JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

I. Other Presentations In Which Either The Date And / Or Sponsoring Organization Is Missing

6. Real Estate Finance/Mortgage Banking/Mortgage Guaranty Insurance

h. "Real Estate Loan Officers/Credit Administrators", no date

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AFTERNOON SESSION
2:30 P.M.

Real Estate Loan Officers/Credit Administrators

I. Basic strategy of a commercial mortgage loan is repayment control or salvage of position.

   A. Pleasure, pain or bail-out.

   B. Real collateral is profit centers and pride of borrower over the same time period as the loan repayment.

      1. FHA defaults when fees and tax shelter were used up.

      2. Retainage, earn out escrows, controls on dividend distributions all control time of distributions.

   C. Letters of commitment define selective measures of pain, such as late payment penalties, loss of interest on escrows, occupancy goals or loan reductions, acceleration of balance due, loss of management contract, etc.

   D. Appraised value less mortgage balance was supposed to measure the pain of equity loss in the event of default. It doesn't since the professional real estate operator has removed cash equity early during the project cycle.

      1. The appraiser should be measuring salvage value if project proves to be imperfect.

      2. Lender who makes nonrecourse loan is selling a put at the amount of the loan balance outstanding plus the legal costs of recapturing title.

      3. The equity required by the borrower should be the cost to the lender of recapturing title and the balance of the loan should not exceed the value of the investment adjusted for its weaknesses - probably market penetration at a rental price.

   E. The loan officer and the appraiser should be attempting to measure profit centers of the borrower in amount and time - similar to value added by the borrower/project manager at each stage of development.

   F. For example, an Embassy Suites Hotel will cost $19 million built on top of a city parking ramp air rights lease. 230 rooms and 100 leased parking spaces. Appraiser concludes on a five-year forecast that it will sell for $27 million in 1994. He assumes it will open in 1989 with a fair share of class A rooms or 62% occupancy at a $85 average rate - rising to 72% occupancy at $115 rate by the end of the fifth year. Value added by the market penetration assumption is the critical assumption. The appraiser should also measure the value added by that assumption. What if the new hotel receives only 75% of its fair share because of location?

G. Make the appraiser measure value added by key assumptions so that the source of risk is apparent and you can distinguish between a business strategy based on a lower price or narrower market and optimal market presumed by highest and best use.

H. Discounted cash flow models should allow you to estimate present value of various components in the profit center orientation of the borrower or investor. Unfortunately, the borrower may be the developer and the investor a passive, hopeful money partner who represents a second mortgage, revenue bond creditor to protect the risk position of the developer. (See Dilmore as point of departure.)

I. The function of an appraisal is to establish certain benchmarks that are relevant to a decision, to tax, to lend, to sell, or to compensate for involuntary conversions. Bankers must learn to purchase appraisals which focus on what the bank needs to know rather than what the appraiser wants to do. You should develop a letter of engagement which specifies the need for certain types of information and the irrelevance of certain kinds of valuation methodology to your decision.