

December 2, 2010 *Interagency Appraisal
and Evaluation Guidelines*

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2010 Guidelines: What's New, Different or Enhanced?

Independence Issues

- While the collateral valuation program has always been required to be isolated from influence by loan production staff, new guidelines now require:
 - Policy should specify methods for communication that ensure independence.
 - Policy should not allow direct or indirect influence or coercion, misstatement or misrepresentation of the value of the property.

2010 Guidelines: What's New, Different or Enhanced?

Independence Issues

- Policy should ensure that the bank avoids inappropriate actions that could compromise the independence of the collateral valuation function including:
 - Communicating predetermined values
 - Specifying minimum value requirement
 - Implying that future services are dependent upon hitting a specific value of a property

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Transactions that Require Evaluations

- Banks' appraisal programs should establish a process for determining when to obtain an appraisal, even through an evaluation may be allowed by regulation – these are higher risk transactions:
 - Loans with LTVs in excess of supervisory limits
 - Atypical properties
 - Properties outside of traditional lending market
 - Transactions or borrowers that present significant/higher risk

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Evaluation Development

- A valuation method should take into consideration the property's actual physical condition and characteristics, as well as the economic and market conditions that affect the estimate of the collateral value.
- The guidelines specifically state that AVMs or tax assessments, in and of themselves, do not meet the criteria for an evaluation.

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Evaluation Content

- This section has been expanded-the guidelines specifically state that an evaluation should contain sufficient information detailing the analysis, assumptions and conclusions to support the credit decision.
- Evaluations, at a minimum, should include:
 - Identification and description of the property;
 - Estimate of MV in its actual physical condition, use and zoning designation as of the current date;

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Evaluation Content

- A description of the method used to confirm the property's actual physical condition;
- A description of the analysis that was performed to value the property; and,
- A statement as to all sources used in the process including:

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Evaluation Content

- External data sources (tax and land records);
- Property-specific data (prior sales);
- Photos of the property and other evidence of an inspection; and,
- A description of the neighborhood or the local market conditions.

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Validity of Appraisals

- Banks may still use an existing appraisal or evaluation to support a subsequent transaction; however, policy must establish criteria to determine that the assumptions in the report remain valid and that the report continues to reflect the market value of the property. Reaffirmation along with a evidence of property inspection/photos to determine condition.

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Validity of Appraisals

- A new appraisal or evaluation would be required, under specific circumstances, including (now) if there have been changes in underlying economic and market assumptions, such capitalization rates and lease terms.

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Reviewing Appraisals and Evaluations

- As part of the credit approval process and prior to a final credit decision, banks should review appraisals and evaluations to ensure that they comply with Agencies' regulations and are consistent with supervisory guidance and the bank's own policies.
- Banks may use the review findings to monitor and evaluate the competency and ongoing performance of appraisers and evaluators.

2010 Guidelines: What's New, Different or Enhanced?

Reviewing Appraisals and Evaluations

- Policies must provide a risk-focused process for reviewing appraisals and evaluations. Policies should:
 - Address independence, training, qualifications and role of reviewer; and,
 - Establish a process and documentation standards for addressing any deficiencies.

2010 Guidelines: What's New, Different or Enhanced?

Reviewing Appraisals and Evaluations

- Banks should implement a risk-focused approach for reviewing appraisals and evaluations.
 - For 1-4 residential real estate, with PRIOR regulatory approval, banks may use automated tools or sampling methods.
 - For transactions involving complex properties or higher-risk CRE loans, the reviews should be comprehensive to assess the technical quality of the appraiser's analysis.

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Reviewing Appraisals and Evaluations

So, are we having fun
yet??

2010 Guidelines: What's New, Different or Enhanced? *Reviewing Appraisals and Evaluations*

- What does that mean? This is where the Agencies have seen the biggest failures: Banks are not prosecuting, testing or challenging the assumptions contained in appraisal reports.
- The Agencies are concerned that Bank's are not evaluating the reasonableness or support for discount rates.

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Reviewing Appraisals and Evaluations

- The Agencies are concerned with an over-use of the cost approach to value.
- The Agencies are concerned with poor reconciliation processes contained in appraisal reports.

2010 Guidelines: What's New, Different or Enhanced?

Reviewing Appraisals and Evaluations

- Can a bank accept an appraisal prepared for another financial institution (whether or not regulated)? Yes, under the following circumstances:
 - Appraiser was engaged directly by the other institution;
 - Appraiser had no direct, indirect or prospective interest in the property; and,
 - The report is subject to the most strenuous level of review and is deemed acceptable.

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Third Party Arrangements

- If any third party is engaged to assist in any part of the collateral valuation process—whether selecting appraisers/evaluators, ordering or reviewing appraisals or evaluations, the institution is accountable and, therefore, the relationship should be contractual.

2010 Guidelines: What's New, Different or Enhanced?

Third Party Arrangements

- The written contract should clearly define the expectations and obligations of both parties including that the third party will perform its services in compliance with the Agencies' appraisal regulations and consistent with the guidelines.
- Policies and procedures should outline the bank's process for exercising due diligence over the third parties; and,

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Third Party Arrangements

- Policies need to establish effective controls to monitor and periodically assess the collateral valuation functions performed by third parties. Regardless of who is performing the function, the examiners will hold YOU accountable.

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Monitoring Collateral Values

- This area has been substantially expanded from previous guidelines but regulators view this as piggy-back stress testing and other real estate monitoring.
- Policies should address the need to obtain updated collateral valuation information to understand and effectively manage risk in real estate portfolios.

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Monitoring Collateral Values

- As always, current collateral information is critical to modifications or workouts.
- Policies and procedures now need to address deterioration in the portfolio, as a result of material changes in the following factors affecting real estate loans:

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Monitoring Collateral Values

- Vacancy rates
- Absorption rates
- Lease terms
- Rental rates and sales prices (including concessions and overruns and delays in construction costs)
- Discount rates and direct cap rates

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Monitoring Collateral Values

- Policies should ensure that:
 - Portfolio monitoring information is timely;
 - When new or updated collateral valuations are appropriate; and,
 - The valuation method to be employed.

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- Questions???

About **MidLantic** Financial

- MidLantic Financial, Inc. was founded in 2001 to offer real estate consulting services to financial institutions, concentrating originally on independent appraisal reviews that were designed specifically to confirm methodologies and to scrutinize support for the value conclusions.
- MidLantic now serves more than 50 bank clients and has expanded its services to include an environmental division and Evaluation services for properties throughout the greater Baltimore/Washington, DC region

MidLantic Financial

- MidLantic is the largest independent appraisal review firm in the Baltimore-Washington region
- MidLantic provides environmental transaction screens and Phase I Assessments through its affiliation with Ctgroup Environmental.
- MidLantic provides all facets of regulatory and risk management assistance.
- MidLantic is the only independent provider of Evaluations

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