Interagency Appraisal and Evaluation Guidelines
December 10, 2010

Understanding the New Interagency Guidelines
Conference Web Page

• Today’s PowerPoint
• Audio
• Questions
Questions

- education@fncinc.com
- Chat box submission
Program Overview

- Overview of the Interagency Guidelines
- Comparison between Interim Final Regulations and the Interagency Guidelines
- Specifics and Applications
- Questions
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Quick Facts on Interagency Guidelines

- **Interagency Appraisal and Evaluation Guidelines**
  - Published in the Federal Register on December 10, 2010, 75 FR 77450
  - Effective on publication
  - Rescinds
    - 1994 Interagency Appraisal and Evaluation Guidelines
    - 2003 Interagency Statement on Independent Appraisal and Evaluation Functions
    - Interagency Statement on the 2006 Revisions to USPAP
  - **Still Effective**
    - 2005 Interagency FAQs on Residential Tract Development
Quick Facts on Interagency Guidelines

• Interagency Guidelines are issued jointly by
  • Office of the Comptroller of the Currency, Treasury (OCC);
  • Board of Governors of the Federal Reserve System (FRB);
  • Federal Deposit Insurance Corporation (FDIC);
  • Office of Thrift Supervision, Treasury (OTS); and
  • National Credit Union Administration (NCUA)

• And apply to all institutions that they regulate
Interagency Guidelines v. Interim Final Regulations

• How are the Interagency Guidelines different from the Interim Final Regulations?
  • Interim Final Regulations, issued by the Federal Reserve Board on Oct. 18, 2010 arise from the Appraisal Independence requirements in Title XIV, Subtitle F of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)
  • Interim Final Regulations apply to Consumer Credit Transactions, that is, “consumer credit transaction secured by the principal dwelling of the consumer,” not all real estate-related transactions
Interagency Guidelines v. Interim Final Regulations

- Interagency Guidelines arise from the appraisal regulations written under Title XI of the Financial Institutions Recovery, Reform, and Enforcement Act of 1989 (FIRREA)
  - Title XI, the appraisal regulations and the Interagency Guidelines apply to all “federally related transactions” which is much broader than consumer credit transactions (“consumer credit transaction secured by the principal dwelling of the consumer”)
What is a Federally Related Transaction?

• (4) Federally related transaction. The term "federally related transaction" means any real estate-related financial transaction which —
  • (A) a federal financial institutions regulatory agency or the Resolution Trust Corporation engages in, contracts for, or regulates; and
  • (B) requires the services of an appraiser.

• (5) Real estate-related financial transaction. The term "real estate-related financial transaction" means any transaction involving —
  • (A) the sale, lease, purchase, investment in or exchange of real property, including interests in property, or the financing thereof;
  • (B) the refinancing of real property or interests in real property; and
  • (C) the use of real property or interests in property as security for a loan or investment, including mortgage-backed securities.
Interagency Guidelines Apply Broadly

- Interagency Guidelines therefore apply to substantially all of the real estate-related transactions (financing, leasing, purchasing) which a regulated institution engages in, for example:
  - Single-family and multi-family residential
  - Commercial and industrial
  - Capital markets, including asset securitization and whole loan sales (and purchases)
- Interagency Guidelines and Interim Final Regulations do intersect especially on issues related to appraisal independence.
Principles in the Interagency Guidelines

• There are three overriding principles that we saw emerge in the Interagency Guidelines
• First, an institution needs to establish consistent, reliable processes by which its policies are established, applied, adhered to, monitored, reviewed and adapted
• For example:
  • An institution’s board of directors or its designated committee is responsible for adopting and reviewing policies and procedures that establish an effective real estate appraisal and evaluation program.
  • The Guidelines provide guidance on the Agencies’ supervisory expectations regarding an institution’s process for selecting, using, validating, and monitoring a valuation method or tool.
  • An institution’s appraisal and evaluation policy should establish internal controls to promote an effective appraisal and evaluation program.
Principles in the Interagency Guidelines

