



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D.C. 20551

DIVISION OF SUPERVISION
AND REGULATION

SR 18-9

October 16, 2018

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: Frequently Asked Questions on the Appraisal Regulations and the Interagency Appraisal and Evaluation Guidelines

Applicability: This guidance applies to all state member banks, bank holding companies, and nonbank subsidiaries of bank holding companies.

The Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (referred to as the “agencies”) are issuing the attached *Frequently Asked Questions on the Appraisal Regulations and the Interagency Appraisal and Evaluation Guidelines* to clarify certain aspects of the agencies’ appraisal regulations and to consolidate some of the interagency frequently asked questions (FAQs) from a previous release issued in 2005.

In response to questions received from financial institutions, these FAQs assemble previously communicated interpretations and requirements and provide additional examples for a supervised institution’s appraisal program, address the appropriate implementation of certain exemptions from the agencies’ appraisal regulations, and discuss the preparation of evaluations. These FAQs replace the “*Interagency FAQs on the Agencies’ Appraisal Regulations and Interagency Statement on Independence of Appraisal and Evaluation Functions*” issued in May 2005.¹ Certain questions from the 2005 release have been revised and incorporated in the attached FAQs. Several of the 2005 FAQs were previously addressed by the agencies in the 2010 *Interagency Appraisal and Evaluation Guidelines*. Institutions should use these FAQs in conjunction with existing regulations and guidance on appraisals.

Reserve Banks are asked to distribute this letter to the supervised institutions in their districts and to appropriate supervisory staff. Questions regarding this letter should be directed to the following individuals in the Risk Policy Section in the Division of Supervision and

¹ With the issuance of this SR letter, SR letter 05-5, “Interagency FAQs on the Agencies’ Appraisal Regulations and Interagency Statement on Independence of Appraisal and Evaluation Functions,” is being made inactive.

Regulation: Carmen Holly, Senior Supervisory Financial Analyst, at (202) 973-6122; or Peter Clifford, Manager Risk Policy Section, at (202) 785-6057.

In addition, institutions may send questions via the Board's public website.²

Michael S. Gibson
Director

Attachments:

- *Frequently Asked Questions on the Appraisal Regulations and the Interagency Appraisal and Evaluation Guidelines*

Cross References:

- SR letter 16-5, "Interagency Advisory on the Use of Evaluations in Real Estate-Related Financial Transactions."
- SR letter 10-16, "Interagency Appraisal and Evaluation Guidelines."
- 12 CFR 208 subpart E, Real Estate Lending, Appraisal Standards, and Minimum Requirements for Appraisal Management Companies
- 12 CFR 208 subpart E, Appendix C, Interagency Guidelines for Real Estate Lending Policies
- 12 CFR 225 subpart G, Appraisal Standards for Federally Related Transactions

Supersedes:

- SR letter 05-5, "Interagency FAQs on the Agencies' Appraisal Regulations and Interagency Statement on Independence of Appraisal and Evaluation Functions."

² See <http://www.federalreserve.gov/apps/contactus/feedback.aspx>

**Federal Deposit Insurance Corporation
Board of Governors of the Federal Reserve System
Office of the Comptroller of the Currency**

**Frequently Asked Questions on the Appraisal Regulations and the
Interagency Appraisal and Evaluation Guidelines**

October 16, 2018

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are issuing these frequently asked questions (FAQs) in response to questions raised regarding the agencies' appraisal regulations and guidance. These FAQs do not introduce new policy or guidance but assemble previously communicated policy and interpretations. The FAQs focus on, and should be reviewed in conjunction with, the agencies' appraisal regulations issued under Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Title XI),¹ the real estate lending standards,² the December 2010 *Interagency Appraisal and Evaluation Guidelines* (Valuation Guidelines),³ and the March 2016 *Interagency Advisory on the Use of Evaluations in Real Estate-Related Financial Transactions* (Evaluations Advisory).⁴ Institutions should also be aware of other regulations and guidance related to appraisals, which these FAQs do not address.⁵

¹ The agencies' appraisal regulations were promulgated pursuant to Title XI. See 12 U.S.C. § 3339. The agencies' Title XI appraisal regulations apply to transactions entered into by the agencies or by institutions regulated by the agencies that are depository institutions or bank holding companies or subsidiaries of depository institutions or bank holding companies. OCC: 12 CFR Part 34, subpart C; Board: 12 CFR Part 225, subpart G; 12 CFR Part 208, subpart E; and FDIC: 12 CFR Part 323, subpart A.

² The real estate lending standards were adopted by the OCC, the Board, and the FDIC. OCC: 12 CFR Part 34, subpart D; Board: 12 CFR Part 208.51 and Part 208, Appendix C; and FDIC: 12 CFR Part 365, subpart A, Appendix A.

