



## Pretend and Extend: A Deep Dive into Commercial Real Estate Lending's Hidden Crisis

### CHAPTER 14:

### THE CONTINUUM OF CLARITY WHY EVALUATION AND APPRAISAL ARE NOT OPPOSITES

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The commercial real estate lending industry has long operated under a false binary: evaluations versus appraisals, speed versus accuracy, cost efficiency versus regulatory compliance. This artificial division has created operational blind spots that compromise both risk management effectiveness and cost optimization. In reality, evaluations and certified appraisals represent complementary points on a continuum of clarity, each serving distinct but interconnected roles in comprehensive due diligence frameworks.

The regulatory landscape reinforces this artificial separation through threshold-based requirements. All federally related transactions that are commercial real estate transactions having a transaction value of more than \$500,000 shall require an appraisal prepared by a State certified appraiser, while smaller transactions may utilize evaluations. Yet this regulatory structure, designed for administrative efficiency, has inadvertently encouraged lenders to view these tools as mutually exclusive alternatives rather than components of an integrated valuation strategy.

#### Understanding the Continuum

The most sophisticated lending institutions recognize that valuation clarity exists along a spectrum, with different analytical tools appropriate for different risk tolerances and decision requirements. At one end, automated valuation models (AVMs) and broker price opinions provide rapid, cost-effective insights suitable for initial screening or portfolio monitoring. In the middle, evaluations offer professional analysis with standardized

reporting formats. At the other end, certified appraisals deliver comprehensive, defensible valuations with full regulatory compliance and professional liability coverage.

This continuum approach acknowledges a fundamental truth: the optimal level of valuation rigor should match the complexity and risk profile of both the transaction and the decision being made. A routine refinancing of a stabilized office building with strong tenant credit may require different analytical depth than the acquisition financing of a mixed-use development with speculative lease-up assumptions.

More importantly, movement along this continuum need not be predetermined. The same valuation professional conducting an evaluation can identify analytical limitations or unexpected complexity that warrant escalation to certified appraisal standards. This seamless transition capability represents one of the most underutilized advantages of the continuum approach.

#### Evaluation Excellence: More Than Appraisal Light

The commercial lending industry's treatment of evaluations as "appraisal light" fundamentally misunderstands their analytical value and appropriate application. An evaluation provides an estimate of the market value of real estate but is not subject to the same requirements as a Title XI appraisal, such as the requirement to use a certified or licensed appraiser, yet this regulatory distinction doesn't diminish their analytical rigor when properly deployed.

Well-executed evaluations excel in several specific contexts:

#### Transaction Monitoring and Portfolio Surveillance:

For existing borrowers with established relationships, evaluations provide cost-effective mechanisms for periodic value verification without the expense and timeline requirements of certified appraisals. This is particularly valuable for loan modification discussions or credit line adjustments where approximate value ranges suffice for decision-making.

#### Initial Due Diligence and Screening:

In competitive transaction environments, evaluations enable rapid preliminary underwriting while preserving the option to escalate to certified appraisals based on findings. This approach prevents deals from stalling while maintaining analytical integrity.

#### Low-Complexity Property Types:

For standardized property types with abundant comparable transactions—such as neighborhood retail centers or suburban office buildings—evaluations can provide sufficient analytical depth at significantly reduced cost and timeline.

The key insight is that evaluation effectiveness depends not on the professional credentials of the analyst, but on the appropriateness of the analytical framework to the complexity of the valuation challenge. Simple properties in active markets with abundant data may require less analytical complexity than unique properties or those in transitional markets.

## When Clarity Demands Certification

Certified appraisals serve specific functions that evaluations cannot replicate, but these functions relate to analytical depth, professional liability, and regulatory compliance rather than fundamental competence. Understanding when these additional requirements justify the incremental cost and timeline represents critical institutional knowledge for commercial lenders.

**Complex Property Types and Analysis:** Properties requiring specialized analytical techniques—such as special purpose buildings, development sites, or assets with unique income characteristics—benefit from the comprehensive analytical frameworks that certified appraisals provide. The difference isn't just professional credentials, but access to specialized analytical techniques and reporting standards.

**High-Risk Transactions and Borrowers:** When transaction structures involve significant leverage, speculative assumptions, or borrower credit concerns, the additional analytical depth and professional liability coverage of certified appraisals provide meaningful risk mitigation. This includes construction-to-permanent financing, cash-out refinancing above traditional loan-to-value thresholds, or loans to borrowers with limited operating history.

**Regulatory and Examination Scrutiny:** Beyond the formal threshold requirements, certain lending relationships or portfolio concentrations may warrant certified appraisals to demonstrate prudent risk management practices. This is particularly relevant for institutions facing regulatory attention or those with significant commercial real estate concentrations.

**Legal and Workout Scenarios:** When valuation opinions may be subject to legal challenge—such as in foreclosure proceedings, bankruptcy courts, or borrower disputes—the professional standards and liability coverage associated with certified appraisals become essential.

## The Escalation Advantage

The most sophisticated aspect of continuum-based valuation management involves seamless escalation from evaluation to certified appraisal based on analytical findings rather than predetermined transaction characteristics. This approach maximizes both cost efficiency and analytical comprehensiveness.