• Second, back to the fundamentals:—Safety and Soundness comes first. Sometimes the cheapest and fastest option is not the appropriate option.
  • An institution should not allow lower cost or the speed of delivery time to inappropriately influence its appraisal ordering procedures or the appraiser’s determination of the scope of work for an appraisal supporting a federally related transaction.
  • As loan repayment becomes more dependent on the sale of collateral, an institution’s policies should address the need to obtain an appraisal or evaluation for safety and soundness reasons even though one is not otherwise required by the Agencies’ appraisal regulations.
Principles in the Interagency Guidelines

• Third, back to the fundamentals, part 2. The fundamental principles of appraisal have not changed. Appraisals still need to:
  • Conform to generally accepted appraisal standards as evidenced by the USPAP unless principles of safe and sound banking require compliance with stricter standards
  • Be written and contain sufficient information and analysis to support the institution’s decision to engage in the transaction
    • The appraisal also should include a discussion on market conditions, including relevant information on property value trends, demand and supply factors, and exposure time
  • Analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units
And, now for the Interagency Guidelines

- The new Interagency Guidelines at 70 pages provide much more detail and guidance than the nine-page 1994 Interagency Guidelines they replace
  - There are 18 sections and four appendixes
  - We will focus on the key elements (and quote sections as much as possible), but will not cover everything
  - To make sure we do not get lost, we will alert you to the section by number
  - This presentation is not a substitute for reading and reviewing the Interagency Guidelines yourself in order to implement them in your institution
V. Independence of the Appraisal and Evaluation Program

• “For both appraisal and evaluation functions, an institution should maintain standards of independence as part of an effective collateral valuation program for all of its real estate lending activity.”

• “The collateral valuation program is an integral component of the credit underwriting process and, therefore, should be isolated from influence by the institution’s loan production staff.”
V. Independence of the Appraisal and Evaluation Program

• “An institution should establish reporting lines independent of loan production…”
  • “…for staff who administer the institution’s collateral valuation program, including the ordering, reviewing, and acceptance of appraisals and evaluations.”
  • Small/rural institution or branch exception

• “Appraisers must be:
  • Independent of the loan production and collection processes and
  • Have no direct, indirect or prospective interest, financial or otherwise, in the property or transaction.”

• “These standards of independence also should apply to persons who perform evaluations.”
V. Independence of the Appraisal and Evaluation Program

• Communications (between institution and appraiser or evaluator)
  • Exchange of appropriate information about the assignment (real exchange, including need to establish process for responding to appraiser questions)
  • Avoid communications that might compromise appraisal independence
    • Similar to HVCC and Interim Final Regulations standards—but you should review for differences
      • Interagency Guidelines “an institution should not directly or indirectly coerce, influence, or otherwise encourage an appraiser or a person who performs an evaluation to misstate or misrepresent the value of the property”
      • Interim Final Regulations. Comment 42(c)(1)–2 clarifies that a covered person does not violate § 226.42(c)(1) if the person does not engage in an act or practice set forth in § 226.42(c)(1) for the purpose of causing the value assigned to the consumer’s principal dwelling to be based on a factor other than the independent judgment of a person that prepares valuations
V. Independence of the Appraisal and Evaluation Program

- Avoid communications that might compromise appraisal independence
  - Avoid influencing value through prohibited means
  - But may request clarification, correct factual errors etc.
  - Provide copy of sales contract
  - Second appraisal permitted but not if value shopping

- Reporting an appraiser to a state regulatory agency is not coercion (although be careful of false allegations)
VI. Selection of Appraiser or Persons Who Perform Valuations

• “An institution or its agent must directly select and engage the appraiser.”
  • Same for persons performing an evaluation
  • Borrower cannot order or recommend (*but can alert you to the existence of a current appraisal*)
  • (And remember, under Fannie Mae/Freddie Mac HVCC and post-HVCC rules, a mortgage broker or real estate agent still cannot be the “agent” who selects or engages. FHA has similar prohibitions, see 4155.2 4.1.1)

• The selection and engagement needs to be independent of loan production
  • See definition in Appendix D. “all personnel responsible for generating or approving loans, as well as their subordinates and supervisors.” Anyone compensated based on loan volume.
VI. Selection of Appraiser or Persons Who Perform Valuations