³ 75 FR 77450 (December 10, 2010).

⁴ OCC Bulletin 2016-8 (March 4, 2016); Board SR Letter 16-5 (March 4, 2016); and *Supervisory Expectations for Evaluations*, FDIC FIL-16-2016 (March 4, 2016).

⁵ The agencies, together with the National Credit Union Administration (NCUA), the Federal Housing Finance Administration (FHFA) and Bureau of Consumer Financial Protection (BCFP), have promulgated joint rules regarding appraisals for higher-priced mortgage loans (HPML Appraisal Rule). See 78 FR 10367 (Feb. 13, 2013) and 78 FR 78520 (Dec. 26, 2013) (implementing amendments made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to the Truth in Lending Act at 15 U.S.C. § 1639h); OCC: 12 CFR Part 34, subpart G; Board: 12 CFR 226.43; NCUA: 12 CFR 722.3(f); BCFP: 12 CFR 1026.35(c); and FHFA: 12 CFR 1222, subpart A. The FDIC adopted the HPML Appraisal Rule as published at 12 CFR 1026.35(a) and (c) (78 FR at 10370, 10415). Additionally, in 2010

These FAQs incorporate some of the FAQs issued by the agencies in 2005 (see questions 14 through 23).⁶ Many of the questions in the 2005 FAQs are directly addressed in the Valuation Guidelines and, therefore, have not been included in this FAQ document. These FAQs supersede the 2005 FAQs.⁷

Appraisal and Evaluation Programs

1. Why does a financial institution need a program for establishing the market value of real property?

Answer: Financial institutions should have a program for valuing real property to ensure they are engaging in real estate-related lending in a safe and sound manner and in compliance with Title XI and the agencies' appraisal regulations.⁸

Lending secured by real estate is a large part of many financial institutions' business plans and is important to the communities served by those institutions. Lessons learned from past crises have shown that poorly managed real estate lending programs, including the failure to properly value real estate that secures transactions, can result in higher loan losses, reduced profitability, and bank failures.

In light of these problems, Congress adopted Title XI,⁹ requiring financial institutions to obtain appraisals prepared by state-certified or state-licensed appraisers for all federally related transactions (FRTs)¹⁰ and requiring the agencies to issue regulations relating to such appraisals.¹¹

(effective April 1, 2011), the Board issued the Interim Final Rule on Valuation Independence (IFR on Valuation Independence) establishing independence rules for consumer purpose residential mortgage loans secured by a consumer's primary dwelling. *See* 75 FR 66554 (Oct. 28, 2010) and 75 FR 80675 (Dec. 23, 2010) (implementing Dodd-Frank Act amendments to the Truth in Lending Act at 15 U.S.C. § 1639e); Board: 12 CFR 226.42 and BCFP: 12 CFR 1026.42. Under the Dodd-Frank Act, the IFR on Valuation Independence is deemed to have been prescribed jointly by the OCC, Board, FDIC, NCUA, BCFP and FHFA. *See* 15 U.S.C. § 1639e(g)(2). For those transactions within the scope of the HPML Appraisal Rule or IFR on Valuation Independence, institutions must comply with those rules.

⁶ *Frequently Asked Questions on the Appraisal Regulations and the Interagency Statement on Independent Appraisal and Evaluation Functions* (March 22, 2005) (2005 FAQs).

⁷ In some cases, the 2005 FAQs have been edited for clarity and consistency with current rules.

⁸ Financial institutions should also have a program for establishing the market value of real property to comply with the real estate lending standards, which require financial institutions to determine the value used in loan-to-value calculations based in part on a value set forth in an appraisal or an evaluation. OCC: 12 CFR Part 34, subpart D, Appendix A; Board: 12 CFR 208, subpart E, Appendix C; and FDIC: 12 CFR Part 365, subpart A, Appendix A.

⁹ 12 U.S.C. §§ 3331 *et seq.*

¹⁰ 12 U.S.C. § 3349. *See* 12 U.S.C. § 3350(4) for the Title XI definition of "federally related transaction."

¹¹ 12 U.S.C. § 3339.

Congress expanded Title XI and adopted new provisions relating to appraisals in the Dodd-Frank Act after the 2008 financial crisis.

