

Propose Interagency Appraisal and Evaluation Guidelines

Attention: Robert E. Feldman, Executive Secretary
Comments, Federal Deposit Insurance Corporation
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Washington, DC 20429

Following are my comments regarding some of the individual items in the Proposed Interagency Appraisal and Evaluation Guidelines, as today is the last day for comment. However, the point I would like to make, above all others, is that the best thing that can be done with the Proposed Interagency Appraisal and Evaluation Guidelines at this point in time is take them off of the table until the current financial crisis is over and we can gain some experience and understanding of the situation. As the financial markets are in total disarray, the last thing the markets need at this point in time is further instability and releasing and rehashing proposed guidelines will do nothing to alleviate the problems or calm the markets. With that said, I offer the following comments:

Pg 20 – ...the institution does not communicate ...or a loan amount or target loan to value ratio to a person performing an appraisal or evaluation.

The Scope of Work rule in USPAP requires that the appraiser obtain adequate information about the intended use of the assignment results and the assignment conditions. The scope of work needed for credible assignment results for low loan to value transactions can be quite different from the scope of work required for high loan to value transactions. The inability to communicate this aspect of the assignment conditions hampers the appraiser's ability to understand the assignment and to employ a proper scope of work. This could result in either an inadequate scope providing an assignment result that is not credible or an unnecessary scope of work that does not enhance the safety and soundness of the transaction. It could also result in the appraiser misinterpreting an appraisal request based on a low loan to value ratio with inappropriate diligence on the lending institutions part.

Pg 21-22 – Independence is compromised when a borrower or loan production personnel recommends... a person to perform an appraisal or evaluation.

I would suggest that "recommends" be removed from this sentence. The selection of an appraiser must be done on an independent basis. However, we do not operate in a compartmented industry. The prohibition from any recommendation from loan production personnel presumes the selection is not done on an independent basis. For example, if the loan production personnel recommended an appraiser who would have been included in the blind bidding process anyway, must that appraiser now be excluded simply because they were recommended by loan production personnel out of a concern of the appearance of a lack of independence? Independence is not compromised by a recommendation. Independence is only compromised when a recommendation to use a certain appraiser becomes a directive or worse an ultimatum.

Pg 22 Institutions should use engagement letters...

Does it matter whether the engagement letter is written by the institution or by the appraiser?

Pg 23 – An institution may refer to the USPAP certification to confirm whether the appraiser is independent of the property and the transaction, as required by the Agencies' appraisal regulations.

Does “refer” mean “rely”?

Pg 24 The appraiser’s scope of work should be consistent with

A primary driver for scope of work is the Intended Use and this criterion should be included, possibly at the end of the first sentence discussing Scope of Work.

Pg 25 – an institution may request a prospective market value as completed and as stabilized.

It would be more precise to use “prospective market value upon completion and/or a prospective market value upon stabilization”.

However, this section, as well as the discussion of prospective market value on page 28 begs the question of whether the regulator’s are looking for the prospective market value of subject property as of the prospective date, which is the value defined in the USPAP, or are they looking for a value as of a prospective date stated in current dollars? As it is now appraisers provide both, but call it Prospective Market Value, but in the case of stating the value in current dollars....it may or may not be.

The guidance on page 28 indicates that a prospective value should be based on “current and reasonably expected market conditions.” How can one value be both? In the next sentence the advice is that “there should be a point reference to the market conditions and time frame on which the appraiser based the analysis.” Does this mean that if the appraisers estimate a truly prospective value they need to define what they anticipate market conditions will be at the time the Prospective Market Value is pertinent? If that is the case it needs to be spelled out more clearly, since as it is now some/many appraisers simply multiply the concluded value stated in current dollars by an inflation multiplier.

Pg 25 – While an institution may request the appraiser to provide the sum of retail sales for a proposed development.

The sum of retail sales for a tract development with unsold units (note –this could be for an existing tract development – not only for a proposed tract development) has been willfully incorrectly construed as market value by numerous institutions since the implementation of FIRREA in 1991. To include an allowance for this oft abused mathematical sum encourages continued mis-use. If this sentence is to remain, then the following phrase “*this value is not the market value of the property*” must be modified because an arithmetical sum is not a value.

Pg 25 – Appropriate deductions and discounts should include items such as leasing commissions, rent loss, tenant improvements, and entrepreneurial profit.

