From: Vince Vincent

Subject: Appraisal and Evaluation Guidelines

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Comments:

31 December 2008

Re: Proposed Interagency Appraisal and Evaluation Guidelines
ID OCC-2008-0021
OP-1338
OTS-2008-0012

I would like to bring to your attention, what I consider to be, a faulty appraisal practice. During the course of my duties as a review appraiser for a commercial bank, I have observed appraisers that use entitlements as a method to justify the overvaluation of a property. The inflated value is then used as the borrower's equity contribution for a federally related commercial real estate loan.

For example, a developer purchases a parcel of land with the intention of developing the land with a 50 unit condominium building. The developer acquires the land for $5,000,000. The bank engages an appraiser to value the land, and the appraiser claims that the developer obtained zoning changes that allowed higher density development, preliminary municipal approval, and other entitlements. The appraiser then values the parcel at $7,000,000. The time that has elapsed from the date of the $5,000,000 purchase to the date of the $7,000,000 appraisal might be merely 3 - 6 months.

The problem for the review appraiser is that it is impossible to challenge the appraiser's claim. But, the increase in value does not pass the reasonableness test. The appraiser is implying that the seller was not aware that the highest and best use would be to obtain a more favorable zoning classification. The appraiser also implies that the seller either acted as an uninformed party, or that the seller was aware that the parcel was really worth $7,000,000, but agreed to sell the property at a deep discount, for some unknown reason. When challenged, the appraiser offers that the seller was under duress. There is no concrete evidence to support the appraiser's claim, and it is not possible for the reviewer appraiser to obtain concrete evidence that would prove/disprove the appraisers claim.

If a property was purchased for $5,000,000 and then could be sold for $7,000,000, wouldn't the huge return be sufficient incentive to motivate investors to actively seek out these types of deals? An investor would purchase a parcel, spend a relatively small amount of money to obtain the "entitlements", and turn around and sell the property for a large profit. And wouldn't these deals show up in multiple listing data? In other words, wouldn' t a market exist for these types of transactions? In reality, there are no such deals that show up on multiple listing services.

I am aware that the FDIC requires appraiser's to value a property "as-is". But the appraiser will argue that the zoning at the time of purchase did not represent the highest and best use, which negates the benefit of the FDIC as-is ruling.

I would like to provide a real life example. This is the most recent example of an appraiser that overvalues a property. It was taken from an actual

appraisal:

Begin example:
Appraiser: Title to the property is currently vested in X, a limited liability company. The property was purchased from Y in March 2008 for $9,625,000. There has been no other transfer of the subject property in the previous three years. The most recent sales price is lower than our concluded land value ($12,500,000) presented herein. The subject was placed under contract roughly two years prior to closing, and in the interim the buyer has successfully "up-zoned" the site. The site is zoned DX-5, with a FAR of 5x. The buyer had the density increased to 9.81x. In addition, the buyer had also received all government approvals, including necessary entitlements, to develop a 26-story apartment house. In our opinion, the increase in density, which permits a greater utilization of the site, has enhanced the value of the underlying land. Our concluded land value takes into account the enhancement in value due to the up-zoning of the site.
End example.

I would submit that the $9,625,000 value actually represented the value with the "up-zoning". Otherwise, the seller was not informed, or simply gave away a 30% discount ($2,875,000).

The most serious part of this problem is that the borrower will use the inflated value of $2,875,000 as an equity contribution. And the bank will accept and underwrite the loan using the inflated value as equity. If the bank has to take back the collateral, it is very unlikely that a buyer will step up and pay $12,500,000 for a parcel that was just purchased for $9,625,000. This is a common practice that creates an unnecessary risk to government insured funds, and it is going undetected.

I hope that you will consider that the FDIC's "as-is" value rule is very valuable, but it is ineffective in the situation that I am describing. I believe that this issue needs to be addressed in the interagency appraisal guidelines.

Thank you for your consideration.