2. What regulations are applicable to appraisal and evaluation programs?

Answer: The agencies have issued appraisal regulations as required by Title XI for the performance of real estate appraisals in connection with FRTs. These regulations prescribe which real estate-related financial transactions require the services of an appraiser, identify which categories of FRTs must be appraised by a state-certified appraiser and which by a state-licensed appraiser, and prescribe minimum standards for the performance of real estate appraisals in connection with FRTs.¹²

Financial institutions should also be aware of and comply with two additional rules that apply specifically to residential mortgage loans secured by a consumer's principal dwelling – the HPMI Appraisal Rule and the IFR on Valuation Independence.¹³ In addition, the agencies adopted regulations regarding real estate lending standards pursuant to section 304 of the Federal Deposit Improvement Act of 1991, which requires banks and federal savings associations to adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by real estate.¹⁴

The *Interagency Guidelines for Real Estate Lending Policies*,¹⁵ which were promulgated as an appendix to the real estate lending standards, were issued to assist financial institutions in formulating and maintaining appropriate real estate lending policies in accordance with the regulations. The agencies' real estate lending standards provide that each financial institution's written policies must be consistent with safe and sound lending practices, and must ensure that the financial institution operates within limits and according to standards that are reviewed and approved by the financial institution's board of directors.

3. What types of transactions require an appraisal?

Answer: The agencies' Title XI appraisal regulations require an appraisal performed by a state-certified or state-licensed appraiser for all FRTs.¹⁶ All real estate-related financial transactions engaged in by financial institutions are FRTs unless the transactions are exempt from the appraisal requirements of the appraisal regulations.¹⁷

¹² OCC: 12 CFR 34, subpart C; Board: 12 CFR Part 225, subpart G; 12 CFR Part 208, subpart E; and FDIC: 12 CFR Part 323.

¹³ See *supra*, note 6.

¹⁴ OCC: 12 CFR 34.62; Board: 12 CFR 208.51; and FDIC: 12 CFR 365.2.

¹⁵ OCC: 12 CFR Part 34, subpart D; Board: 12 CFR Part 208, subpart E, Appendix C; and FDIC: 12 CFR Part 365, subpart A, Appendix A.

¹⁶ OCC: 12 CFR 34.43(a); Board: 12 CFR 225.63(a); and FDIC: 12 CFR 323.3(a).

¹⁷ OCC: 12 CFR 34.43(a); Board: 12 CFR 225.63(a); and FDIC: 12 CFR 323.3(a).

The agencies' Title XI appraisal regulations require an evaluation that is consistent with safe and sound banking practices for certain exempt transactions.¹⁸ The Title XI appraisal regulations apply to both commercial and residential transactions; however, for financial institutions the threshold above which an appraisal is required is different for residential transactions, commercial real estate transactions, and qualifying business loans.¹⁹

As discussed in the Valuation Guidelines, a financial institution's appraisal policy and practices may differ by transaction type. The financial institution should consider the type and complexity of the transaction when ordering appraisals, selecting appraisers, and reviewing appraisals.²⁰ Moreover, for all lending activity, a financial institution should ensure that independence is maintained when ordering appraisals, selecting appraisers, and reviewing appraisals.²¹

4. What is the purpose of the Valuation Guidelines, and do all financial institutions' valuation programs have to meet every aspect of the Valuation Guidelines?

Answer: The Valuation Guidelines are not regulations and do not prescribe a set of requirements that financial institutions must meet, nor do they represent a checklist or a "one size fits all" approach to supervising financial institutions. Instead, the Valuation Guidelines describe a framework to assist financial institutions in complying with the agencies' appraisal regulations and real estate lending standards.

A financial institution's valuation program should be commensurate with the complexity and nature of its real estate lending activities, risk profile, and business model, and must comply with applicable laws and regulations. For example, a financial institution that engages primarily in owner-occupied real estate lending in its local market area should tailor its valuation program to reflect the size and nature of the loans and collateral. In contrast, a financial institution that engages in significant commercial real estate lending or large acquisition, development, and construction (ADC) projects should tailor its valuation program for these types of higher risk transactions.

5. Should a financial institution review all appraisals and evaluations?

Answer: As part of the credit approval process and prior to making a final credit decision, a financial institution should review appraisals and evaluations to confirm that they comply with the agencies' appraisal regulations and the financial institution's internal policies.

¹⁸ OCC: 12 CFR 34.43(b); Board: 12 CFR 225.63(b); and FDIC: 12 CFR 323.3(b).

¹⁹ OCC: 12 CFR 34.43(a)(1), (5) and (13); Board: 12 CFR 225.63(a)(1), (5), (14); and FDIC: 12 CFR 323.3(a)(1), (5), (13). Additionally, the HPML Appraisal Rule requires appraisals for higher priced mortgage loans, which must include an interior visit of the property, unless the HPML is \$25,000 or less (adjusted annually for inflation; \$26,000 for 2018) or another exemption from the rule applies. OCC: 12 CFR 34.203(b)(2); Board: 12 CFR 226.43(b)(2); and BCFP: 12 CFR 1026.35(c)(2)(ii).

²⁰ See Valuation Guidelines, sections VIII and XV.

²¹ See Valuation Guidelines, section V.

