

CLE Conference – TAMPA

The Appraisal of Real Estate

Update on the State of the Appraisal Industry



Bank of America.



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Recycled Paper

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Goals of Presentation

- **FEDERAL REGULATIONS**
- **U.S.P.A.P.**
- **NEWS FROM A.I. ADVISORY COUNCIL**
- **CURRENT REPORT OPTIONS**
- **ALTERNATIVE VALUATION PRODUCTS**
- **TRENDS IN APPRAISAL INDUSTRY**
- **REAL ESTATE MARKET TRENDS**

Key Regulations

- **Basel Accord (B.I.S.)
Risk Rating Systems**

- **October 27, 2003
Joint Agency Statement**

Basel – It's all about Risk

$$\begin{array}{ccccc} \text{Estimated} & & \text{Loss} & & \text{Expected} \\ \text{Default} & & \text{Given} & & \text{Loss} \\ \text{Frequency} & \times & \text{Default} & = & \\ (\text{EDF, DP, PD}) & & (\text{LGD, LR, ...}) & & (\text{EL...}) \end{array}$$

What are the drivers?

Your answer is your Risk Rating Model.

Basel allows institutions to develop Simple or Advanced Internal Ratings System, depending on size.

Basel CMBS Delinquencies - Vintage

Figure 1: Performance Distribution by Vintage (%)

	Delinquency Status					Delinquency					
	1 Mo.	2 Mo.	3 Mo.	Forecl.	REO	Total	Adj. Total (Forecasted REO)	Adj. Total Pct of Orig	Forecasted Future Losses	Losses to Date as Pct of Orig	Proj'd Total Losses
1995	1.66%	3.17%	1.10%	0.00%	5.30%	11.24%	8.45%	1.90%	1.05%	1.63%	2.67%
1996	0.43	0.85	4.68	0.49	2.58	9.03	7.11	3.53	1.94	1.10	3.04
1997	1.04	0.31	2.67	0.52	1.02	5.56	4.32	3.15	1.73	1.07	2.80
1998	0.41	0.16	1.22	0.39	0.63	2.81	2.79	2.39	1.32	0.61	1.93
1999	0.42	0.20	0.87	0.41	0.59	2.49	2.58	2.35	1.29	0.34	1.63
2000	0.81	0.21	1.13	0.36	0.54	3.05	2.72	2.56	1.41	0.34	1.75
2001	0.23	0.24	0.70	0.06	0.22	1.46	1.82	1.77	0.97	0.10	1.08
2002	0.26	0.07	0.12	0.13	0.07	0.65	1.31	1.29	0.71	0.01	0.72
2003	0.01	0.00	0.01	—	—	0.03	1.01	1.00	0.55	—	0.55
All Deals	0.36	0.17	0.84	0.23	0.42	2.02	2.23	2.00	1.10	0.36	1.46

Notes: The adjusted delinquency measure is calculated by applying a likelihood of REO to each delinquency category as follows: current or less than 1 mo. (1%), 30 day (20%), 60 day (40%), 90 day (60%), in foreclosure (80%), and REO (100%). Forecasted additional losses equal 55% of adjusted delinquencies as a percentage of original balance.

Sources: Intex and Banc of America LLC Real Estate research.

