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

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Thomas D. Boyle, MAI
Chief Appraiser
U.S. Bank
Policies & Regulations

AI Seminar: Subdivision Valuation: A Comprehensive Guide to Valuing Improved Subdivisions

Special Reports

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

- Introductory Video
- Oversight Report

Federal Agency Guidance and Policy Statements

- Policy Statement on Prudent Commercial Real Estate Loan Workouts, Federal Financial Institutions Examination Council, October 30, 2009
- 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
- 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 a 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?
- 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.