Reviewers should be independent of the transaction and have no direct or indirect interest in the property or transaction, and be independent of and insulated from any influence by loan production staff. Additionally, as reflected in supervisory guidance, the reviews should confirm that an appraisal or evaluation contains sufficient information and analysis to support the market value conclusion and the decision to engage in the transaction.

The depth of the review should be commensurate with the risk of the transaction. Valuations supporting lower risk transactions may warrant a less robust review, while valuations supporting higher risk transactions with complex or specialized collateral, such as large ADC projects, may warrant a more robust review.²²

6. What cost-effective actions can a smaller financial institution take to implement an appraisal and evaluation review program that meets the standards for independence in the agencies' appraisal regulations?

Answer: A small financial institution with limited staff should implement practical safeguards for reviewing appraisals and evaluations when absolute lines of separation between the collateral valuation program and loan production process cannot be achieved.²³ Small financial institutions could have loan officers, other employees, or directors review an appraisal or evaluation, but those individuals should be appropriately qualified, independent of the transaction, and should abstain from any vote or approval related to such loans.

To the extent that a financial institution is involved in real estate transactions that are complex, out of market, or otherwise exhibit elevated risk, management should assess the level of in-house expertise available to review appraisals or evaluations associated with these types of transactions. If the expertise is not available in-house, the financial institution may find it appropriate to evaluate alternatives, such as outsourcing of the review process, for ensuring that effective and independent reviews are performed.

For transactions subject to the IFR on Valuation Independence, institutions must comply with the provisions of that rule.²⁴

Appraisal Exemptions

7. When is it appropriate for financial institutions to use the “abundance of caution” exemption?

Answer: The abundance of caution exemption²⁵ may only be used in those transactions where a borrower qualifies for an extension of credit based on the strength of the associated cash flow or

²² Valuation Guidelines, section XV.

²³ *Id.*

²⁴ *See, e.g.*, Board: 12 CFR 226.42(d) and BCFP: 12 CFR 1026.42(d).

²⁵ The abundance of caution exemption generally has limited application. *See* Valuation Guidelines, Appendix A, exemption 2.

non-real estate collateral, and knowledge of the market value of the real estate collateral taken as security for the transaction is unnecessary in making the credit decision. The financial institution's credit analysis should clearly document and verify that the credit decision was well supported by repayment sources other than real estate collateral. For transactions that meet the abundance of caution exemption, neither an appraisal nor an evaluation is required.²⁶ Refer to the following examples.

Example 1: Commercial and Industrial Cash Flow Loan. A financial institution extends a commercial business line of credit to a heating and cooling repair business. The financial institution holds the owner's personal guaranty and has taken a security interest in an investment property owned by the guarantor. The financial institution's credit analysis determines that cash flow from business operations has generated sufficient debt service coverage. The guarantor's global cash flow also reflects sufficient debt service coverage, and the guarantor maintains a strong liquid asset position. All of the borrower's other credit attributes are satisfactory. The financial institution's credit analysis has verified and documented that the financial institution would have made the loan without knowledge of the market value of the real estate. Based on the borrower's overall creditworthiness and the sufficiency of cash flow generated by the business to cover the debt service on the loan, the security interest in the real estate can be considered an abundance of caution.

Example 2: Loan Secured by Other Collateral. A financial institution extends a term loan to a construction company to purchase equipment used in the construction business and secures the loan with a lien on the equipment and the borrower's headquarters building.²⁷ The real estate lien can be considered an abundance of caution if, for example, the value of the equipment adequately secures the outstanding balance of the loan and the borrower's global cash flow provides for repayment of the loan. In such a case, the cash flow from the operation of the business is the primary source of repayment for the loan and the equipment is the secondary source of repayment. All of the borrower's other credit attributes are satisfactory. The financial institution's credit analysis verified and documented that the financial institution would have made the loan without knowledge of the market value of the real estate.

Prior to making a final commitment to the borrower, the financial institution should document and retain in the credit file the analysis performed to verify that the abundance of caution exemption has been appropriately applied. If the operating performance or financial condition of the borrower subsequently deteriorates and the financial institution determines that the real estate will be relied upon as a repayment source, an appraisal should then be obtained, unless another exemption applies.

²⁶ OCC: 12 CFR 34.43(a)(2) and (b); Board: 12 CFR 225.63(a)(2) and (b); and FDIC: 12 CFR 323.3(a)(2) and (b).

²⁷ The equipment pledged as collateral is not co-located with the headquarters building.

8. Does a financial institution always need to obtain a new appraisal or evaluation for a renewal of an existing loan at the financial institution, particularly where the property is located in a market that has not changed materially?

