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2012 Appraisal Institute Annual Meeting

Aug. 1-3

Loews Coronado Bay Hotel
San Diego, CA

appraisalinstitute.org/aiconnect



Interagency Appraisal and Evaluation (IAEG) Workshop

Purpose (77456)



- Supersedes the 1994 Interagency Appraisal & Evaluation Guidelines
- Address supervisory matters relating to real estate appraisal and evaluations used to support real estate related financial transactions
- Identifies scope – All real estate related financial transactions originated or purchased by a regulated institution or its operating subsidiary for its own portfolio or as assets held for sale, including activities of commercial and residential real estate mortgage operations, capital market groups, and asset securitization & sale units

Updated Areas

- *Selection of Appraisers or Persons Who Perform Evaluations*
- *Evaluation Development*
- *Reviewing Appraisals and Evaluations*
- *Third Party Arrangements*
- *Appendix A, Appraisal Exemptions*
- *Appendix B, Evaluations Based on Analytical Methods and Technological Tools*
- *Appendix C, Deductions and Discounts*
- *Appendix D, Glossary of Terms*

Validity –



When to Order an New Appraisal

A new appraisal is necessary if the originally reported market value has changed due to factors such as:

- Passage of time
- Volatility of the local market
- Changes in terms and availability of financing
- Natural disasters
- Limited or oversupply of competing properties
- Lack of maintenance of the subject or competing properties
- Changes in underlying economic and market assumptions, such as cap rates and lease terms
- Changes in zoning, building materials or technology
- Environmental contamination

Questions



What is the definition of the “passage of time”?

- Is there a specific time frame?
- Is there a minimum? How about a maximum?

Documentation of Validity?

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Evaluations



- When are they permitted?
- Who is permitted to prepare evaluation reports?
- What are they required to contain?

Evaluations

Evaluations are permitted when:

- The transaction value is equal to or less than \$250,000
- It is a business loan with a transaction value equal to or less than the business loan threshold of \$1 million, and it is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment

Evaluations

Evaluations are permitted when (continued):

- It involves an existing extension of credit at the lending institution, provided that:
 - There has been no obvious and material change in market conditions or physical aspects of the property that threaten the adequacy of the institution's real estate collateral protection after the transaction, even with the advancement of new monies; or
 - There is no advancement of new monies other than funds necessary to cover reasonable closing costs

Evaluation Credentials 1 of 2



- The person selected possesses the requisite education, expertise, and experience to competently complete the assignment
- Performance is periodically reviewed
- Cable of rendering an unbiased opinion
- Independent from the transaction
- Possesses the appropriate appraisal or collateral valuation, education, expertise, and experience relevant to the type of property being valued. Such persons may include appraisers, real estate lending professionals, agricultural extension agents, or foresters.

Evaluation Credentials 2 of 2



Although not required, an institution may use state certified or licensed appraisers to perform evaluations (Refer to proposed Guide Note 13)



How do you credential an evaluator?

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Evaluation

Contents 1 of 3



- Identify the location of the property
- Provide a description of the property and its current and projected use
- Provide an estimate of the property's market value in its actual physical condition, use, and zoning designation as of the effective date of the evaluation
- Describe the method(s) the institution used to confirm the property's actual physical condition and the extent to which an inspection was performed

Evaluation

Contents 2 of 3



- Describe the method(s) the institution used to confirm the property's actual physical condition and the extent to which an inspection was performed
- Described the analysis that was performed and the supporting information used in valuing the property
- Describe the supplemental information that was considered

Evaluation

Contents 3 of 3



- Indicate all sources of information used in the analysis:
 - External data sources
 - Property specific data
 - Evidence of a property inspection
 - Photos of the property
 - Description of the neighborhood
 - Local market conditions
 - Information on the preparer when an evaluation is performed by a person (such as name, contact information and signature)

Evaluations



Cohesive, Complete, Credible valuation process and report

A valuation method should address the property's actual physical condition and characteristics as well as the economic and market conditions that affect the estimate of the collateral's market value.

An evaluation cannot be based on unsupported assumptions, such as the property is in "average" condition, the zoning will change, or the property is not affected by adverse market conditions.

Evaluations



Cohesive, Complete, Credible (continued)

An inspection to determine the actual physical condition of the property and market factors that affect its market value should be considered.

When an inspection is not performed, an institution should be able to demonstrate how these property and market factors were determined.

Can someone other than the evaluator prepare portions of the report?



Alternative Valuation Methods



**AVMs, BPO's and other Alternative
Valuation Methods. What is their role
in IAEG?**

Automated Valuation Models



Definition:

Computer programs that estimate a property's market value based on market, economic and demographic factors.

