Are Commercial Evaluations Reliable? – One Veteran Appraiser's Judgment

CLAY RODGERS, SENIOR MANAGING DIRECTOR-VALUATIONS NOVEMBER 24, 2022

Clay's appraisal career spans 40 years beginning with his valuations work for the largest privately held appraisal firm in the Southeast during the 1980s, extending to his own fee-based appraisal shop in the 2000s, and then joining Boxwood in 2019. He was certified as a National USPAP instructor by the Appraiser Qualifications Board of The Appraisal Foundation and authored and taught continuing education courses for real estate appraisers and mortgage brokers. He is a State-Certified General Appraiser in Florida.

Commercial evaluations of real property have become increasingly useful valuation tools for financial institutions in recent years for a variety of reasons. Compared to traditional USPAP-compliant (Uniform Standards of Professional Appraisal Practice) appraisals, real property commercial evaluations provide lender clients with cost-effective property valuations in a timely manner. The pace of commercial lending transactions, from initial loan application to loan closing and issuance of funds, has accelerated rapidly in recent years. Unfortunately, the traditional appraisal process has not kept up with the faster-paced needs of lender clients and their borrowers. This situation has led to the promulgation and widespread use of commercial evaluations.

> **"From this author's perspective of 40+ years of appraisal, litigation, government and appraisal teaching experience, commercial evaluations can indeed produce credible property valuations on par with more traditional CRE appraisals."**

Traditionally, the vast majority of lending decisions involving real estate-related transactions were supported by commercial real estate (CRE) appraisals prepared by state-licensed and/or state-certified real estate appraisers. Development of these appraisal products are often very time consuming and expensive. Turnaround times of four to six weeks and appraisal fees of $3,000 to $5,000 are not uncommon depending upon the geographic market and assignment complexity.

As traditional CRE appraisal products have failed to keep up with the needs of financial institutions, increasingly commercial evaluations have filled the vacuum. But what exactly is an evaluation, and how does it differ from a traditional appraisal? According to the Interagency Appraisal and Evaluation Guidelines issued by "The Agencies" (OCC, FRB, FDIC, OTS, and NCUA) and codified in the Federal Register, an evaluation is defined as: "A valuation permitted by the Agencies' appraisal regulations for transactions that qualify for the appraisal threshold exemption, business loan exemption, or subsequent transaction exemption."

Additionally, the Guidelines state that an evaluation must be consistent with safe and sound banking practices and should support the institution's decision to engage in the transaction. An institution should be able to demonstrate that an evaluation, whether prepared by an individual or supported by an analytical method or a technological tool, provides a reliable estimate of the collateral's market value as of a stated effective date prior to the decision to enter into a transaction. The evaluation should, at a minimum:

- Identify the location of the property.
- Provide a description of the property and its current and projected use.
- Provide an estimate of the property's market value in its actual physical condition, use and zoning designation as of the effective date of the evaluation (that is, the date that the analysis was completed), with any limiting conditions.
- Describe the method(s) the institution used to confirm the property's actual physical condition and the extent to which an inspection was performed.
- Describe the analysis that was performed and the supporting information that was used in valuing the property.
- Describe the supplemental information that was considered when using an analytical method or technological tool.
- Indicate all source(s) of information used in the analysis, as applicable, to value the property, including:

    ✓ External data sources (such as market sales databases and public tax and land records).

    ✓ Property-specific data (such as previous sales data for the subject property, tax assessment data, and comparable sales information);

    ✓ Evidence of a property inspection.

    ✓ Photos of the property.

    ✓ Description of the neighborhood; and/or local market conditions.

    ✓ Include information on the preparer when an evaluation is performed by a person, such as the name and contact information, and signature (electronic or other legally permissible signature) of the preparer.

So, how do the above commercial evaluation requirements differ from more traditional CRE appraisal requirements? The short answer is, they don’t.

The primary difference between commercial evaluations and more traditional CRE appraisal products is rooted in the human component of the valuation process. Regardless of the valuation product label, the quality, accuracy, and reliability of the analysis is a function of the educational background, training, and experience of the analyst. According to the Guidelines, an institution's collateral valuation program should establish criteria to select, evaluate, and monitor the performance of appraisers and persons who perform evaluations. The criteria should ensure that:

- The person selected possesses the requisite education, expertise, and experience to competently complete the assignment.
- The work performed by appraisers and persons providing evaluation services is periodically reviewed by the institution.
- The person selected is capable of rendering an unbiased opinion.
- The person selected is independent and has no direct, indirect, or prospective interest, financial or otherwise, in the property or the transaction.

- The appraiser selected to perform an appraisal holds the appropriate state certification or license at the time of the assignment. Persons who perform evaluations should possess the appropriate appraisal or collateral valuation education, expertise, and experience relevant to the type of property being valued. Such persons may include appraisers, real estate lending professionals, agricultural extension agents, or foresters.

Therefore, while analysts engaged to prepare commercial evaluations are not required to be licensed or certified, they are very clearly required by the Interagency Guidelines to be knowledgeable and qualified to prepare valuation products that will stand up to scrutiny under review by financial institution clients.

Which brings us back to the question presented in the title of this article: Are commercial evaluations reliable? Based upon my personal experience as well as empirical evidence, the answer is a resounding "yes."

From this author's perspective of 40+ years of appraisal, litigation, government and appraisal teaching experience, commercial evaluations can indeed produce credible property valuations on par with more traditional CRE appraisals. The crucial element leading to credible valuation results is the qualifications of analysts preparing evaluations.

Boxwood Means is uniquely positioned to serve the valuation needs of our lender clients thanks to our highly qualified staff of analysts. Specifically, the valuation experience of individual team members ranges from 10 to 40 years and is complemented by broad geographical competence that allows us to reliably serve clients nationwide.

This conclusion is supported by empirical evidence as well because Boxwood is the only CRE property valuations firm in the country that voluntarily tests the performance of our evaluations. We recently conducted a statistical validation study of Boxwood's FieldSmart Evaluations that found that our reports compare favorably to more traditional CRE appraisals in terms of accuracy and reliability. In fact, one of the headline findings was that 78% of all FieldSmart valuation estimates fell within 10% of the post-hoc sales price and, altogether, 88% of the valuations were within 15% of the sales price. This also compares favorably with a study by Cannon and Cole that found that traditional commercial real estate appraisals are, on average, greater than 12% above or below the subsequent property sales price.

Given the pressures that lenders face today to simplify their processes, reduce lending costs, and accelerate cycle times, alternative valuation products like Boxwood's trusted FieldSmart Evaluations are a perfect fit.