Answer: No. A financial institution may use an existing appraisal or evaluation to support the renewal of an existing loan at the financial institution when the market value conclusion within the appraisal or evaluation remains valid.

Validating the market value conclusion of the real property is a fact-specific determination, based on market conditions, property condition, and nature of the transaction. As described in the Valuation Guidelines,²⁸ a financial institution should establish criteria for validating an existing appraisal or evaluation in its written valuation policies. The criteria should consider factors that could impact the market value conclusion in the existing appraisal or evaluation, such as: the volatility of the local market; changes in terms and availability of financing; natural disasters; supply of competing properties; improvements to the subject or competing properties; lack of maintenance on 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; and the passage of time.²⁹ Regarding this last factor, there is no provision in the agencies' appraisal regulations specifying the useful life of an appraisal or evaluation.

The financial institution must also consider whether an appraisal or an evaluation is required for the transaction. The agencies' appraisal regulations require an evaluation for transactions involving an existing extension of credit at the financial institution when either (1) there has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the real estate collateral protection after the transaction, even with the advancement of new money, or (2) there is no advancement of new money, other than funds necessary to cover reasonable closing costs.³⁰ Alternatively, a financial institution could choose to obtain an appraisal, although only an evaluation is required. For example, an institution may choose to obtain an appraisal to achieve a higher level of risk management or to conform to internal policies.

In the context of renewal transactions, whether there has been a material change in market conditions may affect both whether an appraisal or evaluation is required and whether an existing appraisal or evaluation remains valid. A financial institution can assess whether there has been a "material change" in market conditions by considering the factors detailed above for validating an existing appraisal or evaluation. When there has been an obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the real estate collateral protection, the existing appraisal or evaluation is no longer valid. In such situations, if no new money is advanced, a financial institution must obtain a new evaluation, or may choose to satisfy the agencies' appraisal regulations by obtaining a new appraisal.

²⁸ See Valuation Guidelines, section XIV.

²⁹ Valuation Guidelines, section XIV.

³⁰ See OCC: 12 CFR 34.43(a)(7) and (b); Board: 12 CFR 225.63(a)(7) and (b); and FDIC: 12 CFR 323.3(a)(7) and (b).

However, if new money is advanced, a financial institution must obtain a new appraisal unless another exemption from the appraisal requirement applies. Refer to the following examples.³¹

Example 1. A financial institution originated a revolving line of credit for a specified term, and at the end of the term, renews the line for another specified term with no new money advanced. The financial institution's credit analysis concluded that there had been a material change in market conditions or the physical aspects of the property that threatened the adequacy of the real estate collateral protection. Based on this conclusion, the financial institution could not validate an existing appraisal or evaluation to support the transaction. The agencies' appraisal regulations would require an evaluation, rather than an appraisal, because no new money was advanced, even though the financial institution concluded there is a threat to the adequacy of the collateral protection. Alternatively, the financial institution could choose to obtain a new appraisal, although only an evaluation would be required.

Example 2. A financial institution originated an ADC loan and, at maturity, renewed the loan and advanced new money that exceeded the original credit commitment. The financial institution's credit analysis concluded that a material change in market conditions or the physical aspects of the property threatened the adequacy of the real estate collateral protection. Based on this conclusion, the financial institution could not validate an existing appraisal or evaluation to support the transaction. The agencies' appraisal regulations would require an appraisal to support the transaction, because the financial institution advanced new money and concluded there is a threat to the adequacy of the real estate collateral protection.

Example 3. Consider the same scenario in **Example 2** above; however, the financial institution's credit analysis concluded that there had not been a material change in market conditions or physical aspects of the property that threatened the adequacy of the real estate collateral protection. Based on this conclusion, the agencies' appraisal regulations would require an appropriate evaluation to support the transaction. The financial institution could use a valid existing evaluation or appraisal, or could choose to obtain a new evaluation to support the transaction. Alternatively, a financial institution could choose to obtain a new appraisal, but a new appraisal would not be required.

Example 4. A financial institution originated a balloon mortgage secured by a single family residential property. At the end of the term, the financial institution renews the balance of the mortgage for another term, with no new money advanced. The financial institution's credit analysis concluded that there had not been a material change in market conditions or the physical aspects of the property that threatened the adequacy of the real estate collateral protection. Based on this conclusion, the agencies' appraisal regulations would require the financial institution to obtain an appropriate evaluation to support the transaction. The financial institution could use a valid existing evaluation or appraisal, or could choose to obtain a new evaluation to support the transaction. Alternatively, the financial institution could choose to obtain a new appraisal, although a new appraisal would not be required.

³¹ These examples assume no other exemption from the appraisal requirement applies.

