



Western
Independent
Bankers

The Regulator's Perspective on Appraisals

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Disclaimer: Views expressed are those of the presenter and are not necessarily those of the Federal Reserve Bank of San Francisco or the Board of Governors.

The Regulator's Perspective on Appraisals

□ Agenda

- *Appraisal Regulation*
- *Regulatory Guidance*
- *Examination Findings & Issues*
- *Good Practices*
- *Home Valuation Code of Conduct (HVCC)*
- *Broker Price Opinions (BPOs)*
- *Q&A*

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□ Appraisal Regulation

- *FRB: Regulation H, subpart E (12 CFR 208)
Regulation Y, subpart G (12 CFR 225)*
- *FDIC: 12 CFR part 323*
- *OCC: 12 CFR 34*

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□ Regulatory Guidance

- *1994: Interagency Appraisal and Evaluation Guidelines*
- *2005: Interagency FAQs – Appraisals*
- *2005: Interagency FAQs – Tract Developments*
- *2006: Interagency Revisions to the Uniform Standards of Professional Appraisal Practice*
- *TBD: **Proposed** Interagency Appraisal and Evaluation Guidelines*

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□ Key Requirements

- *An appraisal is required for all real-estate secured transactions in excess of \$250,000 when the bank originates the loan.*
- *An appraisal is required for an existing real-estate secured transaction if there has been an obvious and material change in market conditions or physical aspects of the property, **and** if the bank advances additional funds.*
- *In certain cases, even if the bank is not required to obtain an appraisal, it must still obtain or prepare an appropriate evaluation of the collateral.*

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- Examination Findings & Issues
 - *Appraisal Violations have Increased*
 - *Lack of Adherence to Internal Policies*
 - *Lack of Familiarity with Appraisal/Evaluation Requirements*
 - *Appraisal Requirements vs. FAS 114 Requirements*
 - *Stale Appraisals*
 - *Optimistic Evaluations*

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❑ Common Violations

- *12 CFR 225.63(a)*
 - Failure to obtain an appraisal when required.
- *12 CFR 225.63(b)*
 - Failure to obtain an appropriate evaluation when required.
- *12 CFR 225.64(c)*
 - AV did not include appropriate deductions and discounts for tract developments with unsold units.

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□ Evaluation Requirements

- *Describe the collateral (condition & current use).*
- *Describe the sources of information used in the analysis.*
- *Describe the analysis and supporting information.*
- *Provide an estimate of the market value, with any limiting conditions.*
- *In writing, signed, dated, and include the preparer's name.*
- *Preparer should be independent & qualified.*

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- FAS 114
 - *Impaired Loans*
 - *Impairment Measurement Methods:*
 - Present Value of Cash Flows
 - Observable Market Price
 - Fair Value of Collateral

An updated appraisal may be necessary to determine collateral value for impairment measurement purposes, even if one is not required per regulation.

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□ Common Questions

- *“How often should banks obtain updated appraisals on CRE Properties?”*
 - Focus: Bank Policy
- *“How does LTV impact the examiner's classification of a real estate secured loan?”*
 - Focus: Primary Source of Cash Flow
 - See: Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts (SR 09-07)

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□ Good Practices

- *Revisit Policies & Procedures*
- *Revisit Regulatory Standards & Guidance*
- *Review Approved Appraiser List*
- *Ensure Independence of Appraisal Function*
- *Provide Training to Credit/Appraisal Staff*
- *Ensure all Assumptions are Reasonable and Well-Supported*
- *Remember the Evaluation Requirements*

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Home Valuation Code of Conduct (HVCC)

Broker Price Opinions (BPOs)



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Questions?

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Troubled Assets Forum

Valuations Panel

Western Independent Bankers

December 2, 2009



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Topics

- FDIC Examination Overview
- Discounted Cash Flow (Bulk Value)
- Appraisal Deficiency Example
- Common Appraisal Issues (Local and National)
- Alternative Valuations

FDIC Examinations

- *Large Commercial Credits*
 - *\$1 million to over \$25 million*
 - *Larger CRE loans*
 - *Residential and Non-residential*

- *Discounted Cash Flow Models*
 - *Otherwise known as Bulk Value*
 - *Part 323.4(c) of the FDIC Rules and Regulations*
 - *Appropriate Discount and Deductions for purposed construction or renovation and tract developments with unsold units.*

Appraisal Example:

□ Multi-Use Multi-Phase Construction Project –
Little City (Suburb of Big City)

■ Values:

- As-Is Entire Site (150 condo units and 10 retail/restaurant spaces)
 - \$10 million
- Hypothetical Market Value “As Complete”
 - Phase I (75 Res units + Cml) at \$35 million
 - Phase II As-Is (75 Res units) at \$6 million

Loan Problems

- Renewal of a \$30 million Construction Loan
(2 years into project)
 - Project was only about 10% complete
 - Land Development and Foundations Only
 - Issues with Permits and Flooding
- Relying on 2-Yr Old Appraisal
 - Architectural Designs not Feasible
- Distressed Area, USA

Appraisal Problems

- No actual sales comps or even listings were used to determine the cash flows on sales.
- Relied on prospective asking prices on similar projects located in downtown Big City.

Limited Adjustments

- Luxury Attributes
- Location Near Major Retail/Entertainment Development

More Appraisal Problems

- Arbitrary Cash Flows in DCF Model
- Mistakes in DCF Calculations
- Unreasonable Absorption Periods
- Miscalculated Entitlement Values in Land Value

Summary of common appraisal issues:

- Not using DCF properly, and sometimes not at all
- Not using real comparables, or suitable comparables
- Miscalculations
- Relying heavily on terms such as “luxury” or “amenities” to increase values, without proper support
- Unlikely absorption periods
- Plug figures

Alternative Valuations

- Proposed Interagency Appraisal and Evaluation Guidelines, Appendix B
 - Automated Valuation Methods (AVMs)
 - Tax Assessment Valuations (TAVs)

□ However

Appendix B – Selecting an appropriate AVM

- Relevant information about the data the model provider uses.
- Understand the modeling techniques used.
- Evaluate the model provider's confidence score.
- Ascertain which models provide the most credible values for the bank's lending activities

Appendix B – Bank Policies concerning AVMs

- Address qualifications of the parties responsible for selecting, validating and administering models.
- Establish procedures for validation testing and monitoring of model.
- Maintain AVM performance criteria.
- Establish procedures for another valuation method if performance criteria not met.
- Adopt criteria for the use of multiple AVMs to ensure that results are credible.

Appendix B – Criteria for AVM Use

- Property Type
- Property Location
- Property Condition
- Nature of Transaction

Thank You

Questions?