Federal Banking Agencies Release Advisory Regarding Use of Evaluations Instead of Appraisals

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Federal banking agencies have issued an advisory on the use of evaluations instead of full appraisals for real-estate secured loans. The advisory describes existing supervisory expectations, guidance, and industry practice for using evaluations to estimate the market value of the real property for such loans.

The Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency issued the advisory in response to comments raised in outreach meetings conducted pursuant to the Economic Growth and Regulatory Paperwork Reduction Act ("EGRPRA"). Please note that the National Credit Union Administration ("NCUA") is not a party to the advisory as it is not required to participate in the EGRPRA.

While the federal banking agencies generally require financial institutions to obtain an appraisal from a competent and qualified state-licensed or state-certified appraiser for real estate-related financial transactions, the advisory summarizes the instances in which evaluations are permitted to be used instead of appraisals. Transactions that permit the use of evaluations include the following: (i) transactions in which the transaction value (generally the loan amount) is $250,000 or less (note that an appraisal may still be required under other regulations even if the transaction value is under the threshold, such as for a transaction that is considered a higher-priced mortgage loan); (ii) certain renewals, refinances, or other transactions involving existing extensions of credit; and (iii) real estate-secured business loans in which the transaction value is $1,000,000 or less and the sale of, or rental income derived from, real estate is not the primary source of repayment for the loan. The advisory notes that a financial institution may still decide to obtain an appraisal rather than an evaluation in situations where an appraisal is not legally required. Examples of such situations are where an appraisal may be prudent for credit risk management purposes or for secondary market transactions, or for managing portfolio risks.

The 2010 Interagency Appraisal and Evaluation Guidelines ("Guidelines"), which can be found here, provide guidance on the use of evaluations. The advisory clarifies the following from the Guidelines regarding the use of evaluations:

- Evaluations are not required to be completed by a state-licensed or state-certified appraiser. However, they should be prepared by someone who is knowledgeable, competent and independent of the transaction and loan production function of the financial institution. Therefore, a bank employee or third party may serve as the evaluation preparer as long as they meet the foregoing requirements.
- The three approaches to estimate the market value of real estate are the sales comparison approach, the cost approach, and the income approach. An evaluation preparer may consider one more of these approaches as long as the approach or approaches used are appropriate to the property being valued.
- For some commercial properties and most residential properties, an evaluation preparer may obtain data on recent comparable sales; however, in areas where there have been few, if any, recent comparable sales of similar properties in reasonable proximity to the subject property, the preparer may consider alternative valuation methods and other information for developing an evaluation and supporting a market value conclusion.
- There are other analytical methods and technological tools for estimating the market value of the real estates, such as automated valuation models and tax assessment values. These methods and tools may be used as long as the financial institution can demonstrate that the method and/or tool used is consistent with safe and sound banking practices and the Guidelines. Detailed expectations for selecting, using and validating a technological tool or analytical method can be found in the Guidelines.
- Despite there being no standard format on reaching a market value conclusion in evaluation, an evaluation must contain sufficient information to allow the reader to understand the analysis that was performed to support the value conclusion and the institution's decision to engage in the transaction. The Guidelines set forth the minimum content that should be contained in an evaluation.

Credit unions should note that even though the NCUA is not a party to this advisory, it is a party to the Guidelines and thus, credit unions are subject to the expectations and requirements set forth in such Guidelines as administered by the NCUA.

The complete advisory can be found online at https://www.fdic.gov/news/news/financial/2016/fil16016.pdf.

If you have any questions regarding this advisory or the use of appraisals or evaluations in real estate-related financial transactions in general, please feel free to contact Joseph D. Simon at 516-357-3710 or via email at jsimon@cullenanddykman.com, Kevin Patterson at 516-296-9196 or via email at kpatterson@cullenanddykman.com, or Elizabeth A. Murphy at 516-296-9154 or via email at emurphy@cullenanddykman.com.

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