Institutions may employ AVM's for a variety of uses such as loan underwriting and portfolio monitoring.

AVM's



An institution may not rely solely on the results of a AVM to develop an evaluation unless the resulting evaluation is consistent with safe and sound banking practices and these Guidelines.

AVM would need to address the property's actual physical condition, could not be based on unsupported assumptions, such as "average" condition.

Selecting an AVM



- Perform due diligence on AVM vendors and their models
- Establish a minimum performance criteria for the model
- Perform a detailed validation process
- Evaluate the data used in the models
- Assess model strengths and weaknesses as well as how the model performs for various property types
- Evaluate the vendor's scoring system and methodology for the models

AVM's Use 1 of 2



- Maintain AVM performance criteria
- Establish minimum internal confidence score
- Implement controls to preclude “value shopping” with multiple AVMs
- When AVM results are not reliable, establish a procedure for obtaining a different valuation method (i.e. appraisal, evaluation, etc.)

AVM's Use 2 of 2



- Identify circumstances under which an AVM may not be used such as:
 - Changes in market conditions
 - Model's performance is outside the specified tolerances
 - When a property is non-homogeneous

Validating the AVM



An institution should establish standards and procedures for independent and ongoing monitoring and model validation.

Validation can be performed internally or with the assistance of a third party.

Persons who validate an AVM on an ongoing basis should be independent of the loan production and collection processes and should have requisite expertise and training.

Validation Procedures



Minimum Validation Procedures:

1. Appropriate sample size
2. Level of geographic analysis
3. Testing frequency and criteria for re-testing
4. Standards of performance measures to be used
5. Range of acceptable performance results

Validation

Procedures (Continued)

- A. Compare results of an AVM to actual sales data in a specified market prior to the information being available to the model
- B. Verify whether loans in which an AVM was used to establish value met similar performance expectations of different validation processes
- C. Document results
- D. Analyze findings to update AVM policies and procedures as warranted.

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Reviewer Qualifications



Who Reviews the Appraisal? (Qualifications of the Reviewer)

1. Independent of the transaction and loan production staff
2. Requisite education, expertise, and competence to perform the review
3. Capable of assessing whether the appraisal or evaluation contains sufficient information and analysis to support the institution's decision to engage in the transaction.

Depth of Review



- Risk-Focused
- Type of Transaction
 - All Commercial Appraisals and Evaluations
 - One to Four Family Residential Appraisals
 - Risk-focused based on size, type and complexity of the underlying credit transaction as well as loan and portfolio risk characteristics
 - With prior approval, various techniques such as AVMs or sampling methods

Documentation of the Review Process



- Establish policies for documenting the review of appraisals and evaluations in the credit file
- Address the level of documentation needed for the review given the type of risk and complexity of the transaction
- Resolution of any appraisal or evaluation deficiencies
- Audit trail that documents the resolution of noted deficiencies or details the reasons for relying on a second opinion of market value

Acceptable Review Issues



- 👍 Additional information regarding the subject or comparables
- 👍 Additional supporting data about the basis for the valuation
- 👍 Correct factual errors

Review Process



When a institution identifies deficiencies that cannot be resolved with the appraiser or person who performed the evaluation, the institution must:

- ✓ Obtain an appraisal or evaluation that meets that meets regulatory requirements.
- ✓ The reviewer cannot change the value in the original appraisal.
- ✓ A USPAP compliant appraisal review performed by a state certified or licensed appraiser may result in a second opinion of market value to support its credit decision.

Reviews



Who Reviews the Reviewer? (The Examination Process)

1. Annual Examinations
2. Review of the Appraisal Process
 - a. Policies and Procedures
 - b. Appraiser Monitoring
 - c. Referrals

Referrals



- ✓ An institution should file a complaint with the appropriate state appraiser regulatory officials when it suspects that a state certified or licensed appraiser failed to comply with USPAP, applicable state laws, or engaged in other unethical or unprofessional conduct
- ✓ Effective April 1, 2011 an institution must file a complaint with appropriate state certifying and licensing agency under certain circumstances (TILA)
- ✓ An institution must also file a SAR with FinCEN when suspecting fraud or identifying other transactions meeting the SAR filing criteria

Is there an appeal process? Should there be an appeal process? Is there recourse? How can you re-gain approval once you have been “black” listed?

Market Value



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:

Market Value Definition (continued)

- 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.

Market Value



The estimate of market value should consider the **real property's** actual physical condition, use and zoning as of the effective date of the appraiser's opinion of value.

Market Value



Value opinions such as “going concern value,” “value in use,” or a special value to a specific user may not be used as market value for federally related transactions. (An appraisal may contain separate opinions of such values so long as they are clearly identified and disclosed.)



Total Assets of the Business and Market Value