New Developments in Appraising Real Estate

Mary Sroufe

NORTHWEST CREDIT UNION ASSOCIATION

Topics Covered

- Appraisal and Evaluation Guidelines
  - Effective December 10, 2010
- Appraiser Independence Interim Final Rule
  - Effective April 1, 2011

Appraisal and Evaluation Guidelines

- Appraisals must be conducted in a manner conforming with the uniform appraisal standards
- Evaluations must be consistent with safe and sound business practices
- Financial institutions must review appraisals and evaluations to determine compliance

NORTHWEST CREDIT UNION ASSOCIATION

Appraisal and Evaluation Guidance

- More loans are covered under this guidance than the appraiser independence rules
  - Commercial loans primarily
- If your financial institution complies with the appraiser independence rules for all appraisals, it will be compliant with these guidelines with respect to independence

NORTHWEST CREDIT UNION ASSOCIATION

Appraisal Standards

- Must be written and contain sufficient information to support the transaction
  - Dodd-Frank will require even higher appraisal standards for higher risk mortgages. Once those regulations are in place, appraisers will have to inspect the interior of a property
- Must analyze, apply and report deductions and discounts when providing a market value estimate

Appraisal Standards

- Must be based on market value, not affected by undue stimulus (such as favorable financing)
  - Cannot use going concern or value in use type values either
- Should be based on the property as is, not what it will be worth when it is developed, although that may be considered as well

Appraisal Development

- The financial institution should work with the appraiser to determine what the appropriate scope of work is for the particular appraisal.
- The finished appraisal must contain enough information for the financial institution to make a decision about the transaction in question

Transactions Requiring Appraisals

- An appraisal is not required when the loan:
  - Is a non-business loan under $250,000
  - Is a business loan under $1 million and will not be primarily dependant on real estate for repayment
  - Is an existing extension of credit not involving new money (other than closing costs) or there have been no obvious or material changes in the value of the collateral or market conditions
  - Qualifies for sale to Fannie or Freddie

Transactions Requiring Appraisals

- Some transactions that don’t require appraisals should be appraised anyway
  - Loans with high loan to value ratios
  - Atypical properties
  - High risk borrowers
  - Properties in areas the financial institution is not familiar with

NORTHWEST CREDIT UNION ASSOCIATION

Evaluations

- Less burdensome option for loans not needing appraisals
- Automated Valuation Models are popular tools, as are broker price opinions and tax valuations
- Must provide a property’s market value or sufficient information and analysis to support the value conclusion.

NORTHWEST CREDIT UNION ASSOCIATION

Evaluations

- Dodd-Frank states:
  - In conjunction with the purchase of a consumer's principal dwelling, broker price opinions may not be used as the primary basis to determine the value of a piece of property for the purpose of loan origination of a residential mortgage loan secured by such piece of property
- The value of the specific property must be considered, even if no appraisal is necessary

Evaluations

- The evaluation must take into account both the economic and market conditions and the individual piece of property.
- Automated valuation models alone are not enough under these guidelines
  - The specific property’s condition must be taken into account.

Evaluations

- At a minimum an evaluation should:
  - Identify the location of the property and provide a description including current and projected use.
  - Estimate market value in actual current condition, with current zoning.
  - Describe the method used to determine condition
  - Describe all information used including photos, tax records, sales records, and local market
  - Include information about the preparer and his or her signature

Existing Appraisals and Evaluations

- Factors to be considered when re-using an existing evaluation or appraisal include:
  - Passage of time and volatility of the market
  - Natural disasters and contamination
  - Current supply of similar properties on the market
    - And their condition
  - Changes in zoning
  - Changes in financing available or in market conditions overall

Reviewing Appraisals and Evaluations

- Prior to a final credit decision, a financial institution should review appraisals and evaluations to be sure they comply with regulations, guidance, and internal policy.
- The financial institution should be able to assess the reasonableness of the appraisal or evaluation, including whether the valuation methods, assumptions and data sources are appropriate and well supported.

Reviewing Appraisals and Evaluations

- Policy on valuation review should:
  - Address the independence, education and training qualifications and role of the reviewer
  - Reflect a risk-focused approach for determining the depth of the review
  - Establish a process for resolving any deficiencies in appraisals or evaluations
  - Set forth documentation standards for the review and the resolution of noted deficiencies.

