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Get to Know PCAs

A quality property-condition assessment is imperative for many clients

When helping clients seek a loan for a commercial property, mortgage brokers are in a prime position to sort through and explain the various due-diligence requirements. For commercial loans, engineering due-diligence studies have become especially important. These often are done via property-condition assessments (PCAs).

Brokers can help their clients by understanding what goes into a quality PCA and how to identify potential discrepancies when reviewing the reports.

Two-phase approach

PCAs help lenders understand the type of capital risk involved with the key site systems on the property a borrower is using as collateral. The PCA-preparation process often has two phases.

First, engineers conduct a field inspection of the material asset. They visually evaluate mechanical, electrical and plumbing components, as well as the building shell and structural members, for integrity and condition.

Second, they transcribe the data collected in the field into a narrative summary of the critical site and building systems. They develop a schedule of immediate expenses and a long-term capital-reserve schedule. The narrative summary and the capital-reserve schedule should indicate the:

- **Asset type and grade**, including whether it complies with regulatory building mandates;
- **Condition of the critical building** systems and site features;
- **Short-term cost** of correcting deficiencies; and
- **Long-term cost** of operating and maintaining the site and structures.

Being thorough

Industry standards require PCA reports to consist of a visual observation of site components and elements.

Often, discrepancies in PCA reports can be traced to poor data-collection techniques during the field inspection. Field engineers are the frontline observers in a real estate due-diligence study and the most-critical members of the inspection team. They relay site information to underwriters and technical managers who have never visited the property. When field inspections are not thorough and detailed, the results can be catastrophic for lenders and property-owners.

For example, in one instance, a field engineer inspected a building's 100,000-square-foot flat-roofing system. The inspector traversed a small area of the roof surface in the vicinity of the roof hatch and concluded that the roof was in good condition with only minor signs of deterioration and some loose fasteners that could be repaired.

It was later discovered, however, that the roofing system had numerous areas of deflection and warping, a significantly breached exterior membrane, and severe water-intrusion problems. This resulted in a lawsuit against the due-diligence consultant for negligent engineering practice, loss in value on the lender's collateral, and a massive unanticipated capital expense to the borrower.

In another example, a field engineer inspected a relatively new apartment complex. Based on the date of construction and without removing any electrical-receptacle covers, the engineer concluded that the electrical branch wiring was copper. Later, building maintenance discovered

that the branch wiring was aluminum. Although aluminum wiring is widely permitted and used in high-voltage transmission lines and service entrances, it can be a fire risk in some instances.

Such misses during a PCA inspection can result in catastrophic financial losses for a lender and in some cases, death or serious injury to inhabitants, resulting in further liability and costly litigation for borrowers.

Beyond the minimum

Inspections for large commercial structures often require engineers to cover 10 percent of the net-rentable-floor area. Property-managers, however, may steer field engineers to a nonrepresentative sample of the building areas.

For instance, in assessing a 30-unit apartment, say an inspector limited the observation to three units on the first floor, therefore fulfilling the 10-percent-access requirement. But the inspector did not see a sagging floor on an upper floor caused by the deflection of a load-bearing beam beneath the floor. Building maintenance applied the lumber posts and plywood decking to mask the problem, but the root cause was not addressed until the deflection spread to other areas.

For everyone to have a solid understanding of the entire site, it is important for PCA

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inspections to encompass a full representative sample of the property. Some lenders and property-buyers will even require 50-percent to 100-percent unit inspection to avoid such pitfalls. Structural failures are expensive to repair, can pose life or safety risks to building occupants and employees, and sometimes may warrant revoking the certificate of occupancy.

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Engineering-consulting firms must take the necessary measures to ensure their field inspectors adhere to the standard practice for conducting PCAs. These measures should include an intensive, in-house training program and education on site-inspection protocol, streamlined site-inspection checklists, and degreed and accredited engineers conducting the inspections.

Mortgage brokers can help their clients and lender partners by advising them to order PCAs from firms that provide these thorough and intensive services. ●