Financial institutions should consider the risk posed by transactions that do not require new appraisals or evaluations and may consider obtaining a new appraisal or evaluation based on the financial institution's risk assessment.³² In addition, financial institutions making HPMLs must ensure compliance with the HPML Appraisal Rule.³³

9. When engaging in a renewal transaction, how can a financial institution document the validity of an existing appraisal or evaluation?

Answer: A financial institution should document the assessment of the validity of an existing appraisal or evaluation in the credit file. The documentation should detail the facts and analysis to support the financial institution's determination that the market value conclusion of the collateral can be used to support the subsequent transaction. The level of detail for the assessment of the validity of appraisals or evaluations in the credit file could vary in accordance with the transaction type. For example, documentation for a renewal of a residential mortgage loan may be less detailed than for a residential tract development loan or commercial property.

10. Are real estate transactions secured by farmland eligible for the \$1 million exemption for certain business loans?

Answer: Yes, real estate transactions secured by farmland are eligible for the \$1 million exemption if they meet the regulatory requirements. The agencies appraisal regulations establish a \$1 million threshold above which appraisals are required for business loans that are not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment (qualifying business loans).³⁴ A loan secured by farmland could be treated as a qualifying business loan and be eligible for the corresponding \$1 million threshold if repayment is primarily from the proceeds from the farm business (for example, sale of crops and related payments).

However, a loan secured by farmland whose repayment is primarily from rental income from renting or leasing the farmland to a non-affiliated entity would not be eligible for the qualifying business loan threshold.³⁵ Transactions secured by multiple farmland properties that are owned by one or more affiliated limited liability companies could meet the qualifying business loan exemption, if they meet the source of repayment requirements provided in the appraisal regulations.³⁶

³² See Valuation Guidelines, Appendix A, exemption 7.

³³ See OCC: 12 CFR 34.203(b)(7); Board, 12 CFR 226.43(b)(7); and BCFP: 12 CFR 1026.35(c)(2)(vii). See also FHFA: 12 CFR 1222, subpart A.

³⁴ OCC: 12 CFR 34.43(a)(5); Board: 12 CFR 225.63(a)(5); and FDIC: 12 CFR 323.3(a)(5).

³⁵ 83 FR 15030 (April 9, 2018).

³⁶ *Id.*

Appraisals and Evaluations

11. What information should be contained in an evaluation?

Answer: The agencies' appraisal regulations require evaluations to be appropriate for the transaction and consistent with safe and sound banking practices, but do not specifically define the content to support the evaluation.³⁷ As explained in the Valuation Guidelines,³⁸ 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. An evaluation should include sufficient information to identify the property, address the property's actual physical condition, and detail the analysis, assumptions, and conclusions that support the market value conclusion. The level of detail documented in the evaluation should reflect the risk in the transaction. For example, in general, an evaluation for most residential properties could be less detailed than evaluations for commercial properties.

When developing policies and procedures regarding supplemental information that a financial institution will require to develop an evaluation, the financial institution should be aware that some valuation assignments, such as for properties in rural areas or non-disclosure states³⁹ or properties that are not sufficiently similar to other properties in the local market, may be more challenging to value due to a lack of comparable sales data. Although the sales comparison approach is the most used valuation method, in areas where there have been few, if any, recent comparable sales of similar properties in reasonable proximity to the subject property, the person who performs an evaluation may consider alternative valuation methods and other information for developing an evaluation and supporting a market value conclusion.

For example, the cost approach to valuing real property might be an appropriate valuation approach, particularly if the property is newer construction. Similarly, for an income producing or rental property, the income approach could be appropriate to support a market value conclusion in an evaluation.⁴⁰

12. When would a financial institution be able to use a tax assessment valuation (TAV) in the development of an evaluation?

Answer: A financial institution could use a TAV as a component in the development of an evaluation when it demonstrates a valid correlation between the TAV and the market value of the property by:

- Determining and documenting how the tax jurisdiction calculates the TAV and how frequently property revaluations occur;

³⁷ OCC: 12 CFR 34.43(b); Board: 12 CFR 225.63(b); and FDIC: 12 CFR 323.3(b).

³⁸ See Valuation Guidelines, section XIII.

³⁹ Nondisclosure States do not make information concerning property transactions available to the public.

⁴⁰ See Valuation Guidelines, sections XII, and XIII; Evaluations Advisory.

- Performing an analysis to determine the relationship between the TAV and market values for properties within a tax jurisdiction; and
- Testing and documenting how TAVs correlate to market value based on contemporaneous sales at the time of assessment and revalidating whether the correlation remains stable as of the effective date of the evaluation.

A TAV with a valid correlation analysis could be used, along with other supporting information appropriate to the type of transaction, to prepare an evaluation and develop a market value conclusion. A TAV is not, in and of itself, an alternative to an evaluation. As with all evaluations, transactions that rely heavily on a TAV as part of the evaluation process should describe and document the method(s) the financial institution used to confirm the property's actual physical condition and the extent to which an inspection was performed.

