Review Writing Systems – Tech Tools

Populate Date in Excel with RangeNames

Below is a portion of a Word Table
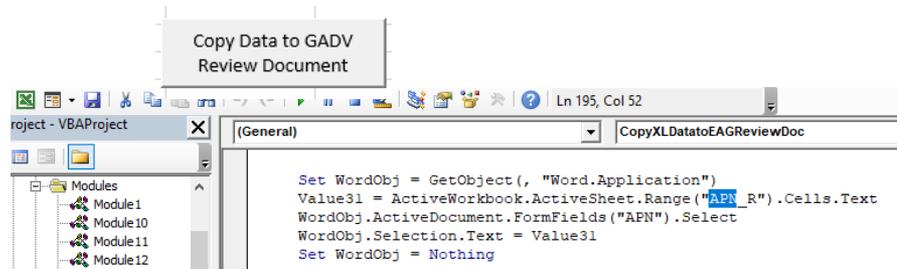
Write the VBA Code to Pick up Drop Off

Hit the VBA button and watch VBA move XL data to the Word Documer

Make the Report Error Free

- <u>Review Writing Systems</u> – They generally do NOT exist.
- <u>Create Your Own</u> - If you want one, you will need to make one. I have over $1,500,000 invested in mine. Like the appraisal software, it uses an Excel spreadsheet (with 30+ worksheets) a Database, Word template, and a lot of VBA code to complete the review document. The key concept is to "RangeName" every cell in XL you want moved to Word. Then "BookMark" every place in Word you want the information. Then use VBA to pick up and drop off the info. You can do this. It saves time.

Make the Report Error Free

Pitfalls of Not Using Appraisal Writing Software
- Inconsistencies – With most of the platforms, you type everything once in Excel, and the software copies that to every place in the appraisal it needs to go. As a reviewer, the record inconsistency was an appraisal with the APN reported in 6 places, all were different. The next issue is errors associated with typing in Word.

Make the Report Error Free

Pitfalls of Not Using Appraisal Writing Software
- Errors Typing in Word –The other day, an appraisal had a nice adjustment grid in the Sales Approach with well-support adjustments. The Approach concluded to $165 PSF, yet the final line in the Sales Approach showed:

$160 times 10,000 SF, or $1,650,000

The appraiser had typed $160 when the entire approach pointed to $165. It may be "just a typo", but this was the Primary Approach. Correction Time.

Make the Report Error Free

Recommendations when Using Appraisal Writing Software

- Use a Blank Template Every Time, NEVER start with a Previous Appraisal – A blank template eliminates bleed-through from a prior report with text that does not apply to the subject, and errors from hidden rows used in the expense analysis from a prior report.

Recommendations

Appraisal Recommendations
- Develop either via a Software system or create your own, a "tech platform" that can deliver "near error-free" reports.
- Develop a template system that is based on your toughest client's expectations, then create Tech tools that modify it for each client.
- Have a detailed Executive Summary that includes everything in your client's review template.   • Deliver "Unlocked" PDF
- Include a Significant Observations or SWOT analysis with a lot of thought and commentary
- Never argue with the Reviewer, battle vs war

Recommendations continued

Review Recommendations
- Understand your client's expectations, including data and math verification.
- Community vs. TBTF banks – if using your template, adjust it based on the Client's needs
- Develop a Tech system to save time
- Type once and only once
- Continuous system improvement - 5 keystrokes
  - War Story – development of the review platform
- Be kind to the appraiser. If support is missing, assume it's in the file, but didn't make it to the report. Focus on the Appraisal, not the Appraiser

Other Recommendations

Review Recommendations Continued
- Check your ego outside the door before you begin the review.
- Learn to be the chameleon. There are many ways to "skin the cat." Is the method in the report reasonable?
- If you disagree with something, support your opinion. Do not merely say "well, based on my XX years, this is…" Pull comps, get data
- Do not require the appraiser to write the report the way you would have written the report
  - War story - Greer's Philosophy