• Person selected for the assignment needs to be competent
  • Requisite education, expertise and experience relevant to the type of property appraised
  • Geographic competence
  • Capable to rendering an unbiased opinion
  • Independent and has no direct or indirect interest in the property (conflict of interest)
  • Appropriately licensed
  • Work has been periodically reviewed by the institution
VI (A) Approved Appraiser List

- Approved appraiser list returns to the lexicon
- Same rules apply
  - Appropriate process for development and administration of the list
    - And review to see that you are complying with your own processes—and the list promotes appraisal independence
  - Process for adding appraisers and periodic monitoring of their performance (should they stay on the list)
- “For residential transactions, loan production staff can use a revolving, pre-approved appraiser list, provided the development and maintenance of the list is not under their control.”
  - Query whether the list can account for special qualifications for certain properties or assignments
  - You may want to restrict the use of the revolving appraiser list to certain property types or risk profiles to address this issue
VI (B) Engagement Letters

• “An institution should use written engagement letters when ordering appraisals, particularly for large, complex, or out-of-area commercial real estate properties.”
  • In addition to the other information, the engagement letter will identify the intended use and user(s), as defined in USPAP
  • An institution should include the engagement letter in its credit file
  • To avoid the appearance of any conflict of interest, appraisal or evaluation development work should not commence until the institution has selected and engaged a person for the assignment

• On a practical level, this document establishes your expectations and assignment conditions so there is no misunderstanding about what is required
VIII. Minimum Appraisal Standards

- Conform to USPAP unless principles of safe and sound banking require compliance with stricter standards
  - An AVM by itself is not an appraisal even if signed by an appraiser, since it does not conform to USPAP and regulatory standards
- “Be written and contain sufficient information and analysis to support the institution’s decision to engage in the transaction.”
  - Be careful about the scope of work.
  - “The appraisal report should contain sufficient disclosure of the nature and extent of inspection and research performed by the appraiser to verify the property’s condition and support the appraiser’s opinion of market value.”
VIII. Minimum Appraisal Standards

• Analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units
  • This requirement is discussed in depth in Appendix C: Deductions and Discounts
VIII. Minimum Appraisal Standards

• “Be based upon the definition of market value set forth in the appraisal regulation.”

• Each appraisal must contain an estimate of market value, as defined by the Agencies’ appraisal regulations. The definition of market value assumes that the price is not affected by undue stimulus, which would allow the value of the real property to be increased by favorable financing or seller concessions. Value opinions such as “going concern value,” “value in use,” or a special value to a specific property user may not be used as market value for federally related transactions.
VIII. Minimum Appraisal Standards

• “Be based upon the definition of market value set forth in the appraisal regulation.”

• The estimate of market value should consider the real property’s actual physical condition, use, and zoning as of the effective date of the appraiser’s opinion of value. For a transaction financing construction or renovation of a building, an institution would generally request an appraiser to provide the property’s current market value in its “as is” condition, and, as applicable, its prospective market value upon completion and/or prospective market value upon stabilization.
VIII. Minimum Appraisal Standards

- “Be performed by state certified or licensed appraisers in accordance with requirements set forth in the appraisal regulation.”
- “As stated in the Agencies’ appraisal regulations, a state certified or licensed appraiser may not be considered competent solely by virtue of being certified or licensed. In communicating an appraisal assignment, an institution should convey to the appraiser that the Agencies’ minimum appraisal standards must be followed.”
IX. Appraisal Development

• “The appraisal must reflect an appropriate scope of work that provides for ‘credible’ assignment results.”

• “The appraiser’s scope of work should reflect the extent to which the property is identified and inspected, the type and extent of data researched, and the analyses applied to arrive at opinions or conclusions.”

