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Thrift Bulletin

**Handbook:** Thrift Activities
**Subject:** Real Estate Appraisal

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RESCINDED

# Real Estate Appraisal and Evaluation Guidelines

*Summary*: This Bulletin sets forth guidelines adopted by the Office of Thrift Supervision (OTS) regarding real estate appraisals and evaluations. The Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board are issuing similar guidelines.

*For Further Information Contact:* Your Regional office or Supervision Policy (Credit Risk), OTS, Washington, D.C.

*Thrift Bulletin 55*

## Overview

The OTS and the other federal financial institutions regulatory agencies adopted regulations to implement Title XI of FIRREA in August 1990 (*see* 12 C.F.R. 564). These rules require that *appraisals* for federally related transactions be performed by licensed or certified appraisers. A *federally related transaction* means any real estate-related financial transaction made by a regulated institution that requires the services of an appraiser. The regulation also sets forth appraisal standards to be used by certified and licensed appraisers in performing appraisals of subject transactions.

Certain real estate-related transactions are exempt from the requirement of 12 C.F.R. 564 that a certified or licensed appraiser perform the appraisal. Real estate-related financial transactions that do not require an appraisal include loans of $100,000 or less. Consistent with the regulation, however, those transactions that do not require an appraisal must receive an *evaluation* of the real estate collateral that reflects prudent lending practices and OTS policies and guidelines.

As with an appraisal, an evaluation is an integral part of the decision-making process, but it is only one of the elements to be considered when underwriting a real estate loan. Like appraisals, evaluations are used to validate real estate values. The value of real estate taken as loan collateral provides additional support for the borrower's credit capacity if the borrower's cash flow fails to permit satisfactory debt service. Also, an appraisal or evaluation is necessary to determine an appropriate carrying value, and probable sales price, for foreclosed properties.

## Appraisal Standards

For the purposes of 12 C.F.R. 564 and these guidelines, an appraisal is defined to be "a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately described property as of a specific date(s), supported by the presentation and analysis of relevant market information" (12 C.F.R. 564.2(a)). An appraisal contains certain formal elements recognized by industry practices and must conform to generally accepted appraisal standards, evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP), developed by the Appraisal Standards Board of the Appraisal Foundation.

An appraisal estimates a property's value under three approaches—the cost, income, and comparable sales approaches—and reconciles the values of each approach. An appraisal typically contains a description of the property, a disclosure of sales history, and an opinion as to the highest and best use of the property. The appraiser certifies the appraisal as to content, independence, property inspection, compensation, opinions, and assistance.

## Evaluation Standards

An evaluation need not meet all of the detailed requirements of an appraisal as set forth in 12 C.F.R. 564. File documentation should, however, support the estimate of value and include sufficient information for an individual to fully understand the evaluator's analysis. The evaluation should describe the property and its location, and discuss its use, especially if it is nonresidential. The evaluation should include the evaluator's calculations, supporting assumptions for the estimate of value, and, if utilized, a discussion of comparable property values. An evaluation must be written, signed and dated, and include the preparer's name and address. To qualify, an evaluator must be capable of rendering unbiased estimates of value and must have real estate-related training or experience relevant to the type of property.

The scope of an evaluation should be consistent with the complexity of the transaction and type of real estate collateral. An evaluation that supports a more complex transaction generally needs a more detailed analysis. An evaluation for a less complex transaction will generally require a less detailed analysis, and may be based upon information such as the current tax assessed value or comparable property sales from sales data services, such as the multiple listing service. The institution may use its own real estate loan portfolio experience and appraisals prepared in accordance with 12 C.F.R. 564 for loans on comparable properties as a basis for an evaluation.

Policies and Procedures for Appraisals and Evaluations

The board of directors is responsible for adopting and reviewing policies and procedures that establish effective real estate appraisal and evaluation programs. At a minimum, the programs should:

- incorporate prudent standards and procedures for obtaining initial and subsequent appraisals and evaluations;
- be tailored to the institution's size and location and to the nature of its real estate-related activities;
- establish a method(s) to monitor the value of real estate collateral securing an institution's real estate loans; and,
- establish the manner in which an institution selects, evaluates, and monitors individuals who perform or review real estate appraisals and evaluations.

Competency, expertise, independence,[1] and ability to render a high quality written report are the appropriate selection criteria for appraisers and evaluators.

Savings associations and their subsidiaries are also required to comply with 12 C.F.R. 564.8, which sets forth the responsibilities of management to develop written appraisal policies to ensure that adequate appraisals are obtained consistent with the requirements of the OTS appraisal rule, to institute procedures pertaining to the hiring of qualified appraisers, and to annually review the performance of appraisers.

Timing of Appraisals and Evaluations

The institution should have procedures in effect that require appraisals and evaluations to be completed and received in sufficient time to be analyzed before a final credit or other decision is made. In cases where an institution acts to prudently protect its interests by modifying the terms and conditions of an existing extension of credit, an appraisal or evaluation may be obtained subsequent to the restructuring.

