

# Special Assets: Understanding the Valuation Needs of Asset Managers & Special Servicers

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## Special Reports

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*Commercial Real Estate Loan Losses and Risk to Financial Stability, Congressional Oversight Panel, February 11, 2010*

- [Introductory Video](#)
- [Oversight Report](#)

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## Federal Agency Guidance and Policy Statements

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- [Policy Statement on Prudent Commercial Real Estate Loan Workouts](#), Federal Financial Institutions Examination Council, October 30, 2009
- [Concentrations in Commercial Real Estate Lending – Sound Risk Management Practices](#), Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, December 12, 2006
- [Interagency Policy Statement on the Allowance for Loan and Lease Losses](#), Federal Reserve, Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, National Credit Union Administration, December 13, 2006
- [Frequently Asked Questions on Residential Tract Development Lending](#), Federal Reserve, Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, National Credit Union Administration, September 8, 2005
- [Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions](#), Federal Financial Institutions Examination Council, July 2, 2001
- [Interagency Appraisal and Evaluation Guidelines](#), Federal Reserve, Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, October 28, 1994
- [Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989](#)

# FIRREA

- Upon transfer to OREO, a national bank shall substantiate the parcel's market value by obtaining either:
  - An appraisal or
  - An appropriate evaluation
- A national bank shall develop a prudent real estate collateral evaluation policy that allows the bank to monitor the value of each parcel of OREO in an manner consistent with prudent banking practice.



# Appraisals for foreclosures

- Keys
  - Quality appraiser
  - Communicate, communicate, communicate
    - “Challenging” property?
    - “Unusual” types of value?
    - “Challenged” market?
    - “Challenging” review

# Who is ordering?

- **Lender or Outside Counsel as Agent for Lender?**
  - **What is intended use? Is litigation support needed?**
  - **Who selects appraiser? (For FIRREA compliant reports, selection must remain independent from business line – bank appraisal department or attorney acting as agent can select – preferable if bank appraisal department selects)**
  - **Who determines scope of work? (bank appraisal department should set base scope of work – attorney can augment scope of work as needed)**
  - **Appraiser payment (What happens if counsel is slow to pay one of your best appraisers?)**
  - **Subsequent review by bank – does this break attorney-client privilege work product?**

# Which Value(s)?



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- Appraisal Group is to obtain type(s) of value requested.
- Appraisal Group should provide definitions of types of value to appraisers to ensure understanding.
  - Market value
    - “a reasonable time is allowed for exposure in the open market”
    - exposure period derived from market
  - Liquidation value
  - Disposition Value

# Disposition vs. Liquidation Values

## Disposition Value

- Consummation of the sale will occur within a limited future marketing period specified by the client.
- Seller is under compulsion to sell.
- An adequate marketing effort will be made in the limited time allowed for the completion of the sale.

## Liquidation value

- Consummation of the sale will occur within a limited future marketing period specified by the client.
- Seller is under extreme compulsion to sell.
- A limited marketing effort and time will be allowed for the completion of the sale.

# Appraiser selection considerations

- Last appraiser?
  - “Don’t change horses mid-stream” vs. How good is your horse?
    - May know most about property
    - May not. (how was last appraisal?) May need to upgrade to a more qualified appraiser
- New appraiser?
  - Assuming there is a value difference, will using a different appraiser complicate the acceptance?
  - Will appraisal be used in litigation and if so, is this appraiser qualified & willing to testify?
  - Provide all or part of prior appraisal?



# Property Information

- Adequate subject property information should be available, but not always...
  - Loan officer no longer with the bank?
  - Incomplete loan file?
  - Property character or condition different from last valuation?
  - Appraisal ordered by a prior acquired institution?

# If inadequate information ....

- Engagement process will be elongated as appraiser will need to research the property.
- Revelations regarding the property may change the appropriate scope of work resulting in continued discussions of fee, delivery and potentially, appraiser.
- Extraordinary Assumptions.

# What is adequate information?

## To Bid

- Building size
- Land size
- Age/year built
- Occupancy
- Condition

## To Appraise

- Legal description
- Preliminary title report (describes easements, encumbrances etc.)
- Income/expense history, copies of leases

# Other considerations

- **Written engagement letters**
- **Property inspection (access, vacant units, property maintenance)**
- **Is the property actually being managed to the leases?**
- **Lease review (any opt out clauses?, major tenants coming up for renewal?)**
- **Vacant land – status of approvals?  
Location of utilities?**

# Environmental Issues

- **Chemicals and wastes abandoned on site** - Hazardous material, hazardous waste and unused and sometimes unlabeled containers with chemicals abandoned on site leave the Bank to figure out how to properly dispose of the material without becoming a hazardous waste generator.
- **Broken water lines and resulting water and mold damage** Buildings left unheated and water supply left on often leads to broken pipes, water damage and mold.
- **Buildings left with leaking roofs or sumps in basement that have been shut off, resulting water damage and mold** - with water entering interior and damaging walls and leading to mold growth.