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Updated Real Estate Appraisal Guidelines

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This article describes the Interagency Appraisal and Evaluation Guidelines which provide further clarification of appraisal regulations and supervisory guidance to institutions and examiners about prudent appraisal and evaluation programs.

The Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of Thrift Supervision ("OTS"), and the National Credit Union Administration ("NCUA") (collectively, the "Agencies") issued the Interagency Appraisal and Evaluation Guidelines (the "Guidelines") to provide further clarification of the Agencies' appraisal regulations and supervisory guidance to institutions and examiners about prudent appraisal and evaluation programs. They apply to all real estate appraisals in connection with federally related transactions, which are defined as those real estate-related financial transactions that an Agency engages in, contracts for, or regulates and that require the services of an appraiser. The Guidelines set forth the minimum standards for the performance of real estate appraisals and specify the requirement for evaluations of real estate collateral in certain transactions that do not require an appraisal.

The Guidelines became effective on December 10, 2010, and supersede the 1994 Guidelines. The following is a summary of the Guidelines, as well as brief explanation as to their applicability.

Background

The Issuance of the Guidelines

In October 1994, OCC, FRB, FDIC, and OTS issued the Guidelines to provide guidance to regulated financial institutions on prudent appraisal and evaluation policies. Since the issuance of these Guidelines, the Agencies have issued additional supervisory guidance documents to promote sound practices in appraisal and evaluation programs. There have also been significant industry developments, such as advancements in information technology that have affected the development and delivery of appraisals and evaluations. In response to these developments, the Agencies published the Proposed Interagency Appraisal and Evaluation Guidelines (the "Proposal"). The Agencies considered the comments to the Proposal while making revisions to the Proposal and issuing the Guidelines.

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Supervisory Policy

Comments to the Guidelines expressed the view that the Proposal gave too much discretion to regulated institutions in the development and implementation of their appraisal and evaluation programs. The Agencies believe that the Proposal adequately addressed the issue of enforceability and their supervisory process, yet decided to incorporate minor edits to better distinguish between regulatory requirements and prudent banking practices. The Agencies also expanded certain sections to provide further clarification in an effort to promote consistency in the application and enforcement of their regulatory requirements and supervisory expectations. An institution's real estate appraisal and evaluation policies will be reviewed as part of the examination of the institution's overall real estate-related activities. Institutions that fail to comply with the regulations or to maintain a sound appraisal and evaluation program consistent with supervisory guidance will be cited in supervisory letters or examination reports and may be criticized for unsafe and unsound banking practices.

Independence of the Appraisal and Evaluation Program

The Agencies' regulations' specific independent requirements exceed those set forth in the Uniform Standards of Professional Appraisal Practice ("USPAP"). In response to comments made regarding the Proposal, the Agencies expanded this section to further detail their expectations for appropriate communication and information sharing with persons performing collateral valuation assignments.

An institution should not directly or indirectly coerce, influence or otherwise encourage an appraiser or evaluator to misrepresent the value of the property by communicating a predetermined or expected estimate of value, or specifying a minimum value requirement or conditioning a person's compensation on loan consummation. However, an institution is permitted to request that the appraiser consider additional information about the subject or comparable properties, provide additional supporting information about the basis of valuation and correct factual errors in an appraisal.

An institution should maintain standards of independence as part of an effective collateral valuation program for all of its real estate lending activity. Appraisers must be independent of the loan production and collection processes and have no direct, indirect or prospective interest, financial or otherwise, in the property or transaction. Additionally, an institution's policies and procedures should specify methods for communication that ensure independence in the collateral valuation function.

For a small or rural institution, it may not always be possible to separate the collateral valuation program from the loan production process. If absolute lines of independence cannot be achieved, an institution should be able to demonstrate clearly that it has prudent safeguards to isolate its collateral valuation program from influence or interference from the loan production process.

Selection of Appraisers or Persons Who Perform Evaluation

An institution must directly select and engage appraisers and persons who perform evaluations. The only exception to this requirement is that the Agencies' regulations allow an institution to use an appraisal prepared for another financial services institution provided certain conditions are met. An institution should establish criteria to select, evaluate, and monitor the performance of the appraisers or evaluators. The criteria should ensure that the person selected possesses the requisite expertise and experience, is capable of rendering an unbiased opinion, is independent and has no interest in the property or transaction and holds the appropriate state certification or license. An institution should maintain documentation to demonstrate that the individual is competent, independent, and has the relevant expertise and knowledge for the market, location and type of real property being valued. The work performed by such individuals should be periodically reviewed.

