ABA Staff Analysis: Final Interagency Appraisal and Evaluation Guidelines
75 F.R. 77450 (December 10, 2010)
January 2011

On December 2, 2010, the five federal banking agencies—the Federal Reserve Board (FRB), Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Office of Thrift Supervision (OTS) and National Credit Union Administration (NCUA) (collectively, the “Agencies”)—issued revisions to the Interagency Appraisal and Evaluation Guidelines (“Guidelines”).

The Guidelines, applicable to all regulated banking institutions, identify the components of a safe and sound program for performing appraisals and evaluations for real estate-related financial transactions. Further, they promote consistency in the application and enforcement of the Agencies’ appraisal regulations and safe and sound banking practices. The Guidelines, including their appendices, update and replace existing supervisory guidance documents to reflect recent developments concerning appraisals and evaluations, as well as changes in appraisal standards and advancements in regulated institutions’ collateral valuation methods.

The Agencies recognize that revisions to the Guidelines may not cover all the changes brought about by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). The Agencies state that it may be necessary to engage in future regulations to fully implement the provisions of the Dodd-Frank Wall.

Background

The initial set of Appraisal Guidelines were jointly issued by the Banking Agencies in October 1994 and were meant to provide guidance on implementing the appraisal regulations promulgated in accordance with Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). As a result of continuing developments, advancements in information technology, and changes in the real estate valuation industry, the Banking Agencies proposed revisions to the Guidelines on November 19, 2008. See 73 Fed. Reg. 69647. The Guidelines also reflect refinements made by the Agencies in the supervision of institutions’ appraisal and evaluation programs.

The 2010 Guidelines are now issued after considering all the comments submitted on the 2008 Proposal.

The Guidelines contain four appendices that clarify current regulatory requirements and supervisory Guidance, and are organized as follows—

- Appendix A provides further clarification on real estate-related financial transactions that are exempt from the Agencies’ appraisal regulations.
- Appendix B addresses an institution’s use of analytical methods or technological tools in the development of an evaluation.
- Appendix C clarifies the minimum appraisal standards required by the Agencies’ appraisal regulations for analyzing and reporting appropriate deductions and discounts in appraisals.
- Appendix D (previously Appendix C in the Proposal) provides a glossary of terms.

The following description is meant as a summary only, and institutions should refer to the actual guidelines to identify all applicable details.

Effective Date

The Guidelines became effective upon publication, on December 10, 2010.
Coverage

The Guidelines apply to all real estate lending functions and real estate-related financial transactions originated or purchased by a regulated institution for its own portfolio or for assets held for sale.

The revised Guidelines are not limited only to consumer credit transactions secured by consumers’ principal dwellings. These Guidelines apply to all real estate-related financial transactions, and therefore cover activities of commercial and residential real estate mortgage operations, as well as capital markets groups and asset securitization and sales units.

The regulated institutions that are governed by the Guidelines include: national or state-chartered banks and their subsidiaries, bank holding companies and their non-bank subsidiaries, federal savings associations and their subsidiaries, federal savings and loan holding companies and their subsidiaries, and credit unions.

Supervisory Policy

- An institution’s real estate appraisal and evaluation policies and procedures will be reviewed as part of the examination of the institution’s overall real estate-related activities.

- Examiners will consider the size and the nature of an institution’s real estate-related activities when assessing the appropriateness of its program.

- When analyzing individual transactions, examiners will review an appraisal or evaluation to determine whether the methods, assumptions, and value conclusions are “reasonable.”