Compliance Procedures

Institutions should establish procedures to ensure appraisals and evaluations satisfy the technical requirements of 12 C.F.R. 564, this Bulletin, and internal policies and procedures. Checklists may be used to assist an institution's personnel in determining the completeness of appraisals and evaluations. Loan files should contain documentation that the appraisal or evaluation received an appropriate technical compliance check.

The technical compliance procedures should provide a comprehensive assessment to detect deficiencies in appraisals and evaluations. If there are deficiencies that render an appraisal's or evaluation's estimate of value unreliable, the institution should obtain a replacement prior to making itsfinal credit decision. Deficiencies that do not affect the estimate of value should be corrected by the individual who conducted the appraisal or evaluation before the transaction is completed.

Audit/Critique Procedures

Institutions should also test the substance of appraisals and evaluations through audit procedures. An institution's audit procedures should provide for a critique of selected appraisals and evaluations. The criteria to identify transactions subject to this substance critique should be consistent with prudent audit sampling or testing practices and have a bias toward large credit exposures and loans secured by out-of-area properties and specialized types of properties.

The critique should assess the adequacy, reasonableness, and appropriateness of the methods, assumptions and techniques that were used to perform the appraisal or evaluation. An individual who performs critiques, whether an institution employee or an outside auditor or consultant, should have real estate-related training or experience and be independent of the transaction.

The estimate of value in an appraisal or evaluation may not be changed as a result of a critique. Changes to an appraisal's estimate of value are permitted only as a result of a review conducted in compliance with Standard III of USPAP.

Useful life of appraisals or evaluations

The programs should establish criteria to determine whether an existing appraisal or evaluation continues to be valid to support a subsequent transaction. The useful life of an appraisal or evaluation will vary depending upon the circumstances of the property and the market place. An institution's management should determine if there have been material changes to the underlying assumptions in the appraisal or evaluation that effect the original estimate of value.

Examples of factors that could cause material changes to reported values include: the passage of time; the volatility of the local market; the availability of financing; the inventory of competing properties; new improvements to, or lack of maintenance of, the subject property or competing surrounding properties; a change in zoning; or, environmental contamination. If the useful life of an appraisal or evaluation has lapsed, an institution should determine whether there is a need to reappraise or reevaluate the real estate.

Reappraisals and reevaluations of collateral

An institution's real estate appraisal and evaluation programs should also include safety and soundness considerations that identify when it is in the institution's interests to reappraise or reevaluate real estate collateral. Some of these considerations are the condition, performance, quality and status of the loan, and the strength of the underlying collateral. In problem situations, such as loan workouts, renewals, or restructurings, or troubled real estate loans, when the institution is more dependent upon the real estate collateral, management should consider the prudence of a reappraisal or reevaluation of the collateral.

Management should also be guided by the November 7, 1991 Interagency Policy Statement on the Review and Classification of Commercial Real Estate Loans on this issue.

Institutions should document information sources and analyses used to determine the validity of an existing appraisal or evaluation. Reappraisals and reevaluations of collateral must comply with 12 C.F.R. 564 and this Bulletin.

Updated Appraisal

An updated appraisal is currently not an acceptable appraisal as defined by 12 C.F.R. 564. An institution may, however, use an updated appraisal: (1) to evaluate real estate not subject to the appraisal requirements in 12 C.F.R. 564, and (2) to assess the useful life of an appraisal.

The OTS and other federal banking agencies have under consideration a broader application of the Departure Provision of the USPAP. This may result in future modifications to the agencies' regulations that may expand the use of updated appraisals.

Supervisory Policy

The OTS will review an institution's real estate appraisal and evaluation policies, programs, and procedures as part of the examination process. Examiners will consider the institution's size and the nature of its real estate-related activities in their assessment of the appropriateness of its programs.

In the analysis of individual transactions, examiners will review appraisals or evaluations to determine that the methods, assumptions, and findings are reasonable and in compliance with 12 C.F.R. 564 and this Bulletin. In addition, examiners will review the steps taken by an institution to ensure that the individuals who perform its appraisals or evaluations are qualified, and are not subject to any conflicts of interest.

Failure to establish and maintain acceptable programs or to comply with applicable regulations and policies is considered an unsafe and unsound practice. Institutions will be required to correct violations and deficiencies detected in their appraisal and evaluation practices.

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1 In order to avoid potential conflicts of interest, staff appraisers should not be supervised by loan underwriters, loan officers or collection officers. The OTS recognizes that, in certain cases, it may be necessary for loan officers or other institution-related individuals to perform appraisals or evaluations. Such cases would depend on the institution's particular circumstances. An example would be a small rural institution where the only qualified individual to perform appraisals or evaluations is a loan officer, and separating this person from the loan and collection departments would be difficult. In these situations, the OTS recommends that this individual perform appraisal or evaluation work on loans in which he or she is not otherwise involved. In cases where loan officers or other related individuals perform appraisals, regulated institutions must ensure that the appraisers are licensed or certified and that the appraisals are adequate. Directors and officers should abstain from any vote and/or approval that involves assets on which they have performed an appraisal or evaluation. Sufficient safeguards must be in place to permit appraisers and evaluators to exercise independent judgment.

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