An institution's use of a borrower-ordered or borrower-provided appraisal violates the Agencies' regulations. However, a borrower can inform an institution that a current appraisal exists and the institution may request it directly from the other financial services institution.

An institution may establish an Approved Appraiser List. If it chooses to do so, there should be appropriate procedures for its administration, such as a process for qualifying an appraiser for initial placement on the list, as well as periodic monitoring of the appraiser's performance and credentials. There should also be periodic internal review of the use of the approved appraiser list to confirm that appropriate procedures and controls exist to ensure independence in the development, maintenance and administration of the list.

When ordering appraisals, especially for large, complex or out-of-area commercial properties, an institution should use written engagement letters. These letters should identify the intended use and user and whether there are any legal or contractual restrictions on the sharing of the appraisal with other parties.

Transactions that Require Appraisals

Most real estate-related financial transactions are considered federally related transactions and require appraisals. The Agencies reserve the right to require an appraisal to address safety and soundness concerns in a transaction.

Minimum Standards of Appraisal

To promote the quality of appraisals, the Proposal and the Guidelines provide further clarification of the minimum appraisal standards in the Agencies' regulations and contain guidance on appraisal development and reporting to reflect revisions to USPAP. The following is a list of requirements for an appraisal:

- The appraisal must conform to generally accepted appraisal standards, as evidenced by USPAP unless principles of safe and sound banking require compliance with stricter standards. The Agency regulations do not permit an appraiser to appraise any property in which he has an interest even though this is allowed by USPAP. The appraisal must contain an opinion of market value and, under USPAP, it must also contain a certification that the appraiser has complied with USPAP. Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act provides that broker price opinions may not be used as the primary basis to determine the value of a piece of property for the purpose of loan origination of a residential mortgage loan secured by such piece of property.

- The appraisal must be written and must contain sufficient information to support the institution's decision to engage in the transaction. The level of detail should be sufficient for the institution to understand the appraiser's analysis and opinion regarding the property's market value. An institution should ensure that the scope of work established by the appraiser is appropriate and consistent with the extent of the research and analyses employed for similar property types, market conditions and transactions. Under USPAP, appraisal reports must contain sufficient information to enable the intended user of the appraisal to understand the report properly.

- As discussed in more detail below, the appraisal must analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leases buildings, non-market lease terms and tract developments with unsold units.

- The appraisal must contain an estimate of market value and be based upon the definition of market value set forth in the Agencies' regulations. The estimate of market value should consider the property's actual physical condition, use and zoning as of the effective date of the opinion. Value opinions such as "going concern value," "value in use," or a special value to a specific property user may not be used as market value for federally related transactions but may be contained in separate opinions so long as they are clearly identified and disclosed.

- The appraisal must be performed by state certified or licensed appraisers in accordance with the Agencies' regulation requirements. An institution must consider an appraiser's education and expertise. Appraisers should be selected based on their competency to perform the appraisal, including knowledge of the property type and specific property market. According to the Agencies' regulations, a state certified or licensed appraiser may not be considered competent solely by virtue of being certified or licensed.

Appraisals

Appraisal Development

The Agencies' regulations require appraisals to comply with the requirements in USPAP. The appraiser's scope of work should reflect the extent to which the property is identified and inspected, the type and extent of data researched and the analyses applied to arrive at certain conclusions. The appraiser is also required to disclose whether he/she previously appraised the property.

An institution is responsible for obtaining an appraisal that contains sufficient information and analysis to support its decision to engage in the transaction. It should discuss its needs and expectations for the appraisal with the appraiser but should not unduly influence the appraiser. According to USPAP, the appraisal must include any approach to value that is applicable and necessary. The appraiser should also disclose the rationale for the omission of a valuation approach. The appraiser must analyze and reconcile the information from the approaches to arrive at the estimated market value. An appraisal should include a discussion on market conditions and may include information on the prevalence and effects of sales and financing concessions, the list-to-sale price ratio and availability of financing. An appraisal should reflect an analysis of the property's sales history and an opinion as to the highest and best use of the property. Under USPAP, an appraiser must disclose whether the subject property was inspected and whether anyone provided significant assistance to the appraiser.

