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Appraisers and risk management

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Banks of all sizes are under pressure to identify the value of their portfolios. The pressure comes not only from government regulators, but also from individual and institutional investors. The investors are a bit less concerned because they feel their deposits/investments are insured by the federal government. But that only puts more pressure on the regulators to make sure the banks have it right. Consequently, banks feel pressure not only on the actual portfolio risk, but also because of regulatory risk. Regulatory reporting and defensive banking costs money and the money spent comes right off the bottom line. But until the regulators believe, and can assure the investing public, that banks are managing risk properly, there will be continued regulatory pressure - and continued reporting, and continuing regulatory costs.

Historically, appraisers have been employed to assist bankers in valuing the underlying assets upon which lending decisions are made. Most good appraisers are knowledgeable about the market they serve, the information necessary to value a property and the techniques needed to determine value. The very honest appraisers will tell you that they wish their data was better - more timely, more accurate, more detailed. The busy ones get lots of assignments that allow them to analyze the financial characteristics of leases, vacancies, expenses and capitalization rates. That level of detail is not necessarily available for the comparable sales that they did not have the opportunity to appraise. Like their banking clients, they sometimes must rely on generally available published reports and marketing materials. Few parties to a sale or lease transaction want to reveal the details of the transaction to the level that most appraisers need. Consequently, appraisers end up interpolating and extrapolating trends and indicators. That all well and good - until the trends start to change. When trends and market indicators change, appraisers and their lending clients can get caught flat-footed.

When appraisers have enough data and the data is detailed enough, it is amazing how well they can predict trends. Banks have that data. Problem is - they can't provide it to appraisers because of privacy and bank secrecy issues.

Most lenders require leases, vacancy reports and Income & Expense reports from their borrowers on an annual basis. The loan officer reviews the information professionally - and then files it with a folder full of other papers. But that information is valuable to other loan officers. The other loan officers probably don't care about the details of a new lease, but they do care about the trends. Are rental rates going down? Are vacancy rates going up? Are expense ratios getting too high to cover the debt service? Is investor risk being reflected in higher cap rates? All these answers are available. The information is in the "paper" files of the bank. Were it stored and managed in a computerized database, the data mining could begin. And when you mine data, you get information and you get reports. The information helps to manage the risk, and the reports help to meet the regulatory requirements.

Properly managed and analyzed, the computerized database will reduce risk and relieve regulatory pressures. The bigger the bank, the more valuable the database because more data means better information. The smaller the bank, the more risky each new loan becomes; that's because the larger more sophisticated lenders will be dumping the weaker properties and smaller banks might unwittingly consider the business a new opportunity.

Everything we do in life is being analyzed by computers. What we buy (Amazon), what type of advertising we respond to (Google), who we "like" on Facebook, what music we listen to on iTunes or Shazam or Pandora, etc.

So why aren't we analyzing leases, vacancies, expenses and cap rates so that we can predict trends? Mostly we don't do it because so much of the data we need is in the heads and the paper files of appraisers and loan officers - and very little of it is in a computerized database that is accessible to the people, programs and techniques that need it.

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