Consider a routine refinancing evaluation that identifies unexpected vacancy increases, recent comparable sales at significant discounts to previous levels, or unusual tenant modification activity. Rather than completing an evaluation that raises more questions than it answers, the same valuation professional can expand the analytical scope to certified appraisal standards, providing comprehensive analysis of the issues identified during initial evaluation work.

## This escalation capability offers several advantages:

**Cost Optimization:** Institutions avoid paying for certified appraisal level analysis when evaluations provide sufficient clarity, while ensuring comprehensive analysis when complexity emerges.

**Timeline Management:** Starting with evaluation-level analysis allows rapid identification of properties requiring deeper analytical attention, enabling more efficient resource allocation across portfolio pipelines.

**Professional Continuity:** The same analyst familiar with property-specific issues can expand analytical depth without the inefficiencies of transferring incomplete analysis to different professionals.

**Risk Calibration:** Analytical findings, rather than transaction characteristics, determine the appropriate level of valuation rigor, ensuring resources focus on properties where additional clarity provides the greatest risk management benefit.

## Implementing Continuum-Based Policies

For commercial lending institutions, implementing continuum-based valuation policies requires moving

beyond binary thinking toward frameworks that recognize the interconnected nature of evaluation and appraisal analysis. This involves several operational considerations:

**Professional Relationships:** Rather than maintaining separate vendor relationships for evaluations and appraisals, institutions benefit from working with valuation professionals capable of providing both services and making appropriate escalation recommendations based on analytical findings.

**Internal Training and Guidelines:** Credit officers and relationship managers need clear frameworks for understanding when evaluation findings warrant escalation to certified appraisal standards. This includes recognition of property complexity indicators, market condition factors, and borrower risk characteristics that suggest additional analytical depth would provide meaningful decision-making value.

**Cost-Benefit Analysis:** Policies should explicitly recognize that the incremental cost of certified appraisals may be justified by factors beyond regulatory requirements, including transaction complexity, borrower risk profile, or portfolio concentration considerations.

**Documentation Standards:** Whether utilizing evaluations or certified appraisals, consistent documentation of valuation scope decisions helps demonstrate prudent risk management practices and supports regulatory examination processes.

**Quality Control Processes:** Effective continuum management requires quality control frameworks that assess both the appropriateness of valuation scope decisions and the quality of analytical work product, regardless of whether evaluations or certified appraisals were utilized.

## Beyond Regulatory Compliance

The most significant missed opportunity in commercial real estate valuation involves treating regulatory threshold requirements as analytical decision points rather than minimum compliance standards. The Appraisal Rule increases the current appraisal threshold for commercial real estate (CRE) transactions from \$250,000 to \$500,000, yet these thresholds reflect

administrative efficiency considerations rather than risk-based analytical requirements.

Sophisticated institutions recognize that risk-appropriate valuation decisions may call for certified appraisals below regulatory thresholds or evaluations that exceed typical scope expectations based on property and borrower characteristics. The regulatory framework provides minimum standards, not optimal risk management guidance.

This perspective becomes particularly important as commercial real estate markets face increasing volatility and complexity. Properties that appeared routine during stable market conditions may require enhanced analytical attention during transition periods, regardless of transaction size or borrower characteristics that previously suggested evaluation-level analysis would suffice.

### The Integration Imperative

The false opposition between evaluations and appraisals reflects broader institutional tendencies to treat risk management tools as competing alternatives rather than complementary components of comprehensive due diligence frameworks. The same thinking that positions evaluations and appraisals as opposites often treats credit analysis and market analysis as separate functions, or views regulatory compliance and risk management as distinct objectives.

In reality, effective commercial real estate lending requires integration across multiple analytical dimensions, with valuation clarity serving as a foundational component that informs credit decisions, regulatory compliance, and portfolio management strategies. Evaluations and certified appraisals represent different tools for achieving appropriate levels of clarity, not different philosophies of risk management.

The institutions that master this integration—treating evaluations and appraisals as complementary points on a clarity continuum rather than competing alternatives—position themselves for superior risk-adjusted returns

while maintaining cost efficiency and regulatory compliance. They avoid the operational inefficiencies of predetermined analytical approaches while ensuring adequate rigor for complex or high-risk scenarios.

More fundamentally, they recognize that the goal isn't choosing between evaluations and appraisals, but achieving optimal clarity for each unique combination of property characteristics, market conditions, borrower profile, and institutional risk tolerance. This nuanced approach to valuation management represents both a competitive advantage and a professional imperative for commercial lenders navigating increasingly complex real estate markets.

The continuum of clarity isn't just about valuation methodology—it's about institutional sophistication in matching analytical tools to decision requirements. The lenders who master this matching process will find themselves better positioned for both current market challenges and whatever complexities emerge in commercial real estate's continuing evolution.

This analysis reflects current regulatory frameworks and industry best practices. Institutions should consult with compliance and risk management teams to ensure valuation policies align with specific regulatory requirements and institutional risk tolerances.



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