Appraisal Reports

An institution is responsible for identifying the appropriate appraisal report option to support its credit decision and should consider the risk, size and complexity of the transaction and the real estate collateral. The report should contain sufficient detail to allow the institution to understand the scope of work performed, which includes disclosure of research and analysis performed, as well as disclosure of the research and analysis typically warranted for the type of appraisal, but omitted, along with the rationale for its omission.

Evaluations

Financial institutions appreciate the flexibility in permitting the use of evaluations for low-risk transactions consistent with the Agencies' regulations. The Appraisal exemptions section was revised in response to comments on the Proposal. The Guidelines do not expand the categories of appraisal exemptions set forth in the Agency regulations but the section does incorporate technical edits to address specific comments. The dollar amount of the appraisal threshold and of the business loan threshold from the Agencies' regulations were incorporated into this section. The section also addresses the factors that an institution should consider in determining whether to obtain an appraisal even though an evaluation is permitted.

Note that this topic was moved from the *Evaluation Content* section in the Proposal to this section as it related to the regulatory requirement that evaluations reflect safe and sound banking practices. Although some comments from appraisers and appraiser organizations noted that the Agencies should not permit evaluations, the Agencies believe that the Guidelines adequately address an institution's responsibility to maintain policies and procedures for obtaining an appropriate appraisal or evaluation to support its credit decision.

Transactions that Require Evaluations

The use of evaluations is permitted for low-risk transactions. The following transactions may receive an evaluation: (1) Transactions that have a transaction value equal to or less than $250,000; (2) Transactions that are business loans with a transaction value equal to or less than $1 million and are not dependent on the sale of, or rental income derived from, real estate as the primary source of repayments; (3) Transactions that involve an existing extension of credit at the lending institution, provided that (a) there has been no obvious and material change in market conditions or physical aspects of the property that threaten the adequacy of the institution's real estate protection after the transaction, or (b) there is no advancement of new monies other than funds necessary to cover reasonable closing costs.

Evaluation Development

The Guidelines clarify how institutions can use analytical methods or technological tools to develop an evaluation. The Agencies revised the Guidelines to stress that an institution should consider transaction risk when it is evaluating the appropriate collateral valuation method and level of documentation for an evaluation. An evaluation must be consistent with safe and sound banking practices and should support the institution's decision to engage in the transaction. A valuation method that does not provide a property's market value or sufficient information to support the value is not acceptable as an evaluation. The Guidelines now emphasize the importance of considering the property's condition in the development of an evaluation, regardless of the method or tool use.

Aside from the property's actual physical condition, a valuation method should address the economic and market conditions that affect the estimate of the collateral's market value. An institution should establish criteria for determining the level and extent of research or inspection necessary to ascertain the property's actual physical condition and the economic and market factors that should be considered in developing an evaluation.

The Guidelines confirm that broker price opinions and other similar valuation methods, in and of themselves, do not comply with the minimum appraisal standards in the Agencies' regulations and are not consistent with the Agencies' minimum supervisory expectations for evaluations.

Evaluation Content

An evaluation should contain sufficient information detailing the analysis, assumptions and conclusions to support the credit decision. The evaluation should, at a minimum:

- identify the location of the property;
- provide a description of the property and its current and projected use;
- provide an estimate of the property's market value in its actual physical condition, use and zoning designation as of the valuation's effective date, with any limiting conditions;
- describe the method the institution used to confirm the property's actual physical condition and the extent to which an inspection was performed;
- describe the analysis that was performed and the supporting information that was used in valuing the property;
- describe the supplemental information that was considered when using an analytical method or technological tool;
- indicate all sources of information used in the analysis to value the property, including external data sources, property-specific data, evidence of a property inspection, photos of the property, description of the neighborhood or local market conditions; and
- include information on the preparer, such as the name and contact information and signature of the preparer.

Guidelines Applicable to Appraisals and Evaluations

Existing Appraisals and Evaluations

The Guidelines confirm that appraisals obtained from other financial services institutions must comply with the Agencies' regulations and be consistent with supervisory guidance, including the standards of independence. The Guidelines remind institutions that they generally should not rely on evaluations prepared by another financial services institution. Minor edits were made to this section to reaffirm that small institutions should ensure that reviewers are independent and appropriately qualified and may need to employ additional personnel or engage a third party to perform the review function.