Financial institutions should establish policies and procedures that specify the supplemental information that is required to develop an evaluation supported by a TAV.⁴¹ A financial institution should be able to demonstrate that such an evaluation provides a credible market value conclusion and supports the financial institution's decision to enter into a transaction.

13. If a financial institution engages in a FRT with an intermediate lender, such as a warehouse lender, in which the financial institution extends credit to the intermediate lender collateralized by the intermediate lender's real estate-related transactions with third parties, can the financial institution accept appraisals ordered by the intermediate lender to support the value of the underlying real estate collateral?

Answer: Yes, the financial institution may accept the appraisals from the intermediate lender, provided the intermediate lender is a financial services institution,⁴² the appraiser has no direct or indirect interest in the property or the transaction, *and* the other requirements of the appraisal regulations are fulfilled.⁴³

14. Can a financial institution approve a residential or commercial real estate loan subject to receipt and review of an appraisal or evaluation, or must the appraisal or evaluation be obtained and reviewed prior to making the final decision?

Answer: A financial institution may grant conditional approvals to prospective borrowers before obtaining an appraisal or evaluation. However, a final credit decision or action should only occur after the financial institution receives, reviews, and accepts the appraisal or evaluation.

⁴¹ See Valuation Guidelines, Appendix B.

⁴² See Valuation Guidelines, Appendix D.

⁴³ OCC: 12 CFR 34.45(b)(2); Board: 12 CFR 225.65(b)(2); and FDIC: 12 CFR 323.5(b)(2).

Although the agencies' appraisal regulations do not specifically define "financial services institution," the term is intended to describe entities that provide services in connection with real estate lending transactions on an ongoing basis, including loan brokers. See Valuation Guidelines, Appendix D.

15. The work-out plan on a problem loan calls for a financial institution to receive an assignment of a note secured by a deed of trust on a different property. Is this transaction considered a real-estate-related financial transaction and is an appraisal required on the collateral property?

Answer: Yes, this transaction is considered a real-estate-related financial transaction. The agencies' appraisal regulations require an evaluation in certain loan workout situations.⁴⁴ In such situations, although only an evaluation would be required, the financial institution could choose to obtain a new appraisal.

Independence

16. A financial institution plans to make a construction loan to a tract developer to build multiple homes.⁴⁵ Is it permissible for the developer to order appraisals on the properties to support the construction loan request? Could the developer select an appraiser from the lender's approved appraiser list and in turn submit the appraiser's name to potential permanent lenders?

Answer: No, the financial institution may not accept a borrower-ordered appraisal and may not allow the borrower to select an appraiser from its approved appraiser list.⁴⁶

17. Are appraisers required to disclose whether they have been engaged to appraise a given property in the past?

Answer: The agencies' appraisal regulations do not specifically require that the financial institution obtain information from appraisers as to whether an appraiser has previously appraised a given property. However, the regulations do require that all appraisals conform to Uniform Standards of Professional Appraisal Practice (USPAP), and USPAP requires that an appraiser disclose any services regarding a given property performed by the appraiser within the three-year period immediately preceding acceptance of an assignment, as an appraiser or in any other capacity.⁴⁷ The agencies' appraisal regulations also require a financial institution, when engaging a fee appraiser, to confirm that the appraiser has no direct or indirect interest, financial or otherwise, in the property or the transaction. The financial institution should ask relevant questions of an appraiser to confirm that the appraiser is independent of the transaction and capable of rendering an unbiased opinion.⁴⁸

⁴⁴ See Valuation Guidelines, Appendix A, exemptions 7 and 8.

⁴⁵ See Frequently Asked Questions on Residential Tract Development and Lending (September 8, 2005); OCC: <https://www.occ.gov/news-issuances/bulletins/2005/bulletin-2005-32.html>; Board: <https://www.federalreserve.gov/boarddocs/srletters/2005/SR0514a1.pdf>; and FDIC: <https://www.fdic.gov/news/news/financial/2005/fi19005a.html>.

⁴⁶ OCC: 12 CFR 34.45(b); Board: 12 CFR 225.65(b); and FDIC: 12 CFR 323.5(b).

⁴⁷ USPAP, 2018-2019 Edition, Ethics Rule.

⁴⁸ Valuation Guidelines, section VI.

18. Can a staff appraiser or an appraisal company affiliated with the financial institution be considered independent, since the financial institution compensates them?

