**Appraisal Overview Commercial vs. Residential:**

Nearly all mortgage transactions use appraisal reports to help determine the value of a given property. In general, there are two types of appraisals - Residential Appraisals (known as URAR - Universal Residential Appraisal Report) and Commercial Appraisals.

All appraisals are performed by properly licensed individuals. Residential and Commercial appraisals carry different licensing needs.

Residential appraisals are fairly straight forward. An appraiser makes a general assessment of value based on similar recently closed comparable sales in the immediate area (generally 3 to 6 comparable properties are used). They then adjust the specific value of the subject property against its condition and inherent desirability as compared to the comparable properties used in their appraisal report.

This approach is called the COMP approach.

In some cases, mostly with investment residential mortgages, the appraiser will also do a comparable rent analysis to try to determine the general market rent for the specific property being appraised.

Commercial appraisals are not so straightforward. In general there are two ways to value a commercial property. The first is the COMP approach, and it is very similar to the COMP approach used in a residential appraisal. The second is the income approach. This is very different from residential appraisals.

The income approach is an approach to valuation where the appraisal will do a comparable rent analysis and then use those figures to determine a value. Generally, the value is determined by dividing the net income of a property (gross income minus expenses for the property) by a reasonable CAP (capitalization) rate for a specific property in a specific area. A CAP rate is a measurement of the cost of financing capital for a specific property in a specific area. CAP rate figures are posted by large banking institutions (the largest being CBRE) and updated regularly depending on many different market conditions and factors.

Mathematically the income valuation approach is expressed via: Value = Net Income / Cap Rate.

Another complication of commercial appraisals is that lenders will overweight certain aspects of a commercial appraisal depending on their own lending criteria and risk analysis. Some lenders will lean on the COMP approach (typically ones where they are not verifying the income or qualifying the creditworthiness of a tenant). Others will lean on the COMP approach. Others will use a more blended approach. Others may judge the overall liquidity of a certain property in a given market over the value.

Ultimately, the commercial appraisal is much more dynamic and much less agreed upon across multiple lenders as compared to residential appraisals where lenders typically agree upon the COMP approach as being the best valuation method.