An institution may use an existing appraisal or evaluation to support a subsequent transaction in certain circumstances and the institution should establish criteria for assessing whether an existing appraisal or valuation remains valid. A new appraisal or valuation is necessary if the originally reported market value has changed due to factors such as: passage of time, volatility of the local market, changes in terms and availability of financing, natural disasters, limited or oversupply of competing properties, improvements to the subject property or competing properties, lack of maintenance of the subject or competing properties, changes in underlying economic and market assumptions, environmental contamination and changes in zoning, building materials or technology.

Reviewing Appraisals and Evaluations

The Guidelines were expanded to clarify the Agencies' expectations for an appropriate depth of review, the educational and training qualifications for reviewers, the resolution of valuation deficiencies and related documentation standards. The Guidelines now discuss the appropriate depth of review by property type, including factors to consider in the review of appraisals and evaluations of commercial and single-family residential real estate. The Guidelines retain the possible use of automated tools and sampling methods in the review of appraisals and evaluations in supporting lower risk residential mortgages. With prior approval from its primary federal regulator, an institution may use such tools or methods for its review process.

The Agency regulations specify that appraisals must contain sufficient information and analysis to support an institution's decision to engage in the credit transaction and evaluations must be consistent with safe and sound banking practices. As part of the credit approval process and prior to a final credit decision, an institution should review appraisals and evaluations to ensure their compliance with the regulations and its own internal policies. Through the review process, the institution should be able to assess the reasonableness of the appraisal or evaluation. When an institution identifies an appraisal or evaluation that is inconsistent with the Agencies' regulations and deficiencies cannot be resolved with the person who performed the appraisal or evaluation, the institution must obtain an appraisal or evaluation that meets the regulatory requirements prior to making a credit decision. An institution's policies and procedures for reviewing appraisals and evaluation should, at a minimum, do the following:

- Address the independence, educational and training qualifications, and role of the reviewer. Reviewers should be capable of assessing whether the appraisal or evaluation contains sufficient information and analysis to support the institution's decision to engage in the transaction.

- Reflect a risk-focused approach for determining the depth of the review. The depth of the review should be sufficient to ensure that the methods, assumptions, data sources and conclusions are reasonable, well-supported and appropriate for the transaction, property and market. The review process should be commensurate with the type of transaction. *Commercial real estate* transactions involving complex properties or high-risk commercial loans should be reviewed more comprehensively to assess the technical quality of the appraiser's analysis. Those involving commercial properties securing lower risk transactions may be less technical but should provide meaningful results that are commensurate with the size, type and complexity of the underlying credit transaction. The reviews of *residential real estate* should reflect a risk-focused approach that is commensurate with the size, type and complexity of the underlying credit transaction, as well as loan and portfolio risk characteristics. Risk factors may include debt-to-income ratios, loan-to-value ratios, levels of documentation, transaction dollar amount and other relevant factors.

If an institution is unable to confirm that the appraisal meets the requirements, it must obtain an appraisal prior to engaging in the transaction. An institution may use an appraisal that was prepared by an appraiser engaged directly by another financial services institution so long as the appraisal conforms to the Agency regulations and is otherwise acceptable. An institution should confirm that the appraiser was engaged directly by the other financial services institution, the appraiser has no interest in the property or transaction, and the other institution (not the borrower) ordered the appraisal.

- Establish a process for resolving any deficiencies in appraisals or evaluations. Procedures should include communicating the noted deficiencies to and requesting correction of such deficiencies by the appraiser or evaluator and addressing significant deficiencies that could not be resolved with the original appraisal by obtaining a second appraisal or relying on a review that complies with USPAP. The institution should also replace evaluations made prior to the credit decision that do not provide credible results or lack sufficient information to support the final credit decision.

- Set forth documentation standards for the review and the resolution of noted deficiencies. The policies should address the level of documentation needed for the review. The documentation should describe the resolution of any appraisal or evaluation deficiencies, including reasons for obtaining and relying on a second appraisal or evaluation. The documentation should also provide an audit trail that documents the resolution of noted deficiencies or details the reasons for relying on a second opinion.