• “Further, USPAP requires the appraiser to disclose whether he or she previously appraised the property.”
IX. Appraisal Development

- An institution should not allow lower cost or the speed of delivery time to inappropriately influence its appraisal ordering procedures or the appraiser’s determination of the scope of work for an appraisal supporting a federally related transaction.
  - Not much else to say about this...
- “An appraisal must include any approach to value (cost, income and sales comparable approach) that is applicable and necessary to the assignment.”
  - “Further, the appraiser should disclose the rationale for the omission of a valuation approach.”
IX. Appraisal Development

• The appraiser must analyze and reconcile the information from the approaches to arrive at the estimated market value.
• The appraisal also should include a discussion on market conditions, including relevant information on property value trends, demand and supply factors, and exposure time.
• Other information might include the prevalence and effect of sales and financing concessions, the list-to-sale price ratio, and availability of financing.
• In addition, an appraisal should reflect an analysis of the property’s sales history and an opinion as to the highest and best use of the property.

*These are all recitations of the fundamentals for any appraisal. What is it that the agencies have seen that would have them reiterating them here? This is one of the three principles we believe they are reinforcing.*
X. Appraisal Report

• The institution should consider the risk, size, and complexity of the transaction and the real estate collateral when determining the appraisal report format to be specified in its appraisal engagement instructions to an appraiser.
  • Remember that the Interagency Guidelines govern not just typical residential appraisals, but also all other property types and risk characteristics.

• Restricted Use Appraisal Reports. “Generally, a report option that is restricted to a single client and intended user will not be appropriate to support most federally related transactions. These reports lack sufficient supporting information and analysis for underwriting purposes. These less detailed reports may be appropriate for real estate portfolio monitoring purposes.”
  • In other words, a “Restricted Use Appraisal Report” will not be acceptable for transactions.
XI. Transactions that Require Evaluations

- The Agencies’ appraisal regulations permit an institution to obtain an appropriate evaluation of real property collateral in lieu of an appraisal for transactions that qualify for certain exemptions. These exemptions include a transaction that:
  - Has a transaction value equal to or less than the appraisal threshold of $250,000.
  - Is a business loan with a transaction value equal to or less than the business loan threshold of $1 million, and is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment.
XI. Transactions that Require Evaluations

• Involves an existing extension of credit at the lending institution, provided that:
  • There has been no obvious and material change in market conditions or physical aspects of the property that threaten the adequacy of the institution’s real estate collateral protection after the transaction, even with the advancement of new monies; or
  • There is no advancement of new monies other than funds necessary to cover reasonable closing costs.

• Covered in detail in Appendix A, Appraisal Exemptions
XI. Transactions that Require Evaluations

• Although the Agencies’ appraisal regulations allow an institution to use an evaluation for certain transactions, an institution should establish policies and procedures for determining when to obtain an appraisal for such transactions.

• For example, an institution should consider obtaining an appraisal as an institution’s portfolio risk increases or for higher risk real estate-related financial transactions...
XII. Evaluation Development

• An evaluation must be consistent with safe and sound banking practices and should support the institution’s decision to engage in the transaction.
  • “An evaluation
    • whether prepared by an individual or supported by an analytical method or a technological tool,
    • provides a reliable estimate of the collateral’s market value as of a stated effective date.”
    • BPO would not qualify if it only produces a likely sales price—needs to estimate market value
XII. Evaluation Development

• “A valuation method should address the property’s actual physical condition and characteristics as well as the economic and market conditions that affect the estimate of the collateral’s market value.”

• “It would not be acceptable for an institution to base an evaluation on unsupported assumptions, such as a property is in ‘average’ condition, the zoning will change, or the property is not affected by adverse market conditions.”
XII. Evaluation Development

- **Actual Conditions.** “An institution should establish criteria for determining the level and extent of research or inspection necessary to ascertain the property’s actual physical condition, and the economic and market factors that should be considered in developing an evaluation.”

- “**An institution should consider performing an inspection to ascertain the actual physical condition of the property and market factors that affect its market value.**”

- “**When an inspection is not performed, an institution should be able to demonstrate how these property and market factors were determined.**”
XIII. Evaluation Content

• “An evaluation should contain sufficient information detailing the analysis, assumptions, and conclusions to support the credit decision. An evaluation’s content should be documented in the credit file or reproducible.”
  
