Appraisals and Evaluations

FDIC
Division of Risk Management Supervision
Dallas Region

December 19, 2012

Purpose of Part 323

- To ensure that the bank makes an informed decision when entering into a "Real Estate-related Financial Transaction" (the bank knows what the RE is worth before entering into the transaction)
- Importance of bank's Appraisal/Evaluation Policy

RE-related Financial Transactions

- Use of RE as collateral for a loan
- Purchase of RE

  (1) foreclosure and deed in lieu acquisitions

  (2) purchase for bank use
- <u>Refinancing</u> RE (includes renewals and some modifications)
- Sale of RE (ORE/bank premises)
- Lease of RE (lessor or lessee)

When is an Appraisal Required?

For all RE-related financial transactions, with the following common exceptions (see Sec 323.3 for list and description of all 12 exceptions):

- Transaction value is $250,000 or less
- Lien on RE taken as collateral in an abundance of caution
- Business loan that has a transaction value of $1MM or less, AND is not dependent on the sale of, or rental income derived from, the RE as the primary source of repayment

Exceptions to appraisal requirement (continued)

- Renewal/Refinance/Modification of an existing credit at the institution, provided that

(i) there has been no obvious and material change in market conditions or the property that threatens the adequacy of the RE protection, even with the advancement of new monies;

<u>OR</u>

(ii) there is no advancement of new monies, other than funds to cover closing costs

When is an evaluation required?

For RE-related financial transactions that do not require an appraisal. These generally are transactions with the following characteristics:

- Transaction value of $250,000 or less
- Business loan $1MM or less and not meeting the requirement for an appraisal
- Renewal/Refinance/Modification and not meeting the requirement for an appraisal (e.g., no advancement of new monies, <u>OR</u> new monies but no obvious or material change in market conditions or the property that threatens RE collateral protection)

When is an evaluation required? (continued)

Includes the following transactions not meeting the requirements for an appraisal:

- Purchase or sale of RE for $250,000 or less
- Acquisition of RE by foreclosure or deed in lieu. Existing appraisal/evaluation may be used if validated, or a new value must be determined (before the bid is made or the deed in lieu agreement signed). Must also be aware of State law, which may require an appraisal.

Example #1

- 5 yr CRE term loan of $2MM
- AV of RE collateral at origination: $3MM
- Obvious and material deterioration in local RE market conditions at time of renewal
- Add'l funds of $500,000 to be advanced at renewal
- **Appraisal is required** because of additional funds advanced AND market deterioration threatening collateral protection

Example #2

- 5 yr CRE term loan of $2MM
- AV of RE collateral at origination: $3MM
- Obvious and material deterioration in local RE market conditions at time of renewal
- No additional funds other than reasonable closing costs to be advanced at renewal
- **An evaluation is required.** An appraisal is <u>not</u> required as no funds other than reasonable closing costs were advanced.

Example #3

- 5 yr CRE term loan of $2MM
- AV of RE collateral at origination: $3MM
- No obvious or material change in local RE market conditions since origination date
- Additional funds above reasonable closing costs are to be advanced at renewal
- **An evaluation is required.** An appraisal is <u>not</u> required as no obvious or material change in local RE markets is evident.

What Is an Evaluation?

- A supported and credible determination of MV - prepared by a qualified individual (does not have to be a state-certified or state-licensed appraiser).

- Validation of an appraisal or evaluation.

What are the Requirements for an Evaluation?

- Evaluation consistent with safe and sound banking practices – means that it must provide a <u>Credible Value</u>

- Must meet the documentation standards in Interagency Appraisal and Evaluation Guidelines (FIL 82-2010)

Who Can Perform an Evaluation?

- Anyone who is qualified – RE-related training or experience and knowledge of the market. Bank employees, RE lenders, consultants, realtors, agricultural extension agents, foresters, etc.

- Must be independent of the transaction.

Use of Existing Appraisals

- There is no one-year rule. An appraisal is either “valid” or “not valid.”
- An appraisal may be used for subsequent transactions as long as it remains valid.
- Bank policy should include criteria to determine whether or not an appraisal or evaluation remains valid.

Residential Tract Development Appraisals

- 5 or more units (attached or detached houses, condos, or lots) constructed or to be constructed as one development.

- Projects that *cannot* be constructed and sold within one year must include deductions and discounts for holding and marketing costs and entrepreneurial profit. The sum of retail values is not the MV for Part 323 purposes.

Residential Tract Development Appraisals (continued)

- Projects that *can* be constructed and sold within one year can be valued at the sum of retail values.
  - Refer to FIL-90-2005 for full criteria.
- Bulk sale is the discounted value of sales at retail value – not a distressed or fire sale value.

Modifications

- No appraisal/evaluation for a modification that involves a limited change in the terms of the note or loan agreement and does not adversely affect the bank's RE collateral protection.
- Consider the impact of:
  - Re-setting interest rate to market
  - Changing due dates
  - Adding/Releasing collateral, obligors, or guarantors
  - Reduction of payment
  - Putting loan on interest-only

Note Structure

- Business loans – consider variable rate or modifications to reset the interest rates. Loan covenants and events of default may give the flexibility needed.

- 1-4 family mortgages – consider putting a program in place to validate existing appraisals/evaluations. Another option is to originate variable-rate mortgages.

Valuation of Rental Houses

Must consider it as rental property – can be satisfied by:

(1) Income approach

(2) Use of rental property sales comps

(3) Other methods that are USPAP-compliant or supported by the scope of work utilized by the appraiser/evaluator.

Added Collateral for Problem Loans

- If adding RE to strengthen a problem loan, and not a renewal/refinance/modification, an appraisal/evaluation is not required.

- However - if the loan is impaired, a current value of the added RE collateral will be needed to calculate the amount of impairment.

Impaired Loans

- If a loan is impaired, the impairment calculation must be based on current collateral values according to FAS 114/ASC 310. This can be satisfied by a 323.3(b)-compliant evaluation or a USPAP compliant appraisal.

Highest and Best Use

- Must assess HBU "as vacant" and "as improved."
- Will determine if property is over- or under-improved
- "Hold for Investment" or "Hold until market for (what ever use) improves" are investment strategies – not HBUs.

Enterprise Value (aka Going Concern Value or Goodwill)

- Pertains to Income Producing Property – hotels/motels, mini-warehouses, convenience stores, strip centers, office buildings, etc.

- Enterprise Value cannot be included in the value of the real property and improvements thereto.

Enterprise Value (Continued)

Engagement Letter should specify what values the appraisal should provide, for example:

- real property and improvements
- personal property
- enterprise (going concern)

TRANSACTION	A	E
New RE-related loan greater than $250,000 (and not meeting any exceptions to the appraisal requirement)	x	
New RE-related business loan of $1 million or less if not dependent on sale of or rental income of RE as primary source of repayment		x
All other new RE-related loans		x
Renewal/Refinance/Modification with no new money		x
Renewal/Refinance/Modification with new money and the adequacy of RE collateral protection after the transaction **is not** threatened		x
Renewal/Refinance/Modification of RE loan with new money and the adequacy of RE collateral protection after the transaction **is** threatened	x	
Acquire ORE via foreclosure or deed in lieu		x
Buy/Sell RE for more than $250,000	x	
Buy/Sell RE for $250,000 or less		x

References

- FDIC Rules & Regulations: Part 323—Appraisals
- FDIC Supervisory Insights, Winter 2011 — "Navigating the Real Estate Valuation Process"
- FIL 90-2005 Residential Tract Development Lending: Frequently Asked Questions
- FIL 82-2010 Interagency Guidance: Appraisal and Evaluation Guidelines

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