Appraisal Reviews ... Critical for Mitigating Credit Risk

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This article is about the importance of conducting Appraisal Reviews and how the legal environment is creating additional risks for non-compliance with appraisal practice standards and also how that risk is impacting the need to actually formally review appraisals and not just accept them at “face value.” The first step is to define the concept of Appraisal Review. The great majority of appraisers (1.) practice appraisal in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP). Appraisal Review is defined by USPAP as the act or process of developing and communicating an opinion about the quality of another appraiser’s work that was performed as part of an appraisal or appraisal review assignment. Appraisal Review is a critical analysis of the appraisal report measured objectively against USPAP or other established appraisal standards (2.), measured against the logic and evidence presented in the report, and measured against the credibility and to some extent the competency of the appraisers.

The equipment finance industry includes independent finance companies, banks, asset-based lenders, specialty finance companies, investment banks and more. In most instances, the direct lender is concerned with the collateral value of the underlying equipment as well as the creditworthiness of the borrower. In other instances, such as a true lease, the financing source is equally interested in the front-end collateral value as well as the end-of-lease market value. In still other instances, such as a lease purchase, the financing source is somewhat interested in collateral value, but more interested in the creditworthiness of the lessee.

Banks and finance companies are both in the business of profitably loaning money. However, some dealers or brokers, who are selling the equipment, also own the finance entities. Here the beneficial interest includes the leverage to enable the sale of equipment at a profit as well as the profitable interest from the financing transaction.

'No Bias' Requirement for Appraisal Reports
An appraisal report prepared by a reasonably competent appraiser is required to act without bias and independent from the buyer, seller, or lender. The appraiser must identify the intended use of the appraisal, the intended users and identify the appropriate definition of value. The appraiser's work is governed by appraisal standards (USPAP) to disclose the scope of work performed, disclose the application of recognized appraisal methods and techniques, and include a certification statement that warrants that the appraiser is unbiased and is a disinterested party regarding the property and parties to the transaction. An appraisal report correctly identifies the property being appraised. The appraiser provides a logical and evidence-based opinion of the defined value. An appraisal report is a narrative argument supporting a particularly defined economic exchange value.

An appraisal report is a thesis, not a baseless personal opinion. Additionally, this report is a narrative professionally researched thesis-type opinion of a defined economic exchange value of the rights inherent in the ownership of the underlying property. It is supported by logic and sufficient evidence to present a credible opinion.

There are Many Definitions of Economic Exchange Value
The appraiser is required to identify the apposite definition of value and cite the source. The federally regulated lenders mandate the use of market value (3.) to support real estate financing. (4.) The same regulated lenders generally use Orderly Liquidation Value (5.) or Forced Liquidation Value (6.) for non-real estate asset based-lending. The definition of end-of-lease value is variously defined in the lease contract.

Identifying the apposite definition of value and citing its authority is an important element of the appraisal. However, such choices can lead to negligent liability. (7.) What is the clear meaning of Orderly Liquidation Value? The American Society of Appraisers (ASA) Machinery & Equipment discipline defines Orderly Liquidation Value time line as “given a reasonable period of time to find a purchaser.” The Association of Machinery & Equipment Appraisers (AMEA) defines Orderly Liquidation Value time line as “over an extended period of time, usually within six to twelve months, as of the effective date of the appraisal.” There is a rather sharp distinction between the ambiguous ASA time line of "a reasonable period of time to find a purchaser, and the AMEA time line of "over an
extended period of time usually six to twelve months.”

An independent professional appraisal report is an important element of collateral finance. Most appraisal reports were rarely critiqued. The rise in federal regulatory oversight, especially the Dodd Frank Act (8.) mandatory review requirement, has brought attention to the need to lessen lender risk and for regulatory compliance. An Appraisal Report Review is insurance against a faulty appraisal. Simply stated, an Appraisal Report Review Report is an objective critique of the underlying appraisal report performed by competent qualified reviewers in compliance with USPAP Standard Rule 4.

The American Society of Appraisers provides 52 hours of appraisal review course work that leads to an Appraisal Review Designation. For more information go to the American Society of Appraisers’ website.

Endnotes:

1. All professional appraisal associations require their members to practice in conformity with USPAP. The IRS Regulations require USPAP, U.S. Federal Financial Institution Regulatory Agencies require USPAP. The Agencies includes the FDIC, NCUA, OCC, and (FRB).
2. There are three sets of generally accepted appraisal standards, USPAP, International Valuation Standards (IVS), and the AICPA standards for business valuation.
3. 12 C.F.R. § 34.42(g) Definition OCC, FDIC, FR
4. Dodd Frank Act specifically mandated that all real estate appraisals be Reviewed under USPAP Standard Rule 3.
5. The American Society of Appraisers’ Machinery & Equipment Committee publishes this definition of Orderly Liquidation Value: “the amount of gross proceeds that could be expected from the sale of the appraised assets, held under orderly sales conditions, given a reasonable period of time to find a purchaser, considering a complete sale of all the assets as is, where is, with the buyer assuming all cost of removal, with all sales made free and clear of all liens and encumbrances.”
6. The American Society of Appraisers, Machinery & Equipment Committee publishes this definition of Forced Liquidation Value: “An opinion of the gross amount, expressed in terms of money, that typically could be realized from a liquidation sale, given a reasonable period of time to find a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis, as of a specific date.”
7. In a $10 Million lawsuit, the appraiser used the AMEA definition with a timeline of 6-12 months. When the lender foreclosed by auction in 30 days and sued the appraiser. The appraiser’s defense was the definition of value.