Appraisal and Evaluation Program

Every institution is responsible for establishing an effective real estate appraisal and evaluation program. The institution’s board of directors, or a specially designated committee, must adopt policies and procedures and review them periodically. Appraisal and evaluation programs should—

- Assure independence of persons ordering, performing, and reviewing appraisals or evaluations.
- Establish selection criteria and procedures to evaluate ongoing performance of appraisers and persons performing evaluations.
- Ensure that appraisals comply with regulations and supervisory guidance.
- Ensure that appraisals and evaluations contain sufficient supporting information.
- Maintain criteria for the content and use of evaluations consistent with safe banking practices.
- Provide for timely receipt and review of appraisal or evaluation report to facilitate credit decision.
- Develop criteria for whether existing appraisal or evaluation may be used to support subsequent transaction.
- Implement internal controls that promote compliance with these program standards.
- Establish criteria for monitoring collateral values.
- Establish criteria for valuations in transactions not otherwise covered by applicable appraisal regulations.

Independence of the Appraisal and Evaluation Program

Institutions should maintain standards of independence as part of their collateral valuation program for all real estate lending activity.

- The collateral valuation program should be isolated from influence by the institution’s loan production staff.
o “Loan Production Staff” includes personnel responsible for generating loan volume or approving loans, as well as their subordinates and supervisors. The term encompasses any employee whose compensation is based on loan volume (such as processing or approving of loans).
  ▪ Exclusions: An employee is not considered loan production staff just because part of their compensation includes a general bonus or profit sharing plan that benefits all employees. Employees responsible solely for credit administration or credit risk management are not considered loan production staff.

● An institution should establish reporting lines independent of loan production for staff who administers the institution’s collateral valuation program, including the ordering, reviewing, and acceptance of appraisals and evaluations.

● 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.

● An institution’s policies and procedures should specify methods for communicating with appraisers or persons that perform evaluations in order to ensure independence in the collateral valuation function.

● The Guidelines soften the standards for “small or rural institutions” or branches, stating that it is not always possible to isolate the collateral valuation program from the loan production process. In such instances, the institution has the duty to demonstrate that it has safeguards in place to prevent the collateral valuation function from being coerced or influenced by the loan production function.
  o Institutions that rely on this provision should have clear policies and procedures that are designed to show independence, provide appropriate training to its personnel, and monitor for compliance.
  o The Guidelines do not define the terms “small” or “rural” institutions or branches.
    ▪ As general guidance, the Board’s recent Interim Final Rules on Appraisal Independence (75 Fed. Reg. 66554, October 28, 2010) set forth that an institution qualifies for certain safe harbors as “smaller institution” if it had assets of $250 million or less for the past two calendar years. (Section 226.42(d)(3)).
    ▪ The absence of a definition means that if institutions believe they qualify as “small or rural,” they should discuss this with their regulatory agency.

Selection of Appraisers or Persons Who Perform Evaluations

● An institution’s collateral valuation program should establish criteria to select, evaluate, and monitor the performance of appraisers and persons who perform evaluations.
  o The person selected should have requisite education, expertise, and experience to competently complete assignment.
  o The valuation work must be periodically reviewed by the institution.
  o Person selected must be capable of rendering an unbiased opinion.
  o Person selected must be independent and have no interest in the property or transaction.
  o Appraiser selected must hold appropriate state certification at time of assignment.
  o Persons performing evaluations should possess appropriate education, expertise, and experience relevant to type of property being valued.

● An institution or its agent must directly select and engage appraisers.
  o A borrower may, however, inform an institution that a current appraisal exists, and the institution may request it directly from the other financial services institution.

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An institution’s selection process should ensure that a qualified, competent and independent person is selected to perform a valuation assignment. An institution should maintain documentation to demonstrate that the appraiser or person performing an evaluation is competent, independent, and has the relevant experience and knowledge for the market, location, and type of real property being valued.

Approved Appraiser Lists: If an institution establishes an approved list for selecting appraisers, the institution should have appropriate procedures for development and administration of the list, as follows—
  - A process for qualifying an appraiser for initial placement on the list,
  - Periodic monitoring of performance and credentials to assess retention of appraiser,
  - Periodic internal review to confirm that appropriate procedures and controls exist to ensure independence in development and maintenance of 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.

