

Federal Banking Agencies Issue Final Rule to Exempt Commercial Real Estate Transactions of \$500,000 or Less from Appraisal Requirements

April 2, 2018

The Federal Reserve Board, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency (the “Agencies”) have issued a final rule to raise the threshold for a commercial real estate transaction requiring an appraisal to \$500,000 (the “Final Rule”). The Agencies believe this increase from the current \$250,000 threshold will significantly reduce the number of transactions requiring an appraisal and “will not pose a threat to the safety and soundness of financial institutions.”

In July of 2017, the Agencies originally proposed to raise the threshold, which has been in place since 1994, to \$400,000 but have now decided that a \$500,000 threshold will “materially reduce regulatory burden and the number of transactions that require an appraisal.” Our advisory describing the notice of proposed rulemaking (“Proposal”) and the background of Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act can be found [here](#).

I. Increase in Appraisal Threshold Level

The Final Rule increases the threshold level at or below which appraisals are *not* required for commercial real estate transactions from \$250,000 to \$500,000. Commentators supporting the threshold increase stated that the increase would be appropriate given the increases in real estate values since the \$250,000 threshold was established. Additional factors considered were the cost and time savings to lenders and borrowers and the burden relief the increase would provide to financial institutions in rural and other areas that may have a shortage of state licensed or certified appraisers.

In determining the exact level of the increase, the Agencies considered the changes in prices for commercial real estate measured by the Federal Reserve Commercial Real Estate Price Index (“CRE Index”). Based on the CRE Index, a commercial property that sold for \$250,000 as of June 30, 1994 (around the time the previous threshold was established) would be expected to have a conservative value of approximately \$509,000 as of December 2017.

In terms of the expected percentage of exempted loans, at the previous \$250,000 threshold, the percentage of commercial properties exempted from the appraisal regulations would be approximately 16.1%. The \$500,000 threshold the Agencies are adopting will increase the percentage of transactions exempted to approximately 31.9%.

II. Definition of Commercial Real Estate under the Final Rule

The Final Rule defines “commercial real estate” transactions as a real estate-related financial transaction that is not secured by a single 1-to-4 family residential property. The Final Rule’s definition of commercial real estate reflects a change from the Proposal. The Proposal included loans that finance the construction of buildings with 1-to-4 dwelling units with no permanent financing in the definition of commercial real estate. The Final Rule excludes all transactions secured by a single 1-to-4 family residential property from the definition of commercial real estate, and thus construction loans secured by a single 1-to-4 family residential property are not exempt from the appraisal requirements.

The Agencies also included the term “single” in the definition of commercial real estate to clarify that only transactions secured by *one* 1-to-4 family residential property are excluded. This eliminates potential confusion by clarifying that a loan for the construction of *multiple* 1-to-4 family residential properties does meet the definition of commercial real estate.

III. Use of Evaluations

For commercial real estate transactions exempted from the appraisal requirements by the Final Rule, regulated institutions must obtain an evaluation of the real property collateral that is “consistent with safe and sound banking practices.” Evaluations are required for: (i) commercial real estate-related financial transactions of \$500,000 or less, (ii) residential real estate-related transactions of \$250,000 or less and (iii) Qualified Business Loans^[1] with a transaction value of \$1 million or less.

Evaluations should be performed by persons who are competent and have relevant experience and knowledge of the market, location, and type of real property being valued. An evaluation need not be performed by a state licensed or certified appraiser, but may be completed by an employee of the regulated institution or a third party.

Finally, the Agencies point out that regulated institutions are encouraged to use a risk-focused approach when considering whether to order an appraisal for real estate financial transactions that might otherwise be exempted under the Final Rule.

Although the National Credit Union Administration (“NCUA”) did not join in this Final Rule, the Agencies coordinated with the NCUA in developing the Proposal and have indicated that the NCUA is evaluating options to develop a separate proposal to provide comparable relief for federally insured credit unions.

The Final Rule was effective as of April 9, 2018.

If you have any questions regarding the Final Rule or appraisal requirements under Title XI in general, please feel free to contact Joseph D. Simon at (516) 357-3710 or via email at jsimon@cullenanddykman.com, or Diana R. Acosta at (516) 357-3739 or via email at dacosta@cullenanddykman.com.

[1] Qualified Business Loans or “QBLs” are business loans that are real estate-related financial transactions and that are not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment.

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