  • There are 8 minimum requirements, some of which are new since the 1994 Interagency Guidelines, including one related to the use of analytical methods
  
  • This is the basic checklist you must always follow
XIV. Validity of Appraisals and Evaluations

• When can I use an existing appraisal or valuation to support a subsequent transaction?

• “An institution should establish criteria for assessing whether an existing appraisal or evaluation continues to reflect the market value of the property (that is, remains valid).”

• “The documentation in the credit file should provide the facts and analysis to support the institution’s conclusion that the existing appraisal or evaluation may be used in the subsequent transaction.”

• In other words, a new appraisal or valuation will be required if it appears that the original market value has changed for any reason—passage of time, changed market, property deterioration and so on.
XV. Reviewing Appraisals and Evaluations

• As part of the credit approval process and prior to a final credit decision, an institution should review appraisals and evaluations to ensure that they comply with the Agencies’ appraisal regulations and are consistent with supervisory guidance and its own internal policies.
  • This review also should ensure that an appraisal or evaluation contains sufficient information and analysis to support the decision to engage in the transaction.
  • Through the review process, the institution should be able to assess the reasonableness of the appraisal or evaluation, including whether the valuation methods, assumptions, and data sources are appropriate and well supported.
XV. Reviewing Appraisals and Evaluations

• When an institution identifies an appraisal or evaluation that is inconsistent with the Agencies’ appraisal regulations and the deficiencies cannot be resolved with the appraiser or person who performed the evaluation, the institution must obtain an appraisal or evaluation that meets the regulatory requirements prior to making a credit decision.

• Though a reviewer cannot change the value conclusion in the original appraisal, an appraisal review performed by an appropriately qualified and competent state certified or licensed appraiser in accordance with USPAP may result in a second opinion of market value.

• An institution may rely on the second opinion of market value obtained through an acceptable USPAP-compliant appraisal review to support its credit decision.
XV. (A) Reviewer Qualifications

• Persons who review appraisals and evaluations should be
  • independent of the transaction and
  • have no direct or indirect interest, financial or otherwise, in the property or transaction, and be independent of and insulated from any influence by loan production staff.
XV. (A) Reviewer Qualifications

• Reviewers also
  • should possess the requisite education, expertise, and competence to perform the review commensurate with the complexity of the transaction, type of real property, and market.
  • should be capable of assessing whether the appraisal or evaluation contains sufficient information and analysis to support the institution’s decision to engage in the transaction.
XV. (B) Depth of Review

- Risk-focused approach.
  - This process should differentiate between high- and low-risk transactions so that the review is commensurate with the risk.
  - The depth of the review should be sufficient to ensure that the methods, assumptions, data sources, and conclusions are reasonable, well supported, and appropriate for the transaction, property, and market.
  - The review also should consider the process through which the appraisal or evaluation is obtained, either directly by the institution or from another financial services institution.
XV. (B) Depth of Review

- **Automated Tools.** “With prior approval from its primary Federal regulator, an institution may employ various techniques, such as automated tools or sampling methods, for performing pre-funding reviews of appraisals or evaluations supporting lower risk residential mortgages.”
  - “When using such techniques, an institution should maintain sufficient data and employ appropriate screening parameters to provide adequate quality assurance and should ensure that the work of all appraisers and persons performing evaluations is periodically reviewed.”
  - “In addition, an institution should establish criteria for when to expand the depth of the review.”
XV. (B) Depth of Review

- **Sampling loan pools.** “An institution may use sampling and audit procedures to verify the seller’s representations and warranties that the appraisals for the underlying loans in a pool of residential loans satisfy the Agencies’ appraisal regulations and are consistent with supervisory guidance and an institution’s internal policies.”

