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

Interagency Advisory on Use of Evaluations in Real Estate-Related Financial Transactions

In outreach meetings conducted by the federal banking agencies[1] (agencies) pursuant to the requirement of the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA),[2] representatives from the financial industry raised questions regarding supervisory expectations for using an evaluation instead of an appraisal for estimating the market value of real property securing real estate-related financial transactions.

Many questions pertained to the circumstances under which evaluations may be used in the underwriting of real estate-related financial transactions and how to support a market value conclusion when there have been few or no recent comparable sales. The federal banking agencies are providing this advisory to respond to those questions by describing existing supervisory expectations, guidance, and industry practice.

Transactions That Permit Evaluations

The agencies' appraisal regulations[3] require financial institutions regulated by the agencies to obtain an appraisal completed by a competent and qualified state-licensed or state-certified appraiser that complies with the Uniform Standards of Professional Appraisal Practice (USPAP)[4] for any real estate-related financial transaction, unless an exception applies.

Under the appraisal regulations, the following transaction types do not require an appraisal, but do require an evaluation:

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[1] The federal banking agencies include the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System (Board), and the Office of the Comptroller of the Currency (OCC).

[2] The federal banking agencies are currently conducting a review of their respective regulations pursuant to EGRPRA, including their appraisal regulations, in order to evaluate whether they are outdated, unnecessary, or unduly burdensome, and to consider how to reduce regulatory burden on insured depository institutions while, at the same time, ensuring their safety and soundness and the safety and soundness of the financial system. This guidance is responding to specific questions that have been raised about appraisals as part of the agencies' EGRPRA outreach process, but this guidance is not intended to indicate the completion of their EGRPRA review of appraisal requirements, which is ongoing. See transcripts at http://egrpra.ffiec.gov/outreach/outreach-index.html.

[3] See FDIC: 12 CFR 323; Board: 12 CFR 208, subpart E, and 12 CFR 225, subpart G; and OCC: 12 CFR 34, subpart C. The National Credit Union Administration (NCUA) regulations are located at 12 CFR 722, but the NCUA is not a party to this advisory as it is being issued in response to comments raised during the EGRPRA process, and the NCUA is not required to participate in EGRPRA.

[4] Appraisal Standards Board of The Appraisal Foundation, Uniform Standards of Professional Appraisal Practice (2016-2017), available at
http://www.appraisalfoundation.org/TAF/Standards/Appraisal_Standards/TAF/USPAP.aspx?hkey=5a640dda-464d-4683-b4e1-190201e0eda7.

- Transactions in which the "transaction value"[5] (generally the loan amount) is $250,000 or less;[6]
- Certain renewals, refinances, or other transactions involving existing extensions of credit; and
- Real estate-secured business loans with a transaction value of $1,000,000 or less and when the sale of, or rental income derived from, real estate is not the primary source of repayment for the loan.

There may be instances when a financial institution finds it prudent or necessary to go beyond the requirements of the agencies' appraisal regulations. For example, obtaining an appraisal may be prudent for credit risk management purposes or may be a prerequisite to participating in some secondary market transactions. Additionally, a financial institution may find it prudent to obtain an appraisal rather than an evaluation when the institution's portfolio risk increases or for higher-risk real estate-related financial transactions.

Preparation of an Evaluation

The Interagency Appraisal and Evaluation Guidelines (Guidelines)[7] provide guidance on the use of and parameters for evaluations. An evaluation is not required to be completed by a state-licensed or state-certified appraiser or to comply with USPAP. The evaluation preparer should, however, be knowledgeable, competent, and independent of the transaction and the loan production function of the institution. Evaluations may be completed by a bank employee or by a third party. In smaller communities, bankers and third-party real estate professionals have access to local market information and may be qualified to prepare evaluations for an institution.

An individual who prepares an evaluation may consider one or more valuation approaches or methodologies to estimate the market value of real estate. The valuation profession considers three approaches to valuing real estate, namely the sales comparison approach, the cost approach, and the income approach. An evaluation should provide a reliable estimate of the market value of the property and, therefore, the approach or approaches used in an evaluation should be appropriate to the property being valued. For most residential properties and some commercial properties, the person preparing an evaluation may obtain data on recent sales of properties similar to the property being valued that reflect recent market activity. Such comparable sales present direct market evidence that may be useful to the preparer in estimating the market value of the subject property.

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[5] "Transaction value" is a defined term in the interagency appraisal regulation. See FDIC: 12 CFR 323.2(m); Board: 12 CFR 225.62(m); and OCC: 12 CFR 34.42(m).

[6] Other regulations may require obtaining an appraisal for certain transactions with transaction values under the threshold. For example, an appraisal may be required under Regulation Z for any transaction that is considered a higher-priced mortgage loan under that regulation due to its interest rate. See Consumer Financial Protection Bureau: 12 CFR 1026.35; Board: 12 CFR 226.43; and OCC: 12 CFR 34, subpart G.

[7] See Interagency Appraisal and Evaluation Guidelines, Federal Register, Vol. 75, No. 237, December 10, 2010, page 77450, at https://www.gpo.gov/fdsys/pkg/FR-2010-12-10/pdf/2010-30913.pdf. While the NCUA has appraisal regulations and is a party to the Guidelines, the NCUA is not a party to this Advisory as it is being issued in response to comments raised during the EGRPRA process, and the NCUA is not required to participate in EGRPRA.

Some valuation assignments, such as for properties in rural areas or non-disclosure states[8] or properties that are not sufficiently similar to other properties in the local market, may be more challenging 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[9] to valuing real property might be appropriate, particularly if the property is newer construction. Similarly, for an income-producing or rental property, the income approach[10] could be appropriate to support a market value conclusion in an evaluation. There are many sources of information available to financial institutions that describe the valuation processes applicable to income-producing properties.

The Guidelines discuss the possible use of several analytical methods and technological tools, such as automated valuation models and tax assessment values. To use one of these methods, an institution should be able to demonstrate that the valuation method is consistent with safe-and-sound banking practices and the Guidelines. The Guidelines detail expectations for selecting, using, and validating an analytical method or technological tool. Institutions should establish policies and procedures that specify the supplemental information that is required to develop an evaluation.

Contents of an Evaluation Report

The Guidelines provide information regarding the minimum content that should be contained in an evaluation. Unlike an appraisal report that must be written in conformity with the requirements of USPAP, there is no standard format for documenting the information and analysis performed to reach a market value conclusion in an evaluation. Regardless of the approach or methodology used to estimate the market value of real property, an evaluation should contain sufficient information to allow a reader to understand the analysis that was performed to support the value conclusion and the institution's decision to engage in the transaction.

[8] States that do not disclose a property's actual sales price are referred to as non-disclosure states.

[9] See definition for cost approach in *The Dictionary of Real Estate Appraisal*, sixth edition, Appraisal Institute, Chicago 2013, page 54.

[10] A discussion of the income approach is included in chapters 23 and 24 of *The Appraisal of Real Estate*, 14th edition, Appraisal Institute, Chicago 2013.