

Evaluations in Compliance with the Interagency Appraisal and Evaluation Guidelines

RECENT REVISIONS TO the Interagency Appraisal and Evaluation Guidelines (IAEG) state that broker price opinions (BPOs) cannot be used as evaluations for regulatory purposes. Evaluations are often used in situations where appraisals are not required. After reviewing the revised guidelines, conferring with regulators, and surveying many chief appraisers, we can shed some light on the use, development, reporting and review of evaluations in compliance with the guidelines.

What are Evaluations and Why Are They Important?

Evaluations are defined in the guidelines as: “A valuation permitted by the Agencies’ appraisal regulations for transactions that qualify for the appraisal threshold exemption, business loan exemption, or subsequent transaction exemption.” (IAEG pg. 60)

According to the guidelines, evaluation policies will be reviewed, and examiners will cite banks that have an inadequate evaluation program. Individual evaluations will also be reviewed for reasonableness of methods, assumptions and value conclusions.

When Can/Should an Evaluation be Used?

Evaluations may be used in lieu of appraisals for: a) deminimus transactions < \$250,000; b) business loans < \$1,000,000, or c) existing credits where there has been no obvious or material change, or there is no advancement of new monies.

Institutions are encouraged to establish policies and procedures for when evaluations can be used in lieu of appraisals. Appraisals are encouraged when portfolio risk increases or for higher risk RE loans such as: high LTVs, atypical properties, unfamiliar markets, high risk credits or high risk borrowers.

Institutions should have policies specifying when evaluations may be used for: a) monitoring collateral values on a portfolio and an individual credit basis; b) modifications of existing credits, or c) workouts of existing credits.

Who Can/Should Perform Evaluations?

The guidelines state that people who perform evaluations should possess “the appropriate appraisal or collateral valuation education, expertise, and experience relevant to the type of property being valued. Such persons may include appraisers, real estate lending professionals, agricultural extension agents, or foresters.”

According to USPAP, an evaluation performed for a bank by a licensed appraiser is also an appraisal that must be USPAP compliant. While appraisers have the ability to perform evaluations as USPAP conforming appraisals, the additional work required generally makes it impractical.

Evaluation Development

The guidelines require that “an institution should be able to demonstrate that an evaluation provides a reliable estimate of the

collateral’s market value.” They also state that “a valuation method that provides a sales or list price, such as a **broker price opinion, cannot be used as an evaluation.**” Institutions must have policies and procedures that lead to “the appropriate valuation method for a transaction rather than using the method that renders the highest value, lowest cost, or fastest turnaround time.” (IAEG pg. 30)

Specific requirements for developing an evaluation are as follows: a) It should address the property’s actual physical condition and economic and market conditions; b) It may not be based on unsupported assumptions; c) Institutions should establish “criteria for determining the level and extent of research or inspection necessary...”; and d) Institutions should “**consider performing an inspection.... When an inspection is not performed, an institution should be able to demonstrate how these property and market factors were determined.**” (IAEG pg. 30)

When developing policies and procedures for evaluations, institutions may want to consider the applicability and necessity of the following: 1) Highest and best use analysis? 2) Cost approach? 3) Sales comparison approach? 3a) Direct verification of sales comps? 4) Income approach? 4a) Are listings sufficient for rent comps? 4b) Can an income approach be completed without access to: a current rent roll? Leases? Operating expense statements? 4c) Is a marked-to-market income approach acceptable? 5) Point-value conclusion? 5a)

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Range-of-value conclusion? 5b) Not-less-than value conclusion?

Reporting Requirements

Evaluation reports should at a minimum:

- 1) Identify the location of the property.
- 2) Describe the property and its current and projected use.
- 3) Estimate the property's market value in its actual current physical condition, use and zoning designation as of the effective date of the evaluation, with any limiting conditions.
- 4) Describe the method(s) the institution used to confirm the property's actual physical condition and the extent to which an inspection was performed.
- 5) Describe the analysis and the supporting information that was used to value the property.
- 6) Describe the supplemental information that was considered.
- 7) Indicate all source(s) of information used including:
 - 7a) external data sources,
 - 7b) property-specific data,
 - 7c) evidence of a property inspection,
 - 7d) photos of the property,
 - 7e) description of the neighborhood or local market conditions,
 - and 7f) include information on the preparer." (IAEG pg. 31)

When developing policies and procedures for evaluations, institutions may want to consider the applicability and necessity of the following:

- 1) Sales comparison analysis: photos of sale comps, map of the sale comps, and/or adjustment grid;
- 2) Income analysis: photos of rent comps, map of rent comps, and/or adjustment grid of rent comps;
- 3) Certification?

Review

The guidelines require that institutions should review evaluations for compliance with the guidelines, supervisory guidance and with internal institution policies. Determining the depth of reviews should be risk-focused to establish reasonableness and appropriateness for the transaction.

Conclusion

In light of the current regulatory focus on interim property and portfolio valuations, institutions would be well advised to establish and manage an effective program for property evaluations. The Interagency Guidelines provide only minimal requirements for developing and reporting evaluations. Institutions are responsible for developing their own policies and procedures for evaluations that are commensurate with the financial well being of the institution. As always, regulators will be the ultimate judge regarding sufficiency of each institution's evaluation program.

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WIB Announces Winners for Innovative Community Banks of the Year Awards

WIB AND BDO announced winners of the 1st Annual Innovative Community Banks of the Year Awards at their Annual Conference in Scottsdale in April. The winners and finalists represent the forward-thinking and creative achievements of community banks in three different asset size categories for innovations in 2011.

"These Innovative Community Banks of the Year Awards represent ways in which community banks are working to meet the needs of both their customers and the communities they serve," said Nancy Sheppard, president & CEO of WIB. "The nominated banks and finalists are great examples of how community banks are adapting successfully to the changing financial services environment."

A panel of 11 industry experts selected the finalists and winners from a pool of nominations in the three asset size categories. The chair of the Awards Advisory Committee is Mike Soza, Partner at BDO, a professional services firm that includes many banks as clients. "BDO is very proud to be co-sponsoring these awards," said Soza. "We are pleased to be able to take part in recognizing an important aspect of the community banking industry."

The 2011 Innovative Community Banks Awards winners (in bold) and finalists are:

Under \$150m in Assets

Bank of Santa Barbara, CA – Recapitalization of Troubled Bank by Local Private Foundations & Philanthropists

Pan American Bank, CA – Social Media

Town & Country Bank, UT – ATM/Debit Card Local Merchant Discount Program

\$150-\$500m in Assets

Presidio Bank, CA – Security Platform for Commercial Online Banking Clients

Circle Bank, CA – Micro Lending Fund for Women Entrepreneurs

Summit State Bank, CA – App to Deposit Checks from Customer's Smartphone

Over \$500m in Assets

Bank of American Fork, UT – Senior Protection Program

Bank of Utah, UT – Video Conferencing System

First Northern Bank, CA – Commercial Solar Financing & Power Production

Profiles of each finalist bank, as well as a list of the judges, are on the WIB website, www.wib.org.