Engagement Letters: An institution should use written engagement letters when ordering appraisals, particularly for large, complex, or out-of-area commercial real estate properties. An engagement letter typically may specify the following: property’s location and legal description, intended use and users of the appraisal, the requirement to provide an opinion of the property’s market value, the expectation that appraiser will comply with applicable laws and regulations, appraisal report format, expected delivery date, and appraisal fee.

Transactions that Require Appraisals

The Agencies have identified certain real estate-related financial transactions that do not require the services of an appraiser and that are exempt from the appraisal requirement. The Agencies provide 12 exemptions, listed under Appendix A to the Guidelines. These are as follows—
  - Appraisal Threshold (for a transaction of $250,000 or less, an evaluation is required)
  - Instances where real estate lien is taken in an “abundance of caution” (exemption inapplicable if the real estate is used in any manner to support the loan)
  - Loan Not Secured by Real Estate
  - Liens for Purposes Other than the Real Estate’s Value
  - Real Estate-Secured Business Loan
  - Leases (exemption applies when the lease is not the economic equivalent of a purchase or sale of the leased property)
  - Renewals, Refinancings, and Other Subsequent Transactions
  - Transactions Involving Real Estate Notes
  - Transactions Wholly or Partially Insured or Guaranteed by a U.S. Government Agency or U.S. Government-Sponsored Agency
  - Transactions that Qualify for Sale to, or Meet the Appraisal Standards of, a U.S. Government Agency or U.S. Government-Sponsored Agency
  - Transactions by Regulated Institutions as Fiduciaries (applicable where the institution acts in a fiduciary capacity)
  - Appraisals not Necessary To Protect Federal Financial and Public Policy Interests or the Safety and Soundness of Financial Institutions (provided on a case-by-case basis by applicable Banking Agency).

For those transactions qualifying for the appraisal threshold, existing extensions of credit, or the business loan exemptions, an institution is exempted from the appraisal requirement, but still must, at a minimum, obtain an evaluation consistent with these Guidelines.

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Minimum Appraisal Standards

The Guidelines set forth minimum standards for appraisals. Under the issuance, appraisals must—

- Conform to generally accepted appraisal standards as evidenced 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.
- 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. (Deductions and discounts are set forth in Appendix C of the Guidelines.)
- Be based on the definition of market value set forth in the applicable Banking Agency appraisal regulation.
- Be performed by state certified or licensed appraiser in accordance with requirements set forth in the applicable Banking Agency appraisal regulations.

Appraisal Development

The Guidelines generally require appraisals that are compliant with USPAP. While an appraiser must comply with USPAP and establish the scope of work in an appraisal assignment, an institution is responsible for obtaining an appraisal that contains sufficient information and analysis to support its decision to engage in the transaction. Therefore, to ensure that an appraisal is appropriate for the intended use, an institution should discuss its needs and expectations for the appraisal with the appraiser.

Appraisal Reports

USPAP provides various appraisal report options that offer varying levels of detail, and the institution is responsible for identifying the appropriate appraisal report option to support its credit decisions. 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.

Transactions that Require Evaluations

The Guidelines emphasize that, notwithstanding the fact that Agencies’ appraisal regulations permit institutions to rely on an evaluation in lieu of an appraisal in certain instances (See Appendix A), institutions should establish policies and procedures for determining when to obtain an appraisal for such transactions. These policies and procedures should be in place even if the regulations explicitly allow for evaluations. The Guidelines state that institutions should consider obtaining an appraisal as an institution’s portfolio risk increases or for higher risk real estate-related financial transactions.

Evaluation Development

Evaluations must be consistent with safe and sound banking practices and should support the institution’s decision to engage in the transaction. Institutions should be able to demonstrate that evaluation, regardless of methodology, provide a reliable estimate of the collateral’s market value.

- The Guidelines states that broker price opinions (BPOs) are not acceptable for use as evaluations, as it is a valuation method that provides a sales or list price, and does not provide a property’s market value. Likewise, information on local housing conditions and trends, such as a competitive market analysis, does not contain sufficient information on a specific property that is needed, and therefore, would not be acceptable as an evaluation. Information obtained from such sources may, however, be useful to develop an evaluation or appraisal.