Third Party Arrangement

This section was expanded to provide additional specificity on an institution's responsibilities for the selection, monitoring and management of arrangements with third parties. An institution is accountable for ensuring that any services performed by a third party, both affiliated and unaffiliated entities, comply with applicable laws and regulations and are consistent with supervisory guidance. An institution should have a written contract that clearly defines the expectations and obligations of both the financial institution and the third party, including that the third party will perform its services in compliance with the regulations and consistent with supervisory guidance. An institution should ensure that the third party selects an appraiser who is competent, independent and has the requisite experience and training for the assignment and thorough knowledge of the property market. An institution should also ensure that when a third party engages an appraiser or evaluator, the third party conveys to that person the intended use of the appraisal or evaluation and that the regulated institution is the client.

Program Compliance

The Agencies revised the Guidelines to reflect a principles-based approach to ensure than an institution's collateral valuation program complies with the Agencies' regulations and is consistent with supervisory guidance and an institution's internal policies. An institution's appraisal and evaluation policies should establish internal controls to promote an effective appraisal and evaluation program. The compliance process should:

- maintain a system of adequate controls, verification and testing to ensure that appraisals and evaluations provide credible market values;
- insulate those responsible for ascertaining the compliance of the institution's appraisal and evaluation function from any influence by loan production staff;
- ensure the institution's practices result in the selection of appraisers and evaluators with the appropriate qualifications and demonstrated competency for the assignment;
- establish procedures to test the quality of the appraisal and evaluation review process;
- use the results of the institution's review process and other relevant information as a basis for considering a person for a future appraisal or evaluation assignment; and
- report appraisal and evaluation deficiencies to appropriate internal parties and, if applicable, to external authorities in a timely manner.

An institution should monitor collateral risk on a portfolio and on an individual credit basis and be able to demonstrate that sufficient information is available to support the current market value of the collateral and the classification of a problem real estate credit. Prudent portfolio monitoring practices include criteria for determining when to obtain a new appraisal or evaluation. The criteria should address deterioration in the credit since origination or changes in market conditions, which may include material changes in current and projected vacancy, absorption rates, lease terms, rental rates and sales prices and fluctuations in discount or direct capitalization rates. In assessing whether changes are material, an institution should consider the individual and aggregate effect of these changes on its collateral protection and the risk in it real estate lending programs or credit portfolios.

Modifications and Workouts of Existing Credits

The revisions to the Guidelines reflect clarifying text on the regulatory requirements for reappraisals of real estate collateral for existing credits, particularly in modification and workout situations.

- *Loan Modifications*: A loan modification to an existing credit that involves a limited change in the terms of the note or loan agreement and that does not adversely affect the institution's real estate collateral protection after the modification does not rise to the level of a new real estate-related financial transaction and, thus, would not require an institution to obtain a new appraisal or evaluation. Institutions can use Automated Valuation Models ("AVM") or other valuation techniques when considering a modification to a residential mortgage loan.

- *Loan Workouts*: Loan workouts that adversely affect an institution's real estate collateral protection after the modification, renew or extend the terms, or require the advancement of new monies or a restructuring are considered new real estate-related financial transactions. If the loan workout does not include the advancement of new monies, other than reasonable closing costs, the institution may obtain an evaluation in lieu of an appraisal. For loan workouts that involve the advancement of new monies, an institution may obtain an evaluation in lieu of an appraisal so long as there has been no obvious and material change in market conditions and no change in the physical aspects of the property that threatens the adequacy of the institution's real estate collateral protection after the workout. An institution must obtain an appraisal when a loan workout involves the advancement of new monies and there is an obvious and material change in either market conditions or physical aspects of the property.

Referrals

The Guidelines were revised to address an institution's responsibility to file a suspicious activity report (a "SAR") with the Financial Crimes Enforcement Network of the U.S. Department of Treasury when it suspects inappropriate appraisal-related activity that meets the SAR filing criteria. Examiners will forward such findings to their supervisory office for appropriate disposition if there are concerns with an institution's ability or willingness to make a referral or file a SAR. An institution should file a complaint with the appropriate state appraiser regulatory officials when it suspects that a state certified or licensed appraiser failed to comply with USPAP, applicable state laws, or engaged in other unethical conduct.