- “If an institution is unable to confirm that the appraisal meets the Agencies’ appraisal requirements, then the institution must obtain an appraisal prior to engaging in the transaction.”
XV. (B) Depth of Review

• Appraisals from other financial services institutions. “An institution may use an appraisal that was prepared by an appraiser engaged directly by another financial services institution, provided the institution determines that the appraisal conforms to the Agencies’ appraisal regulations and is otherwise acceptable.”
  • An institution should assess whether to use the appraisal prior to making a credit decision.
  • An institution should subject such appraisals to at least the same level of review that the institution performs on appraisals it obtains directly for similar properties and document its review in the credit file.
  • An institution generally should not rely on an evaluation prepared by or for another financial services institution.
XV. (D) Documentation of the Review

• An institution should establish policies for documenting the review of appraisals and evaluations in the credit file.
  • Such policies should address the level of documentation needed for the review, given the type, risk and complexity of the transaction.
  • The documentation should describe the resolution of any appraisal or evaluation deficiencies, including reasons for obtaining and relying on a second appraisal or evaluation.
  • The documentation also should provide an audit trail that documents the resolution of noted deficiencies or details the reasons for relying on a second opinion of market value.
XVI. Third-Party Arrangements

• “An institution that engages a third party to perform certain collateral valuation functions on its behalf is responsible for understanding and managing the risks associated with the arrangement.”
  • “An institution should use caution if it engages a third party to administer any part of its appraisal and evaluation function, including the ordering or reviewing of appraisals and evaluations, selecting an appraiser or person to perform evaluations, or providing access to analytical methods or technological tools.”
  • “An institution is accountable for ensuring that any services performed by a third party, both affiliated and unaffiliated entities, comply with applicable laws and regulations and are consistent with supervisory guidance.”
• (See Interagency Guidelines footnote 46 for the individual regulatory agencies’ guidance on third-party arrangements generally.)
XVI. Third-Party Arrangements

• “An institution should have internal controls for identifying, monitoring, and managing the risks associated with using a third-party arrangement for valuation services, including compliance, legal, reputational, and operational risks.”
  
  • “While the arrangement may allow an institution to achieve specific business objectives, such as gaining access to expertise that is not available internally, the reduced operational control over outsourced activities poses additional risk.”

  • “Consistent with safe and sound practices, an institution should have a written contract that clearly defines the expectations and obligations of both the financial institution and the third party, including that the third party will perform its services in compliance with the Agencies’ appraisal regulations and consistent with supervisory guidance.”
XVI. Third-Party Arrangements

• An institution also is responsible for ensuring that a third party selects an appraiser or a person to perform an evaluation who is competent and independent, has the requisite experience and training for the assignment, and thorough knowledge of the subject property’s market.

• An institution should ensure that when a third party engages an appraiser or a person who performs an evaluation the third party conveys to that person:
  • the intended use of the appraisal or evaluation
  • and that the regulated institution is the client.

• For example, an engagement letter facilitates the communication of this information.
XVII. Program Compliance

• Deficiencies in an institution’s appraisal and evaluation program that result in violations of the Agencies’ appraisal regulations or contraventions of the Agencies’ supervisory guidance reflect negatively on management.

• An institution’s appraisal and evaluation policies should establish internal controls to promote an effective appraisal and evaluation program.
XVII. (A) Monitoring Collateral Values

• “Consistent with the Agencies’ real estate lending regulations and guidelines, an institution should monitor collateral risk on a portfolio and on an individual credit basis.”
  • “Therefore, an institution should have policies and procedures that address the need for obtaining current collateral valuation information to understand its collateral position over the life of a credit and effectively manage the risk in its real estate credit portfolios.”
  • “The policies and procedures also should address the need to obtain current valuation information for collateral supporting an existing credit that may be modified or considered for a loan workout.”
XVII. (A) Monitoring Collateral Values

• “The Agencies reserve the right to require an institution to obtain an appraisal or evaluation when there are safety and soundness concerns on an existing real estate secured credit.”

• “Therefore, an institution should be able to demonstrate that sufficient information is available to support the current market value of the collateral and the classification of a problem real estate credit.”
XVII. (B) Portfolio Collateral Risk

• “Prudent portfolio monitoring practices include criteria for determining when to obtain a new appraisal or evaluation.”

