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VALUATIONS SUPPORTING REIMBURSEMENT OF CHARGED-OFF COMMERCIAL REAL ESTATE (CRE) SHARED-LOSS ASSETS

Summary: Reimbursement of charged-off CRE loans under a Commercial Shared-Loss Agreement (CSLA) is based on the market value conclusion or the fair value of the collateral. If the loan is an impaired collateral dependent loan, accounting and regulatory guidelines require a valuation based on the fair value of the collateral. Other valuation opinions such as liquidation value or disposition values may be considered for informational purposes; however, reimbursements of Charge-Offs on Shared-Loss Assets must be based on the market value or fair value of the collateral. This approach is consistent with the Agencies' appraisal regulations, supervisory guidelines, and accounting requirements. The CSLA allows payment only for expenses incurred and actually paid for by the Assuming Institution (AI) even though estimated expenses are contemplated for accounting and regulatory reporting purposes.

Distribution:
Assuming Institutions
RSAM Specialists and Managers
Oversight Managers
Compliance Monitoring Contractors

From:
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Related Topics:
OCC, FRB, FDIC (the Agencies) Appraisal Regulations:
- OCC *12 CFR 34, Subpart C*
- FRB *12 CFR Part 225, Subpart G*
- FDIC *12 CFR Part 323* for State nonmember banks and *12 CFR Part 390, Subpart x* for State Savings Associations

Uniform Standards of Professional Appraisal Practice (USPAP)
Interagency Appraisal and Evaluation Guidelines (December 2010)
Interagency Policy Statement on the Allowance for Loan and Lease Losses (December 2006)
Accounting Standard Codification (ASC) Topic 310, Receivables, and ASC Topic 820, Fair Value Measurements and Disclosures
Call Report FFIEC 031 and 041, Glossary

Highlights:

- Reimbursement of charged-off CRE assets under a CSLA will be based on the market value or fair value conclusion. Charge-offs based on liquidation values or disposition values are not acceptable for shared-loss reimbursement claims.
- AIs should evaluate CRE Shared-Loss Assets for impairment in accordance with supervisory guidelines, ASC Topic 310, *Receivables*, and ASC Topic 820, *Fair Value Measurements and Disclosures.*
    - A loan is impaired when, based on current information and events, it is probable the AI will not be able to collect all amounts due according to the contractual terms of the loan agreement.
    - A loan is collateral dependent if repayment of the loan is expected to be provided solely by the underlying collateral and there are no other available and reliable sources of repayment.
- A property's "as is" market value equals its fair value when the effective dates and assumptions in the value conclusions are the same.
- The CSLAs permit reimbursement of costs to sell only for expenses incurred and actually paid, even though estimated costs to sell may be used under accounting and regulatory reporting guidelines or for impairment purposes when repayment or satisfaction of the loan is dependent on the sale of the collateral.

VALUATIONS SUPPORTING REIMBURSEMENT OF CHARGED-OFF COMMERCIAL REAL ESTATE SHARED-LOSS ASSTS

PURPOSE

To provide guidance regarding valuations Assuming Institutions (AIs) must use to support reimbursement claims of Charged-Off Commercial Real Estate (CRE) Shared-Loss Assets.

STATEMENT

Commercial Shared-Loss Agreements (CSLA) require AIs to exercise their best business judgment in managing, administering, collecting, and maximizing recoveries of CRE Shared-Loss Assets. CSLAs, also, require AIs to file for reimbursement of covered losses on CRE Shared-Loss Assets based on the Agencies'[1] appraisal regulations, Agencies' supervisory guidelines, and accounting requirements.

The Agencies' appraisal regulations require appraisals for federally related transactions to:

- Conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) unless principles of safe and sound banking require compliance with stricter standards;
- Be written and contain sufficient information and analysis to support the institution's decision to engage in the transaction;
- Be based upon the definition of market value set forth in the appraisal regulations; and
- Be performed by state certified or licensed appraisers in accordance with requirements set forth in the appraisal regulations.

AIs should measure impairment in CRE Shared-Loss Assets in accordance with ASC Topic 310, Receivables and ASC Topic 820, Fair Value Measurement and Disclosures. When an individually evaluated loan is deemed impaired, the AI should measure impairment using 1) the present value of expected future cash flows discounted at the loan's effective interest rate that is the contractual interest rate adjusted for any net deferred loan fees or costs, premium, or discount existing at the origination or acquisition of the loan; 2) the loan's observable market price; or 3) the fair value of the collateral.

The market value in an appraisal and the fair value in an impairment analysis are based on similar valuation concepts. Both assume: 1) a property has been exposed to the market for a reasonable period of time, 2) the buyer and seller are well informed and acting in their best interest, 3) marketing activities are usual and customary, and 4) the transaction is not subject to special financing.

A property's "as is" market value equals its fair value when the effective dates and assumptions in the value conclusions are the same. However, the CRE's market value may differ from its fair value for regulatory reporting purposes if the market value and the fair value conclusions are determined as of different dates, or the fair value conclusion reflects different assumptions from those in the market value

[1] The Agencies include the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency.

conclusion. Such situations may occur as a result of changes in market conditions and property use subsequent to the effective date of the appraisal.[2]

If the CRE Shared-Loss Asset is an impaired collateral dependent loan and the satisfaction or repayment of the loan is dependent on the sale or operation of the collateral, reimbursements of charge-offs are based on the fair value of the collateral. ASC Subtopic 310-10 states estimated costs to sell should be used in the measurement of impairment for an impaired collateral dependent loan that is dependent on the sale of the collateral. However, **the Commercial Shared-Loss Agreement allows payment only for expenses incurred and actually paid**, even though estimated expenses are contemplated for accounting and regulatory reporting purposes.