Reviewer Qualifications

- Independent of the transaction, and loan staff
- Capable to assess whether the appraisal or evaluation has enough information to support the decision to engage in the transaction
- A financial institution may need to use a third party to review appraisals for particularly complicated or high risk transactions

Depth of Review

- Commercial loan
  - Generally will require more stringent review
  - Transactions involving high risk or large dollar amounts should be more comprehensively reviewed
- 1-4 family residential real estate loan
  - Look at borrower quality (debt to income, loan to value, documentation) to determine risk
  - For low risk loans, AVM may be used with regulator approval

Depth of Review

- Appraisals from other financial institutions
  - These need at least the same level review as that given to other similar transactions
  - Should confirm
    - The appraiser was engaged directly by the FI
    - The appraiser had no interest in the transaction
    - The FI ordered the appraisal, not the borrower
  - An appraisal where the original client is not disclosed is not acceptable

NORTHWEST CREDIT UNION ASSOCIATION

Resolution of Deficiencies

- Policy and Procedure should address:
  - Communicating deficiencies to appraiser while not coercing inappropriate change
  - Addressing significant deficiencies by ordering a second appraisal when necessary
  - Replacing evaluations prior to the credit decisions when the original evaluation lacks sufficient information to support the credit decision

NORTHWEST CREDIT UNION ASSOCIATION

Documentation of Review

- Policies and procedures for documentation should address:
  - Level of documentation needed, given the type, risk and complexity of the transaction
  - Description of any deficiencies and proposed resolution
  - Actual resolution and reasons for ordering a replacement appraisal or evaluation (when applicable)

Ongoing Appraisals and Evaluations

- Collateral values should be monitored on an ongoing basis. Generally this may be done on an informal basis, but some circumstances may require a formal appraisal or evaluation
  - Significant market deterioration
  - Loan modification
  - Loan workout arrangements
    - Especially when new money is advanced

Appraisal and Evaluation Guidelines

- Questions?

Appraiser Independence

- Interim final rules, effective April 1, 2011
  - Comments were accepted, so these may change
- Applies to any consumer credit transaction secured by the consumer’s principal dwelling
  - Including HELOC and second mortgages
  - Including loans for live aboard boats or RVs
  - Commercial transactions are exempted

Appraiser Independence

- Cannot coerce appraisers directly or indirectly
  - Noting a desired minimum or maximum value
  - Withholding or threatening to withhold payment because the appraisal value is not what is desired
  - Implying that future engagements depend on value determined
  - Excluding an appraiser from hire because the value reported does not meet some threshold
  - Conditioning compensation on loan consummation

NORTHWEST CREDIT UNION ASSOCIATION

Appraiser Independence

- No party may materially misrepresent the value of a consumer's dwelling
  - Financial institutions cannot falsify or materially alter a valuation. Only appraisers may alter the valuation
    - Material valuations significantly affect the determined value
  - Financial institutions cannot induce appraisers to falsify or alter a valuation improperly

Appraiser Independence

- It is permissible for financial institutions to:
  - Ask an appraiser to consider additional information
  - Request further detail or explanation about a valuation
  - Request error correction
  - Obtain multiple valuations to select the most reliable
  - Withhold compensation due to breach of contract

NORTHWEST CREDIT UNION ASSOCIATION

Appraiser Independence

- Appraisers and managers of appraisal functions cannot have a conflict of interest.
- They cannot have a direct or indirect interest, financial or otherwise, in the property or the transaction
- Mere employment by the financial institution is not considered a conflict of interest

NORTHWEST CREDIT UNION ASSOCIATION

Appraiser Independence

- Employees of financial institutions over $250 million have no conflict of interest if:
  - Compensation is not based on the value arrived at
  - Do not report to loan production function, and compensation is not based on loan closing
  - No employee, officer or director in the loan production function may be involved in the section, recommending or influencing the selection of the appraiser or manager

Appraiser Independence

- Employees of financial institutions under $250 million have no conflict of interest if:
  - Compensation is not based on the value arrive at
  - The financial institution requires that any employee, officer or director who orders, performs or reviews a valuation abstain from participating in any decision to approve or set the terms of the transaction

Appraiser Independence

- If a financial institution knows that the valuation was coerced, misrepresented, altered inappropriately, or obtained subject to a conflict of interest, it is prohibited from consummating that loan unless it has determined that the coercion, misrepresentation etc. does not materially misrepresent the value of the collateral

NORTHWEST CREDIT UNION ASSOCIATION

Appraiser Independence

- Compensation for appraisers must be reasonable and customary
  - If the financial institution pays fees that are reasonably related to recent rates on comparably transactions, it is in compliance. Factors:
    - Type of property
    - Scope of work and time performed
    - Qualifications, experience and record of appraiser
    - Work quality

NORTHWEST CREDIT UNION ASSOCIATION

Appraiser Independence

- If a financial institution reasonably believes that an appraiser has materially not complied with the Uniform Standards of Professional Appraisal Practice or ethical or professional requirements, it must refer the matter to the appropriate state agency.
  - Within a reasonable period of time

NORTHWEST CREDIT UNION ASSOCIATION

Appraiser Independence

- Questions?

NORTHWEST CREDIT UNION ASSOCIATION