Exemptions

The Agencies identified certain real estate-related financial transactions that are exempt from the appraisal requirement. The following is a list of such exemptions:

- For transactions with a transaction value of less than $250,000, the regulations require, at a minimum, an evaluation consistent with safe and sound banking practices. If a transaction is secured by several individual properties that are not part of a tract development, the estimate of value of each individual property should determine whether an appraisal or evaluation is required for that property.

- An institution may take a lien on real estate and be exempt from obtaining an appraisal if the lien is taken by the lender in an abundance of caution. In order to qualify for this exemption, the Agencies expect the extension of credit to be well supported by the borrower's cash flow or collateral other than real property. This exemption should not be invoked if the transaction would not be adequately secured by sources of repayment other than the real estate. It should also not be invoked to a loan or loan program unless the institution verifies and documents the primary and secondary repayment sources. Prior to making a final commitment to the borrower, the institution should document and retain in the credit file the analysis performed to verify that the abundance of caution exemption has been appropriately applied.

- An institution is not required to obtain an appraisal on a loan that is not secured by real estate even if the proceeds of the loan are used to acquire or improve real property.

- An institution may take liens against real estate without obtaining an appraisal to protect legal rights to, or control over, other collateral. To apply this exemption, the institution should determine that the market value of the real estate as an individual asset is not necessary to support its decision to extend credit.

- An evaluation is permitted in lieu of an appraisal for business loans with a transaction value of $1 million or less where the primary source of repayment is not from the sale of, or rental income derived from, real estate.

- An institution is not required to obtain an appraisal for operating leases that are not the economic equivalent of the purchase or sale of the leased property.

- An evaluation is permitted for a renewal or refinance of an existing extension of credit when there has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the institution's real estate collateral protection after the transaction (even with the advancement of new monies). To satisfy this condition, the current or planned future use of the property should be consistent with the use identified in the existing appraisal or evaluation. An evaluation is also permitted for a renewal or refinance if there is no advancement of new monies other than funds necessary to cover reasonable closing costs. An institution is considered to have advanced new monies when there is an increase in the principal amount of the loan over the amount of principal outstanding before the renewal or refinancing.

- Another exemption applies to appraisal requirements for transactions involving the purchase, sale, investment in, exchange of, or extension of credit secured by a loan or interest in a loan, pooled loans or interests in real property, including mortgage-backed securities. If each note or real estate interest meets the regulatory requirements for appraisals at the time the note was originated, the institution need not obtain a new appraisal. The institution should employ audit procedures and review a representative sample of appraisals supporting pooled loans or real estate notes to determine that the conditions of the exemptions have been satisfied. An institution may presume that the underlying loans in a marketable, mortgage-backed security satisfy the requirements of the Agencies' regulations whenever an issuer makes a public statement (such as in a prospectus) that the appraisals comply with the regulations. If the mortgages that secure the mortgage warehouse loan are sold to Fannie Mae or Freddie Mac, the sale itself may be used to demonstrate that the underlying loans complied with the appraisal regulations.

- Transactions that are wholly or partially insured or guaranteed by a U.S. government agency or U.S. government-sponsored agency are also exempt from the appraisal requirements. The Agencies expect these transactions to meet all the underwriting requirements of the federal insurer or guarantor in order to receive the insurance or guarantee.

- Another exemption applies to transactions that either (i) qualify for sale to a U.S. government agency or U.S. government-sponsored agency, or (ii) involve a residential real estate transaction in which the appraisal conforms to Fannie Mae or Freddie Mac appraisal standards applicable to that category of real estate. An institution that relies on exemption (i) should maintain adequate documentation that confirms that the transaction qualifies for sale to a U.S. government agency or U.S. government-sponsored agency. If the qualification is not adequately documented, the transaction should be supported by an appraisal that conforms to the Agencies' regulations unless another exemption applies. To qualify for the exemption stated in (ii) above, transactions that do not conform to all Fannie Mae or Freddie Mac underwriting standards must be supported by an appraisal that meets these government-sponsored agencies' appraisal standards for the applicable property type and is documented in the credit file.

- Additionally, an institution acting as a fiduciary is not required to obtain appraisals under the regulations if an appraisal is not required under other laws governing fiduciary responsibilities in connection with a transaction.