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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.

Evaluation Content

An evaluation should contain sufficient information to detail the analysis, assumptions, and conclusions that support the credit decision. An evaluation's content should be documented in the credit file.

The Guidelines set forth the minimum content requirements for an evaluation:

- Identify the location of the property.
- Provide a description of the property and its current and projected use.
- Provide estimate of property's market value in actual physical condition, and the use and zoning designation as of the effective date of the evaluation, with any limiting conditions.
- Describe the method(s) used to confirm actual physical condition and extent to which an inspection was performed.
- Describe analysis performed and supporting information used in valuing the property.
- Describe the supplemental information considered when using analytical method or technological tool.
- Indicate all source(s) of information used in the analysis, as applicable, to value the property.
- Include information on the preparer when an evaluation is performed by a person.

Validity of Appraisals and Evaluation

- Institutions may use existing appraisal or evaluation to support a subsequent transaction in certain circumstances, and should, therefore, establish criteria for assessing whether such appraisal or evaluation remains valid. The documentation in the credit file should provide the facts and analysis to support the institution's conclusion.

- A new appraisal or evaluation is necessary if the originally reported market value has changed due to factors such as: passage of time, volatility of the local market, changes in terms and availability of financing, natural disasters, limited or over-supply of competing properties, improvements to the subject property or competing properties, lack of maintenance of the subject or competing properties, changes in underlying economic and market assumptions, such as capitalization rates and lease terms, changes in zoning, building materials, or technology, environmental contamination.

Reviewing Appraisals and Evaluations

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. An institution may use the review findings to monitor and evaluate the competency and ongoing performance of appraisers and persons who perform evaluations.

Appraisals for federally related transactions must contain sufficient information and analysis to support the institution's decision to engage in the credit transaction. 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, and ensure that they contain sufficient information to support the decision to engage in the transaction.

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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.

An institution’s policies and procedures for reviewing appraisals and evaluations should, at a minimum, address the following four areas:

- **Address the independence, educational and training qualifications, and role of the reviewer.** Persons who review appraisals and evaluations should—
  - Be independent of the transaction and loan production staff, and have no direct or indirect interest, financial or otherwise, in the property or transaction,
  - Possess the requisite education, expertise, and competence to perform the review
  - Be capable of assessing whether the appraisal or evaluation contains sufficient information to support the decision to engage in the transaction.

- **Reflect a risk-focused approach for determining the depth of the review.** The depth of the review should, therefore, 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 depth of review should be specifically tailored to the requisites of the various types of transactions, including commercial real estate, 1-to-4 family residential real estate, appraisals from other financial services institutions, etc.

- **Establish a process for resolving any deficiencies in appraisals or evaluations identified through the review process.**

- **Set forth documentation standards for the review and the resolution of noted deficiencies.** The documentation 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.

**Third Party Arrangements**

In instances where institutions outsource one or more valuation functions to a third party, the institution retains responsibility for the resulting appraisal or evaluation, as well as for compliance with applicable supervisory regulations and guidance. Therefore, before engaging a third party, the institution must have the resources, expertise and controls necessary to identify, monitor and manage the resulting risks. Under the Guidance, effective due diligence is required before the relationship is initiated.

- The institution should have a written contract with the third party that sets forth the terms of the relationship.
- The institution is responsible for making sure that appraisers and persons performing evaluations meet regulatory standards as well as the institution’s own standards. Institutions are obligated to monitor the third party’s performance and periodically assess the overall relationship with the third party.
- If deficiencies are found in the third party’s performance, the institution must resolve any problem, or terminate the relationship.

**Program Compliance**

Under the Guidelines, institutions are expected to have internal controls to support effective appraisal and evaluation programs. Generally, the program must test every aspect of the appraisal and evaluation process for compliance, particularly those outlined in this Guidance.