• “Among other considerations, the criteria should address deterioration in the credit since origination or changes in market conditions.”
  • “Changes in market conditions could include material changes in current and projected vacancy, absorption rates, lease terms, rental rates, and sale prices, including concessions and overruns and delays in construction costs.”
  • “Fluctuations in discount or direct capitalization rates also are indicators of changing market conditions.”
XVII. (B) Portfolio Collateral Risk

• “Consistent with sound collateral valuation monitoring practices, an institution can use a variety of techniques for monitoring the effect of collateral valuation trends on portfolio risk.”
  • “Sources of relevant information may include external market data, internal data, or reviews of recently obtained appraisals and evaluations.”
  • “An institution should be able to demonstrate that it has sufficient, reliable, and timely information on market trends to understand the risk associated with its lending activity.”
XVII. (C) Modifications and Workouts of Existing Credits

• An institution may find it appropriate to modify a loan or to engage in a workout with an existing borrower. The Agencies expect an institution to consider current collateral valuation information to assess its collateral risk and facilitate an informed decision on whether to engage in a modification or workout of an existing real estate credit.
  • Again, safety and soundness
XVII. (C) Modifications and Workouts of Existing Credits

• **Loan Modifications.** A loan modification to an existing credit that involves a limited change(s) in the terms of the note or loan agreement and that does not adversely affect the institution’s real estate collateral protection after the modification does not rise to the level of a new real estate-related financial transaction for purposes of the Agencies’ appraisal regulations.

  • **Footnote 48.** A loan modification that entails a decrease in the interest rate or a single extension of a limited or short-term nature would not be viewed as a subsequent transaction.
XVII. (C) Modifications and Workouts of Existing Credits

• *(Since it is not a new transaction)* “an institution would not be required to obtain either a new appraisal or evaluation to comply with the Agencies’ appraisal regulations, but should have an understanding of its collateral risk.

  • For example, institutions can use automated valuation models or other valuation techniques when considering a modification to a residential mortgage loan.”
XVII. (C) Modifications and Workouts of Existing Credits

• **Loan workouts are different.** “A loan workout can take many forms, including a modification that adversely affects the institution’s real estate collateral protection after the modification, a renewal or extension of loan terms, the advancement of new monies, or a restructuring with or without concessions.”

• “**These types of loan workouts are new real estate-related financial transactions.**”
XVII. (C) Modifications and Workouts of Existing Credits

• If the loan workout does not include the advancement of new monies other than reasonable closing costs, the institution may obtain an evaluation in lieu of an appraisal.

• For loan workouts that involve the advancement of new monies, an institution may obtain an evaluation in lieu of an appraisal provided:
  • There has been no obvious and material change in market conditions and
  • No change in the physical aspects of the property that threatens the adequacy of the institution’s real estate collateral protection after the workout.
XVII. (C) Modifications and Workouts of Existing Credits

• An institution must obtain an appraisal when a loan workout
  • Involves the advancement of new monies and
  • There is an obvious and material change in either market conditions or physical aspects of the property, or both, that threatens the adequacy of the institution’s real estate collateral protection after the workout
  • (Unless another exemption applies). That is, the transaction value is $250,000 or less.
Collateral Valuation Policies for Modifications and Workouts

- Further, for loan workouts, an institution’s policies should specify conditions under which an appraisal or evaluation will be obtained.

- As loan repayment becomes more dependent on the sale of collateral, an institution’s policies should address the need to obtain an appraisal or evaluation for safety and soundness reasons even though one is not otherwise required by the Agencies’ appraisal regulations.
XVIII. Referrals

• An institution should file a complaint with the appropriate state appraiser regulatory officials when it suspects that a state certified or licensed appraiser failed to comply with USPAP and/or applicable state laws or engaged in other unethical or unprofessional conduct.