Source: Intex, Bank of America

data/analysis from James Stouse, CFA, Bank of America

Historic high = roughly 7%; historic low = roughly 0.7%



Basel CMBS Delinquencies - Property Type

Figure 2: CMBS Delinquency by Property Type

	1995	1996	1997	1998	1999	2000	2001	2002	2003	All Deals	Forecasted Future Losses	Losses to Date	Projected Total Losses
Self Storage	1.00%	1.00%	1.00%	1.09%	1.22%	1.35%	1.11%	1.00%	1.00%	1.14%	0.63%	0.03%	0.65%
Manufactured Housing	33.51	2.17	2.11	1.13	2.01	1.07	1.57	1.03	1.00	1.41	0.78	0.09	0.86
Office	9.89	2.54	2.35	2.69	3.11	1.94	1.59	1.08	1.02	1.83	1.01	0.14	1.14
Multifamily	3.07	1.52	2.04	1.74	2.43	2.38	2.81	1.61	1.02	2.01	1.11	0.16	1.26
Retail	8.67	5.08	4.16	2.52	1.80	2.25	1.31	1.10	1.00	1.82	1.00	0.33	1.33
Industrial	1.00	2.72	2.89	2.32	2.97	3.31	1.61	1.58	1.00	2.21	1.22	0.23	1.44
Hotel	21.49	27.75	12.20	4.83	3.37	4.48	2.23	1.00	1.00	5.72	3.15	1.72	4.87
Senior Housing	8.36	25.20	3.35	11.01	4.59	1.00	1.00	1.00	1.00	8.13	4.47	2.89	7.36

Sources: Intex and Banc of America Securities LLC Real Estate research.

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Joint Agency Statement

- **10/27/2003 – Joint Agency Statement**
 - ✓ **FRB**
 - ✓ **OCC**
 - ✓ **FDIC**
 - ✓ **OTS**
 - ✓ **NCUA**
- **Appraiser Independence is Key Topic**

U.S.P.A.P. – Part 1

▪2004 Changes

- Standard 1 – practically none. Market value definition had “Cash” inserted in addition to “Equivalent to Cash...” 1-2-C-I
- Standard 2 – no changes
- In recent years – confidentiality was moved to ethics section – Statement 5 was retired

U.S.P.A.P. – Part 2

- **2004 BIG Changes - New Advisory Opinions**
 - ✓ **AO24 – Normal Course of Business**
 - ✓ **AO25 – Clarification of Client in a Federally Related Transaction**
 - ✓ **AO26 – Readdressing (Transferring) a Report to Another Party**
 - ✓ **AO27 – Appraising the Same Property for a New Client**

U.S.P.A.P. – Part 3 – AO 27

Appraising the Same Property for a New Client

Appraiser A accepts an appraisal assignment from Attorney X. The engagement agreement is silent on accepting other work related to this property, owner etc.. Per AO 27, the appraiser may accept another assignment from Attorney B (i.e. opposing counsel). AO 27 states that Appraiser A may be violating the ethics (i.e. confidentiality) rule if he/she informs either Attorney client of the other.

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News from A.I. Advisory Council

- **Appraiser Independence is a “HOT” topic**
- **Appraisal Quality is a “HOT” topic.**

Comment – The “feds” answered questions from the Appraisal Institute related to the 10/27/2003 Joint Agency Statement. Appraisal Independence was the key issue.

Note: E.A. Greer, MAI is not a member of the Advisory Council. Several coworkers are members.



Written Report Options for Appraisers

Process

Document

	Limited (departures)	Complete (all steps)
Restricted Use (a.k.a. letter report)		
Summary (most common)		
Self Contained (book)		

Oral Reports – no identified subcategories.

No changes in several years!

Alternative Valuation Products

- **Tax Assessed Valuations**

- **Assessed Value is converted to “Full” value and multiplied by a “multiplier.”**

- **Automated Valuations**

- **Hedonic regression models are the most common type.**

- **Hybrid AVMs**

- **AVM results used as supplemental analysis by valuation analyst**



Trends in Appraisal Industry

- Past few years have seen an increased use of “Alternative Valuation” products.
- The number of appraisal reviews has declined.
- Going forward, as interest rates continue to rise, loan losses should eventually rise. Rising loan losses should yield more appraisal activity.
- Currently, there is a trend to soften many states’ consumer protection laws, such as construction defect on condominiums, which may result in less litigation work.

National Market Trends

2004Q1 versus 2003Q4

- Apartment vacancies rose 0.3 percent, from 6.8 to 7.1 percent nationally. Rents were unchanged - \$862
- Industrial – data not available.
- Apartment vacancies rose 0.3 percent, from 6.8 to 7.1 percent nationally. Rents were unchanged - \$862
- Retail vacancies rose 0.07 percent, from 6.97 to 7.04 percent nationally. Rents rose \$0.08, from \$15.75 to \$15.83
- Source: Apartment, Office and Retail – REIS SE

Questions / Comments