Documentation Requirements

Appraisals or evaluations supporting charge-offs of Shared-Loss Assets should provide sufficient information detailing the analysis, assumptions, and conclusions to support the credit decision and be documented in the credit file. Documentation requirements vary according to the type of loan, borrower, and collateral. AIs should review valuations to determine that they conform to the Agencies' appraisal regulations and are otherwise acceptable. Appraisals of CRE may include more than one value conclusion such as an "as is" market value, prospective "as complete" market value, and a prospective "as stabilized" market value. AIs should use the market value conclusion that corresponds to the workout plan, loan commitment, and AI's loss mitigation strategy.

Appraisals may contain other value opinions such as liquidation value or disposition value. Such value opinions are not the same as market value and cannot be used as the basis for reimbursement of CRE Shared-Loss Assets. An appraisal may contain separate opinions so long as they are clearly identified and disclosed. This approach is consistent with the Agencies' supervisory guidelines.

In addition to the current appraisal, AIs are required to provide and maintain current, well documented credit evaluation of the borrower's and guarantor(s)' financial condition, resources, prospects for repayment according to the contractual terms of the loan agreement, as well as the approved credit action memorandum, third party reports, any other documentation supporting the workout strategy and documentation of any review of the appraisal.

Definitions

Collateral Dependent Loan – A loan is collateral dependent if repayment of the loan is expected to be provided solely by the underlying collateral (sale or operation of the collateral) and there are no other available and reliable sources of repayment. In accordance with generally accepted accounting principles, the Agencies require impairment of a collateral dependent loan to be measured using the fair value of collateral method less cost to sell, if applicable. The accounting standard for impaired loans is addressed in ASC Topic 310-10.

Fair Value – "[F]air value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the asset's or liability's principal (or most advantageous) market at the measurement date. . . ."[3] An orderly transaction is a transaction that

[2] See the interagency *Policy Statement on Prudent Commercial Real Estate Loan Workouts*, October 2009, at http://www.fdic.gov/news/news/financial/2009/fil09061a1.pdf.

[3] ASC Topic 820, Fair Value Measurements and Disclosures

assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced liquidation or distressed sale."

Market Value[4] – As defined in the Agencies' appraisal regulations, the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition are the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- Buyer and seller are typically motivated;
- Both parties are well informed or well advised, and acting in what they consider their own best interests;
- A reasonable time is allowed for exposure in the open market;
- Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
- The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Prospective Market Value "as Completed" and "as Stabilized" – "A prospective market value may be appropriate for the valuation of a property interest related to a credit decision for a proposed development or renovation project. According to USPAP, an appraisal with a prospective market value reflects an effective date that is subsequent to the date of the appraisal report. Prospective value opinions are intended to reflect the current expectations and perceptions of market participants, based on available data." [5]

Two prospective value opinions may be required to reflect the time frame during which development, construction, and occupancy will occur. The prospective market value "as completed" reflects the property's market value as of the time that development is expected to be completed. The prospective market value "as stabilized" reflects the property's market value as of the time the property is projected to achieve stabilized occupancy. For an income-producing property, stabilized occupancy is the occupancy level that a property is expected to achieve after the property is exposed to the market for lease over a reasonable period of time and at comparable terms and conditions to other similar properties. (*See* USPAP Statement 4 and Advisory Opinion 17)

REFERENCE MATERIAL

Further information is available from:

- The Agencies' appraisal regulations:

[4] See FDIC 12 C.F.R Part 323, OCC 12 CFR Part 34, or FRB 12 CFR Part 255

[5] Interagency Appraisal and Evaluation Guidelines (December 2, 2010)

- FDIC 12 CFR Part 323 (for State Nonmember Banks) and 12 CFR Part 390, Subpart X (for State Savings Associations) (formerly 12 CFR Part 564)
- OCC 12 CFR Part 34, Subpart C (for National Banks) and 12 CFR Part 164 (for Federal Savings Associations)
- FRB 12 CFR Part 225, Subpart G

- Uniform Standards of Professional Appraisal Practice (USPAP)

- Interagency Appraisal and Evaluation Guidelines (December 2010):
  - http://www.fdic.gov/news/news/financial/2010/fil10082.html
  - http://www.occ.treas.gov/news-issuances/federal-register/75fr77450.pdf
  - http://www.federalreserve.gov/newsevents/press/bcreg/20101202a.html

- Interagency Policy Statement on the Allowance for Loan and Lease Losses (December 2006): http://www.fdic.gov/news/news/financial/2006/fil06105.html

- Frequently Asked Questions on Residential Tract Development Lending and FAQs on the Appraisal Regulations and the Interagency Statement on Independent Appraisal and Evaluation Functions (September 8, 2005): http://www.fdic.gov/news/news/financial/2005/fil2005.html

- ASC Topic 310, Receivables, and ASC Topic 820, Fair Value Measurements and Disclosures

- Call Report Instructions: http://www.fdic.gov/regulations/resources/call/crinst/callinst2013_jun.html