Entrepreneurial profit can be included in the discount rate applied to the cash flows. Adding (*unless included in the discount rate*) after entrepreneurial profit would clarify that entrepreneurial profit does not have to be a line item deduction. Also, ownership responsibility for operating expenses during periods of vacancy , or vacant space expenses, should be mentioned if not mandated.

Pg 25 – For properties subject to leases with terms that do not reflect current market conditions, the appraiser must make appropriate deductions and discounts which should be based on stabilized occupancy at prevailing market terms.

The word “terms” can mean the length of the lease or it can refer to lease provisions such as rental rate, expense reimbursements, etc. It may be appropriate to clarify. Also, what if the lease terms are below

current market level? Is it the intention of the regulators that a value reflecting market lease terms is required even for long term credit tenant leases? If that is the case then appraisal assignments reflecting the leased fee value of investment real estate would all have to reflect the fee simple market value of the property as well; thus incurring additional time and fee to assignments.

Pg 26 – *The appraiser must provide an opinion of value for raw land ...that includes appropriate deductions and discounts. Appropriate deductions and discounts should include items such as holding costs, marketing costs, and entrepreneurial profit.*

If the land value can be directly established using a Sales Comparison methodology with comparable sales, then is it always necessary to provide a land residual analysis as well? If the requirement would be to include deductions and discounts for holding costs, marketing costs and entrepreneurial profit in all raw land appraisals, there is a major problem if there is no development plan in place.

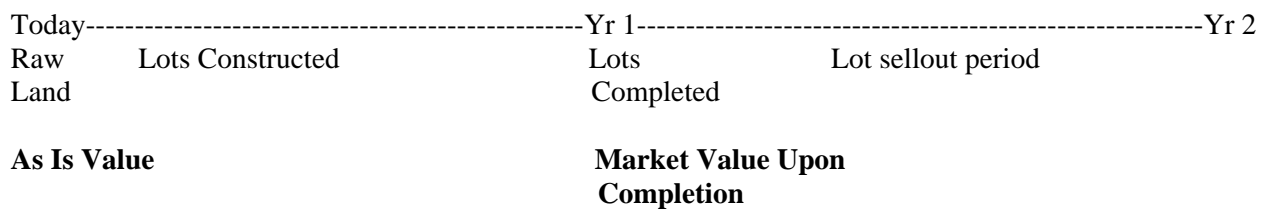
Pg 26 – **Developed Lots.** *For proposed developments of five or more residential lots, the appraiser must analyze and report appropriate deductions and discounts. Only for residential lots? What about lots developed in a commercial or industrial subdivision? Five or more unsold lots in a tract development?*

Pg 26 - *The estimated sales absorption should reflect the expected holding period before the development commences as well as the time frame for the actual development and sale of the lots.*

1) I would suggest changing *sales absorption period* to *sellout period*.

2) The Prospective Market Value Upon Completion of a tract development can be estimated by projecting retail lot sales over the sellout period less appropriate deductions and discounts and considering the time value of money etc. The lot sales should reflect market conditions estimated to be present when the lots are brought to the market. However, to also include the expected holding period before development commences as well as the construction period for the development of the lots is inappropriate and not reflected in sales transactions.

The appropriate valuation scenarios of estimating the As Is Value and the Prospective Value upon Completion are two different valuation scenarios reflecting different time frames and risk to different parties. The Prospective Value upon Completion is typically estimated using the Cost Approach and an Income Approach. The Cost Approach or more commonly known as the Cost of Development Approach appropriately reflects all expenses occurring from the point of the As Is Value up to the point of anticipated completion of the lots. The expenses during the holding period and construction period would be appropriately considered in the Cost Approach. The Income Approach reflects income and expenses (deductions and discounts) that are projected to be incurred following the date of Prospective Value at Completion. To also include any expenses related to the construction or holding period, *which precedes the date of value*, would be inappropriate and again, not reflective of sales transactions.