• An institution also must file a suspicious activity report (SAR) when suspecting fraud or identifying other transactions meeting the SAR filing criteria.
XVIII. Referrals

• In addition, effective April 1, 2011, an institution must file a complaint with the appropriate state appraiser certifying and licensing agency under certain circumstances. [See Interim Final Regulations]
  • 226.42(g) Mandatory reporting—(1)

  Reporting required. Any covered person that reasonably believes an appraiser has not complied with the Uniform Standards of Professional Appraisal Practice or ethical or professional requirements for appraisers under applicable state or federal statutes or regulations shall refer the matter to the appropriate state agency if the failure to comply is material. For purposes of this paragraph (g)(1), a failure to comply is material if it is likely to significantly affect the value assigned to the consumer’s principal dwelling.
Appendix A: Appraisal Exemptions

• Appendix A provides guidance on those transactions which are exempt for one reason or another from the appraisal requirements.
• The most common exemption relates to the “Appraisal Threshold” of $250,000.
• The others include, for example:
  • 2. Abundance of Caution
  • 3. Loans not secured by Real Estate
  • 7. Renewals, Refinancings and Other Subsequent Transactions (which we covered in part under loan modifications and workouts)
  • 8. Transactions Involving Real Estate Notes
Appendix B: Evaluations Based on Analytical Methods or Technological Tools

• Since the 1994 Guidelines, the emergence of analytical methods (such as AVMs) has profoundly altered the valuation of collateral. Appendix B is a thorough discussion of the Agencies’ views on how institutions may use analytical methods and technological tools. Here are some highlights, but you should read this Appendix carefully.

• “The Agencies’ appraisal regulations permit an institution to use an evaluation in lieu of an appraisal for certain transactions. An institution may use a variety of analytical methods and technological tools for developing an evaluation, provided the institution can demonstrate that the valuation method is consistent with safe and sound banking practices and these Guidelines (see sections on Evaluation Development and Evaluation Content).”

• An institution should establish policies and procedures that provide a sound process for using various methods or tools.
Appendix B: Evaluations Based on Analytical Methods or Technological Tools

• An institution should establish an effective system of controls for verifying that a valuation method or tool is employed in a manner consistent with internal policies and procedures.

• Moreover, the institution’s staff responsible for internal controls should have the skills commensurate with the complexity or sophistication of the method or tool.
Appendix B: Evaluations Based on Analytical Methods or Technological Tools

• An institution should establish policies and procedures that provide a sound process for using various methods or tools. Such policies and procedures should (among other issues):
  • Establish criteria for determining whether a particular valuation method or tool is appropriate for a given transaction or lending activity, considering associated risks. These risks include, but are not limited to, transaction size and purpose, credit quality, and leverage tolerance (loan-to-value).
  • Specify criteria when a market event or risk factor would preclude the use of a particular method or tool.
Appendix B: Evaluations Based on Analytical Methods or Technological Tools

- An institution should not select a method or tool solely because it provides the highest value, the lowest cost, or the fastest response or turnaround time.
Appendix C: Deductions and Discounts

• “The Agencies’ appraisal regulations require an appraiser to analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units.”
  • “For such transactions, an appraisal must include the market value of the property, which should reflect the property’s actual physical condition, use, and zoning designation (referred to as the ‘as is’ value of the property), as of the effective date of the appraisal.”
  • “Therefore, if the highest and best use of the property is for development to a different use, the cost of demolition and site preparation should be considered in the analysis.”
Appendix C: Deductions and Discounts

- You should read this entire Appendix carefully if you are engaged in any lending of this nature.
  - Note that a “partially leased building, non-market lease terms and tract developments with unsold units” sound like workouts...
Appendix D: Glossary of Terms

• This is a very helpful glossary of terms especially in understanding the language used by the Agencies. You should read it carefully.

• Special note (since this issue comes up a lot with respect to appraisal management companies and regulators):
  • Client—According to USPAP, the party or parties who engage(s) an appraiser by employment or contract for a specific appraisal assignment. For the purposes of these Guidelines, the appraiser should be aware that the client is the regulated institution. (Refer to the section on Third-Party Arrangements in these Guidelines.)
Summary

• Even at this length, this is just a summary of the Interagency Guidelines.
  • You should read through them carefully on your own behalf.
• They are informed by the current state of the market and the need for good information and valuations to support lending in a declining market, loan modifications, workouts and foreclosures/REOs.
  • Reminder: we need to return to a focus on safety and soundness.
Questions

• Today’s Questions
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Thank You

- Questionnaire