- The Agencies retain the authority to determine when the services of an appraiser are not required in order to protect federal financial and public policy interests or for the safety and soundness of financial institutions. This exemption applies to transactions on a case-by-case basis.

The Use of Automated Valuation Models ("AVMs") and Tax Assessment Valuations ("TAVs")

An institution is responsible for meeting supervisory expectations regarding the selection, use and validation of an AVM and maintaining an effective system of internal controls. The Guidelines were revised to confirm that the result of an AVM, in and of itself, does not meet the Agencies' minimum appraisal standards regardless of whether the results are signed by an appraiser because a state certified or licensed appraiser must perform an appraisal in conformance with USPAP and the Agencies' minimum appraisal standards

An AVM or TAV is not an alternative to an evaluation. An institution may not rely solely on the results of an AVM to develop an evaluation unless the resulting evaluation is consistent with safe and sound banking practices and the Guidelines. An institution should establish standards for independent and ongoing monitoring and model validation. Such validation can be performed internally or with the assistance of a third party, as long as the validation is conducted by qualified individuals that are independent of the model development or sales functions. An institution should ensure that persons who validate an AVM on an ongoing basis are independent of the loan production and collection processes and have the requisite expertise and training. To ensure unbiased test results, an institution should compare the results of an AVM to actual sales data in a specified trade area or market prior to the information being available to the model.

Similarly, an institution may not rely solely on the data provided by local tax authorities to develop an evaluation unless the resulting evaluation is consistent with safe and sound banking practices and the Guidelines. An institution may use a TAV in developing an evaluation when it can demonstrate that a valid correlation exists between the tax assessment data and the market value.

Deductions and Discounts

The Agency regulations require an appraiser to analyze and report appropriate deductions and discounts in the following transactions, which should reflect the property's actual physical condition, use and zoning designation as of the effective date of the appraisal:

- *Proposed Construction or Renovation*—An institution may request a prospective market value upon completion and a prospective market value upon stabilization.
- *Partially Leased Buildings*—The appraiser must make appropriate deductions and discounts to reflect that the property has not achieved stabilized occupancy. The appraisal should also include consideration of the absorption of the unleased space.
- *Non-Market Lease Terms*—The appraisal must clearly state the ownership interest being appraised and provide a discussion of the leases in place.
- *Tract Development with Unsold Units*—Appraisals must reflect deductions and discounts for holding costs, marketing costs and entrepreneurial profit supported by market data. In some cases entrepreneurial profit may be included in the discount rate. The projected sales price and absorption rate of units should be supported by anticipated demand at the time the units are expected to be exposed for sale.
- *Raw Land*—The appraiser must provide an opinion of value based on its current condition and existing zoning. Appropriate deductions should include feasibility studies, permitting, engineering, holding costs, marketing costs, and entrepreneurial profit and other costs specific to the property.
- *Developed Lots*—For existing or proposed developments of five or more residential lots in a single development, appropriate deductions should reflect holding costs, marketing costs, and entrepreneurial profit during the sales absorption period for the sale of the developed lots, as well as the appraiser's estimate of the time frame for the actual development and sale of the lots.
- *Attached or Detached Single-Family Homes*—For proposed construction and sale of five or more attached or detached single-family homes in the same development, appropriate deductions should reflect holding costs, marketing costs, and entrepreneurial profit during the sales absorption period of the completed units. If an institution finances construction on an individual unit basis, an appraisal of the individual units may be used if the institution can demonstrate through an independently obtained feasibility study or market analysis that all units collateralizing the loan

can be constructed and sold within twelve months.

- *Condominiums*—For proposed construction and sale of a condominium building with five or more units, appropriate deductions include holding costs, marketing costs and entrepreneurial profit during the sales absorption period of the completed units. If an institution finances construction of a single condominium building with less than five units or a condominium project with multiple buildings with less than five units per building, the institution may rely on appraisals of the individual units if the institution can demonstrate through an independently obtained feasibility study or market analysis that all units collateralizing the loan can be constructed and sold within twelve months.

Conclusion

The Agencies recognize that revisions to the Guidelines may be necessary to address future regulations implementing the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. In the meantime, however, the foregoing Guidelines were issued in order to promote consistency in both the application and enforcement of the current appraisal requirements and related supervisory guidance. This will serve to strengthen the real estate collateral valuation and risk management practices across insured depository institutions.