Pg 28 – *Further, the market value should not include a going concern value or a special value to a specific property user.*

The most appropriate valuation approach for several cash flow dependent property types, such as hotels, senior housing complexes, movie theaters, car washes etc., is to first estimate the market value of the going concern using primarily an Income Approach based on the cash flow generated from stabilized operation of the business facilitated by the real estate. This is also the basis on which these properties transact, or by definition, the market value of the property. To insist that the market value of the real estate value can somehow be estimated independently of the value of the going concern is not really possible. After the going concern value is estimated, appraisers will commonly estimate the market value of the real estate on a “go dark” basis by a simple cost approach. However, this is different than the transaction value of the real estate as part of the going concern.

Pg 28 – The estimate of market value should consider the real property’s current physical condition, use and zoning as of the appraisal date.

The term “appraisal date” can be interpreted to mean either the date the appraisal was written or the date of the appraised value. USPAP uses the terms “Date of Report” and “date of value” which provide more clarity. This sentence should be clarified.

Pg 28 – An institution should confirm that the appraiser holds a valid credential from the appropriate state regulatory authority.

What will constitute sufficient confirmation of such a credential? What will be required in an audit?

Pg 33 – Provide an estimate of the property’s market value in its actual physical condition.....as of an effective date,

As of the date of the evaluation report or as an effective date of the evaluators choosing? While obviously not intended, this could be construed to mean there is some wiggle room as to what value is being estimated, say with the limiting condition that the renovation will be complete in two months.

Pg 35 – the acquiring institution should obtain documentation that the appraiser was directly engaged by the institution transferring the appraisal.... For example, an engagement letter should confirm that the institution transferring the appraisal....

Transferring implies a formal hand off from the lender who ordered the appraisal. This happens occasionally, but more commonly, the original lender is not even aware that another institution may be relying upon the appraisal they ordered. A formal transfer does not always take place.

Pg 36 - ...arrangements with a third party, acting as agent for the institution,...

It would be beneficial to stress that a third party acting as agent for the borrower cannot act as an agent for the institution.

Pg 38 - With prior approval from its primary regulator, an institution may employ various techniques, such as automated tools or sampling methods, for performing pre-funding reviews of appraisals or evaluations supporting lower risk single-family residential mortgages.

What about lower risk commercial mortgages?

Pg 38 - An institution should not accept appraisal or evaluations that do not adequately support the opinion of market value and should replace unreliable appraisals or evaluations prior to the final credit decision.

Point A, If the reviewer is a licensed or certified, their USPAP obligation is to determine whether the appraisal is credible, not whether it is reliable. Point B, We work and live in a real world competitive environment, where the luxury of replacing appraisals that miss the mark in review does not usually exist; particularly if we, in the appraisal department, order the appraisal. If I were to champion the concept that if we receive an appraisal that does not yield credible assignment results, then that appraisal should be replaced prior to the final credit decision, I would not likely be supported. However, by virtue of a technical review whereby the reviewer revises the concluded value based on the market evidence, then the process is not stalled unnecessarily.

Pg 39 – Any changes to an appraisal’s estimate of value are permitted only as a result of a review conducted by an appropriately qualified state-certified or licensed appraiser in accordance with USPAP.

What is an appropriately licensed certified reviewer? If the reviewer is certified in state A, but is reviewing an appraisal of a property located in state B, does the reviewer need to be licensed/certified in state B? Up to this point, it has been supported by the regulators that review appraisers employed by a regulated institution need only be licensed in the State they reside in and not in all the States where they order and review appraisals.

Pg 53 - Property Type—Is the property homogeneous such as a detached 1-4 family residential dwelling in a typical neighborhood for its market?

Does this mean that only evaluations for this type of property are acceptable?

Pg 53 – Nature of the Transaction

Is the property in an area that is known to have minimal cases of fraud?

Does the frequency of sales of the subject property preclude concern that the property may have been subject to flipping or fraud?

Is there a standard now to require a sale history analysis of the property to be evaluated? What level of fraud is considered minimal?

Pg 56 – Tax Assessment Valuation (TAV) This analysis should be performed for each property type and price tier in a jurisdiction.....

It would appear that this onerous requirement is designed to abolish the use of Tax Assessed Value as a valuation tool, as the amount of work necessary to accomplish this task would be daunting even for a bank with a three state footprint. Comments?

Pg 64 – Sum of Retail Sales

This is not a value, unless four or fewer of something is being addressed.

Pg 65 – *Tract Development*

The examples provided are all residential in nature which may lead to institutions questioning whether (for example) a 6 unit office condominium development is a tract development.