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Lacking Property Sales Data, Appraisers Look to Other Marketplace Drivers to Value Assets

Appraisal business is down, as investment sales activity and refinancing deals have declined. Now, appraisers must rely on supplemental data to make value assessments.

Patricia Kirk | Jan 26, 2023

Rising interest rates are having a snowball effect on all aspects of commercial real estate, limiting access to debt, increasing the cost of capital, lowering yields and leading to a significant decline in investment sales. These factors have created uncertainty around figuring out accurate asset values and widened the gap between sellers' asking prices and what investors are willing to pay, according to property valuation/appraisal experts.

Acquisition appraisals are down, says Eric Enloe senior managing director at Chicago-based Partner Valuation Advisors, a tech-driven property valuation start-up cofounded by this former JLL Capital Markets valuation lead along with JLL colleague Brandon Nunnink. The downturn in transaction activity has limited the data points traditionally used to value assets, presenting challenges for appraisers who must now look beyond sales data to place a value on assets, he notes.

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Without sales data to substantiate value trends in the marketplace, appraisers "must now open their tool bag and dig deeper to back assumptions on cap rates and analyze the impact of interest rates on income," says Grant Norling, MAI, cofounder and vice president of client experience at San Diego-based Valcre, a provider of commercial real estate appraisal software.

Appraisers now have to collect intelligence from a variety of sources, including deals that don't get done, to evaluate market conditions, according to Enloe. He notes that value indicators can vary by type and quality of the real estate asset. In the retail sectors, for example, "investors are bullish on grocery-anchored retail centers, and trophy malls are still in demand. But at the lower spectrum of quality, we have to look at aspects of an asset's repositioning potential." This involves income projections, as well as zoning, neighborhood growth and demand, best use or an unfulfilled need, such as specific type of retail or more housing.

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Tenant demand can also greatly influence property values, according to Norling. He cites a trophy office building that sold a few years ago for $50 million. When the anchor tenant left, it was revalued at $30 million. Meanwhile, the bank holding the loan was shopping the debt for $20 million.

Norling sees the biggest valuation shake-ups on the horizon for office and hotel assets, which currently lead in distressed property sales as a result of pandemic-related market changes. But the impact on office values is not as immediate as for hotels , because office leases in place vary from two to 10 years. “We are seeing office properties go into receivership (the first step toward foreclosure),” Norling notes adding that despite the growing risk of tenants downsizing when their leases are up , sellers aren’t budging on price unless they must sell for some reason.

The run-up in interest rates has also killed the appraisal business for refinancing deals, which Enloe notes “no longer pencil for lenders.” “We’re seeing short-term loan extensions getting done, but refis are hard for lenders to underwrite.”

Both Enloe and Norling say that appraisals for debt transactions by national banks are down significantly, as banks are being very selective about what to finance. Loan leverage has also been affected by the conservative lending stance of traditional real estate lenders, including the national and regional banks and credit unions. Enloe says, for example, that banks had provided 75 to 80 percent LTVs for multifamily assets prior to the rate increase, but LTVs are now at 65 to 70 percent.

Smaller regional and local banks are active in funding real estate deals, but are limited in the amount they can finance, Enloe says. He notes that insurance companies and pension funds are still funding larger deals .

The good news is “the appraisal industry is resilient. Valuers have successfully navigated the highs and lows of past business cycles and will do so again in the current economic downturn,” says Norling.

He notes that governments need appraisals for infrastructure right-of-ways and eminent-domain deals, REITs need portfolio appraisals for reporting requirements and banks need to demonstrate they have reserves to cover assets in their portfolios.

Additionally, property owners today are taking advantage of property devaluations to lower their property taxes and need appraisals to get assets reassessed.

In addition to these entities, Enloe says that his firm is also doing appraisals for banks' loan maintenance and distressed property sales ; pension fund and insurance company portfolios; special services providers (collection companies); and big, national investors' portfolios.

What's more, Norling forecasts that the bid/ask gap in the investment sales market will close in 2023, as sellers come to accept that buyers need to achieve a certain target return on investments and begin to meet buyers halfway on pricing.

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