

Under the Microscope: The Inexact Science of Commercial Appraisals

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Introduction

- About the Speaker
- Current Economic Climate
- Credit Crisis
- Current Commercial Real Estate Market

Appraisal: Science vs. Art

- Is Appraising Fish or Fowl?
- How Scientific Can an Appraisal Be?
- Approaches to Value and Science
 - Cost (not always reflective of market conditions)
 - Sales Comparison (Currency and adequacy of data)
 - Income (Currency and adequacy of data)





When Science Gives Way to Art

- Changing Volatile and Inefficient Markets
- Unique Properties
- Excess and Limited Inventory Supply
- Rural Locations
- Proposed Construction Projects
- High Vacancy Properties
- Specialty and Unique Properties

Variances in Value

- Vacant Land
 1. Sales Price per Square Foot
 2. Sales Price per Acre
- Shopping Center
 1. Market Rent per Square Foot
 2. Sales Price Per Square Foot
- Office Space
 -  Market Rent Per Square Foot
 -  Sales Price Per Square Foot

When the Appraisal is Less Than Scientific (page 1)

- Exercise caution.
 1. Be slow to pull the loan trigger.
 2. Perform serious due diligence.
- Depend upon the best appraiser.
 -  This is not the time to use the fastest, cheapest, good-old-boy appraiser.
 -  Experience and training will rule.
- Review the appraisal very carefully.
 -  Perform in-house review.
 -  Order independent field review.

When the Appraisal is Less Than Scientific (page 2)

- Focus on quality.
 1. Be skeptical of un-established properties, weak tenants, areas of high unemployment, unsupported value conclusions, etc.
 2. Favor modern buildings, choice locations and established properties.
- Place collateral in a risk category.
 - ☞ Consider establishing a property rating system for risk.
 - ☞ Raise the bar for higher risk properties.

Dumb Blonde Appraisal Review Red Flags

- Broad Range Between Approaches to Value (5% or more)
- Projected NOI Exceeds Past History
- The Property Has Current or Past Vacancies Exceeding 5 %
- The Subject Property Has Significant Deferred Maintenance
- Month-to-Month or Short-Term Lease Tenants
- NOI Less than 125% of Debt Service
- Appraised Value Exceeds Estimated Replacement Costs New
- Projected Market Rent Exceeds Comparable Rent
- Comparable Listings Not Addressed
- No “Disposition Value” or “Liquidation Value”
- No “Go Dark Value” or “Value Assuming Vacant”

Closing Summary

- Science is best when you can get it.
- Art can be a good substitute.
- Learn the difference.
- Practice due diligence.
- Weigh risks.
- Underwrite accordingly.

Resource References

- Loopnet.com
- CoStar.com
- MarshallSwift.com