Understanding the New Interagency Appraisal and Evaluation Guidelines

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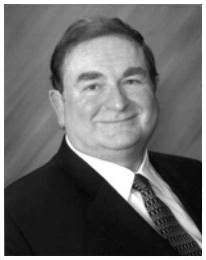

Last December, the FRB, FDIC, OCC, OTS and NCUA jointly published the new Interagency Appraisal and Evaluation Guidelines to update and supersede the 1994 guidelines for providing regulatory guidance on real property valuations for all real estate related transactions at regulated financial institutions (i.e. – banks, thrifts, credit unions, etc.). These guidelines apply to portfolio and capital markets transactions.

The following is a summary of some key elements of the guidelines. Please refer to the guidelines themselves for specific details.

Independence of the Appraisal Program

The guidelines firmly require that institutions or their agents must directly select and engage appraisers. Borrowers may not recommend appraisers. Loan production staff may not recommend or select an appraiser. They may however, exchange factual information about the property with the appraiser.

Engagement Letters

When ordering appraisals, regulated lending institutions must use written engagement letters which include the intended use, user, Scope of Work and reporting option for the appraisal assignment. Engagement letters should also include: a clear identification and description of the property and interest to be appraised, the status and condition of the property, the value(s) to be estimated, and any special appraisal requirements.

Minimum Appraisal Standards

According to the guidelines, all real estate appraisals for regulated institutions must meet the following five minimum requirements: 1) Conform to USPAP; 2) Be written and contain sufficient information and analysis to support the lending decision; 3) Analyze and report deductions and discounts for proposed or non-stabilized properties, non-market lease terms or unsold tracts; 4) Be based on the regulatory definition of Market Value, and include the current Market Value "As Is", as well as Prospective Market Value upon Completion or Stabilization, if applicable; and 5) Be performed by a state licensed or certified appraiser.

Appraisal Development

Lending institutions should discuss their needs and expectations with appraisers in order to develop an appropriate and mutually agreed upon Scope of Work for each assignment. The guidelines state that institutions should not allow lower cost or speed of delivery time to inappropriately influence their determination of a Scope of Work or selection of an appraiser for an assignment. These decisions should instead be based on what would be most appropriate for the particular transaction.

Broker Price Opinions

The guidelines specifically state that broker price opinions cannot be used as appraisals, evaluations or as the basis for any lending transaction, because they do not provide an estimate of the property's market value.

Validity of Appraisals

Lending institutions have to establish their own criteria for how long an appraisal remains valid, and this schedule must be reflected in their policies and procedures. This policy should consider factors such as: the passage of time, volatility of the local market, changes in availability and terms of financing, changes in

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supply of competing properties, and changes in underlying economic and market assumptions (e.g. - cap rates, occupancy, lease rates and terms, etc.).

Appraisal Review

Appraisals for regulated lending institutions should be reviewed prior to a final credit decision to make sure they: a) comply with Agency guidelines and institution requirements; b) contain sufficient information and analysis to support the lending transaction, and c) are reasonable and well supported by appropriate data and analyses. Appraisal reviews may be conducted by in-house appraisal staff, or by outsourced third-party appraisers. Review appraisers cannot change the value conclusion in an appraisal report, but they may develop their own second opinion of Market Value if they do not agree with the conclusions of the original appraiser. Institutions should have a risk-based approach for determining the depth of review, based on the relative risk of the loan transaction.

Resolution of Deficiencies

Lending institutions should develop policies and procedures for resolving weaknesses in appraisals identified through the review process. These policies should include procedures for communicating deficiencies to the appraiser and requesting revisions. These policies should include procedures for addressing significant deficiencies that could not be resolved with the original appraiser. Options could include relying on a USPAP compliant second opinion of Market Value by the review appraiser, or obtaining a second appraisal.

Monitoring Collateral Values/ Loan Modifications and Workouts

Portfolio monitoring policies at regulated lending institutions should include policies regarding when to obtain new appraisals on real property supporting existing loans, particularly for loans that will be modified or worked out. Criteria should address deterioration in the credit or negative changes in market conditions since origination.

These are the updated rules of the road regarding valuations for regulated lending institutions. Understanding and embracing these rules can help to keep the lending process smooth by avoiding regulatory delays on the valuation front.