- **Monitoring Collateral Values**—An institution is expected to monitor collateral values on a portfolio and on an individual credit basis. The institution must maintain policies and procedures that govern the monitoring program. These obligations extend to obtaining information to understand the bank’s 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.

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• **Portfolio Collateral Risk**—An institution’s policies and procedures for monitoring portfolio collateral risk should identify when it is appropriate to obtain new or updated appraisals and evaluations. The criteria should address deterioration in the credit since origination or general changes in market conditions. An institution may use a “variety of techniques” for monitoring the effect of collateral valuation trends on portfolio risk, and sources of relevant information may include external market data, internal data, or reviews of recently obtained appraisals and evaluations.

• **Modifications and Workouts**—When undertaking a loan modification or loan workout, institutions are expected to consider current valuation information. An institution’s policies and procedures need to state when an appraisal or evaluation will be required for a loan modification or workout, and which type of valuation method will be employed in particular circumstances. The Guidelines specify special approaches for each type of arrangement—
  - A “loan modification” to an existing credit that involves a limited change in the terms of the loan agreement would not mandate that the institution obtain either a new appraisal or evaluation to comply with the Agencies’ appraisal regulations. The institution should, however, have an understanding of its collateral risk, and demonstrate that the modification reflects prudent underwriting standards, consistent with safe and sound lending.
  - “Loan workouts” can take various forms, some that may adversely affect the collateral protection for the institution. If the workout does not advance new monies (other than reasonable closing costs), the institution may obtain an evaluation in lieu of an appraisal. Workouts that involve advancement of new monies may also rely on an evaluation provided there has been no obvious and material change in market conditions and no change in physical aspects of the property. Institution should always support and document its rationale for using this latter exemption. Where a workout involves new monies and there is an obvious and material change in market conditions or physical aspects of the property, then the institution must obtain an appraisal.

**Referrals**

The Guidelines direct institutions to file a complaint with the appropriate state appraiser regulatory officials when they suspect that a state certified or licensed appraiser failed to comply with USPAP, applicable state laws, or engaged in other unethical or unprofessional conduct. Section 1472 of Dodd-Frank (as implemented by the Federal Reserve Board’s Interim Appraisal Rule at 12 C.F.R. § 226.42(g)) set forth mandatory reporting requirement for transactions involving principal dwellings.

An institution that files a complaint is not protected by defamation or other claims, therefore requiring the need for careful policies and procedures addressing such reporting. A suspicious activity report (SAR) must be filed with FinCEN when required by applicable regulations.

**Evaluations Based on Analytical Methods or Technological Tools**

Under Appendix B of the Guidelines, institution are allowed to 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. Examiners are instructed to review an institution’s policies, procedures, and internal controls to ensure method or tools are appropriate and consistent with safe and sound banking practices.

- **Automated Valuation Models**— The Guidelines explicitly state that institutions may employ AVMs for a variety of uses such as loan underwriting and portfolio monitoring. An institution may not, however, rely solely on the results of an AVM to develop an evaluation unless the resulting evaluation is consistent with safe and sound banking practices and these Guidelines. (An AVM that simply assumes that the property is in average condition does not pass the test set forth by the Guideline). AVMs would therefore be required to be used together with some type of additional inspection in order to constitute evaluations under these provisions. In addition, an

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institution should establish standards and procedures for independent and ongoing monitoring and model validation, including the testing of multiple AVMs, to ensure that results are credible. The Guidelines direct that institutions must develop policies and procedures regarding an institution’s selection of AVMs, the determination of whether to employ AVMs, and validation of AVM results.

- Tax Assessment Valuations: TAVs are defined as property values assessed by a local tax authority. As with AVMs, the Guidelines direct that TAVs will not by itself qualify as evaluations, and require the right level of supplemental information. Institutions need policies and procedures that specify the type, level and extent of supplemental information that will be required.

Questions? Contact Rod Alba for more information.