Answer: Yes, if a staff appraiser prepares an appraisal, that appraiser must be independent of the loan production function and not involved in the approval of the transaction.⁴⁹ Staff appraisers must not have any direct or indirect interest in the property or transaction.⁵⁰ Likewise, when fee appraisers from an affiliated appraisal company prepare appraisals, such fee appraisers must not have any direct or indirect interest in the property or transaction.⁵¹ For transactions subject to the IFR on Valuation Independence, institutions must refer to that rule for the circumstances under which a staff appraiser or appraisal company affiliated with the creditor would not be considered to have a conflict of interest based on the person's employment or affiliate relationship with the creditor.⁵²

19. May a financial institution accept an appraisal prepared by an appraiser who was engaged by the loan broker for the transaction?

Answer: The agencies' appraisal regulations allow a financial institution to accept an appraisal prepared by an appraiser engaged by another financial services institution, including a loan broker,⁵³ as long as the appraiser has no direct or indirect interest, financial or otherwise, in the property or transaction and the appraisal conforms to the requirements of the regulations and is otherwise acceptable. Financial institutions should review broker-ordered appraisals thoroughly to confirm that the appraisal complies with the regulations and meets the quality standards required by the financial institution's appraisal policies. For transactions subject to the IFR on Valuation Independence, institutions must refer to that rule for the circumstances under which the loan broker ordering the appraisal would not be considered to have a conflict of interest as a result of performing multiple settlement services for the transaction.⁵⁴

20. May an appraisal be routed from one financial institution to another financial institution via the borrower?

Answer: A financial institution should not accept an appraisal from the borrower. However, the borrower can inform the financial institution that there is an existing appraisal. Prior to accepting an appraisal from another financial institution, the institution should confirm that the appraiser is independent of the transaction, the appraiser was engaged directly by the other financial institution, and the appraisal conforms to the agencies' appraisal regulations and is otherwise acceptable.⁵⁵

⁴⁹ OCC: 12 CFR 34.45(a); Board: 12 CFR 225.65(a); and FDIC: 12 CFR 323.5(a).

⁵⁰ *Id.*

⁵¹ OCC: 12 CFR 34.45(b)(1); Board: 12 CFR 225.65(b)(1); and FDIC: 12 CFR 323.5(b)(1).

⁵² See Board: 12 CFR 226.42(d) and BCFP: 12 CFR 1026.42(d).

⁵³ Valuation Guidelines, Appendix D.

⁵⁴ See Board: 12 CFR 226.42(d); BCFP: 12 CFR 1026.42(d).

⁵⁵ OCC: 12 CFR 34.45(b)(2); Board: 12 CFR 225.65(b)(2); and FDIC: 12 CFR 323.5(b)(2).

21. May an appraiser deliver an appraisal report to more than one lender assuming the appraisal has been ordered by one of the lenders?

Answer: The agencies' appraisal regulations do not address whether an appraiser can deliver an appraisal report to more than one lender. The case may depend upon the provisions of the engagement letter. For example, the lender may specify in the engagement letter that the appraisal may be provided to another financial institution if the lender decides not to go forward on the loan. In the case of a syndicated loan, a lead lender is usually responsible for engaging the appraiser and providing copies of the appraisal to the other participating financial institutions. With regard to standards of confidentiality, USPAP directs an appraiser to be aware of, and comply with, all confidentiality and privacy laws and regulations applicable in an assignment.⁵⁶

22. May a financial institution accept a transferred appraisal prepared by an appraiser who had an affiliated business relationship with the financial services institution that originally ordered the appraisal?

Answer: The affiliated business relationship between the financial services institution and the fee appraiser does not violate the independence requirement of the agencies' appraisal regulations, provided the fee appraiser has no direct or indirect interest, financial or otherwise, in the property or the transaction. The financial institution receiving the appraisal should confirm that the appraiser is independent of the transaction and that the appraisal conforms to the agencies' appraisal regulations and is otherwise acceptable.⁵⁷ For transactions subject to the IFR on Valuation Independence or the HPML Appraisal Rule, institutions should confirm that the appraisal complies with those rules.

23. How can a financial institution confirm appraiser independence when accepting an appraisal prepared for another financial services institution?

Answer: Documentation (such as an engagement letter) should be available to indicate that the financial services institution (not the borrower) ordered the appraisal and that the appraiser has no direct or indirect interest, financial or otherwise, in the property or the transaction. The original lender's engagement letter to the appraiser should be included in the credit file.⁵⁸ For transactions subject to the IFR on Valuation Independence, an institution's documentation should be available to indicate that the requirements of that rule are met.

⁵⁶ Refer to the Confidentiality section of the Ethics Rule in the USPAP.

⁵⁷ OCC: 12 CFR 34.45(b)(2); Board: 12 CFR 225.65(b)(2); and FDIC: 12 CFR 323.5(b)(2).

⁵⁸ Valuation Guidelines, section VI.