

FDIC Valuation Program Examinations

Southern California Society of Chief
Appraisers/RMA

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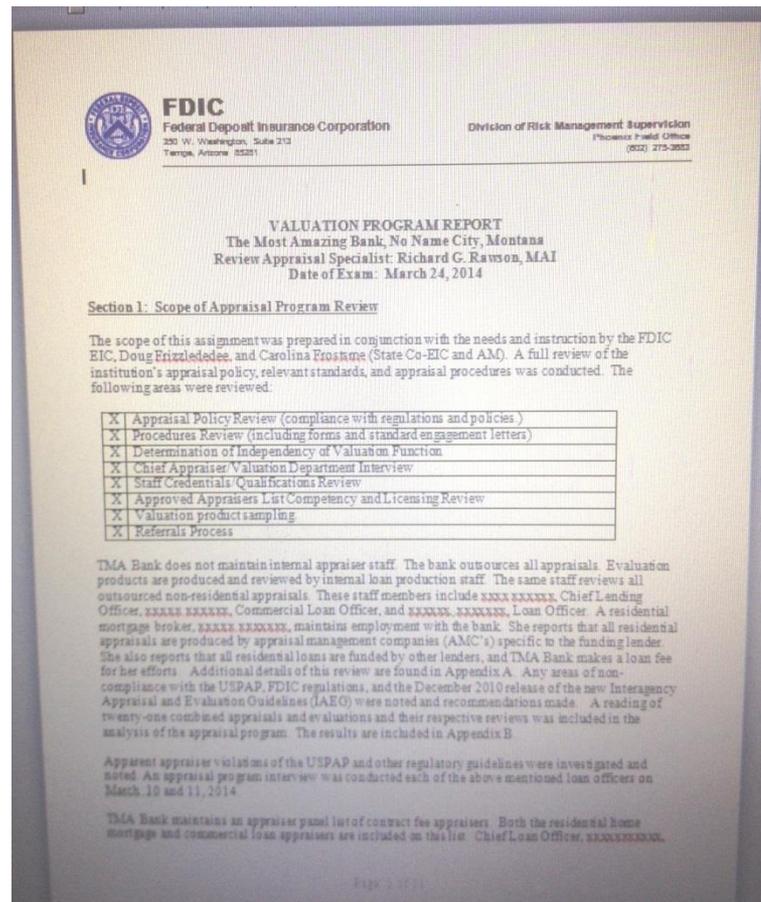
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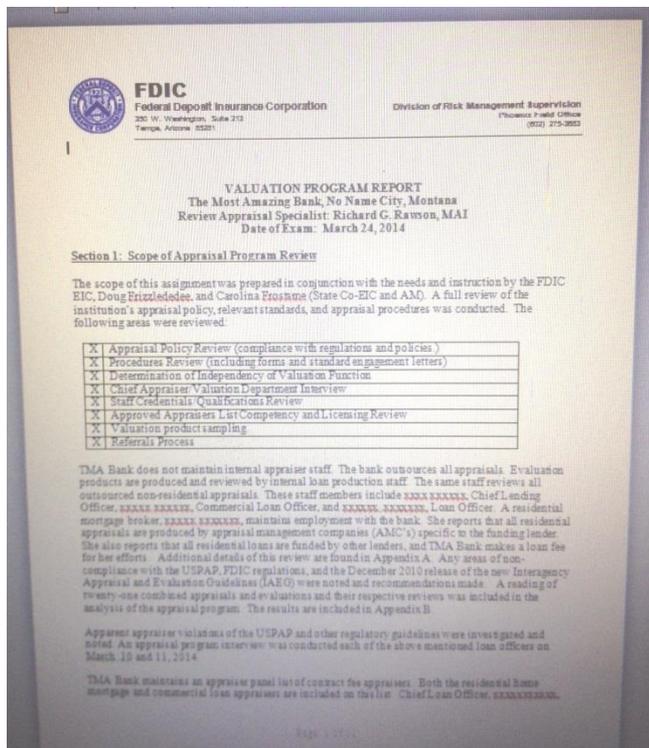
Thank you

Scope of Valuation Program Exam

- FDIC will assess the appropriateness of bank's valuation program as a part of periodic safety and soundness examinations.



Scope of Valuation Program Exam



X	Appraisal Policy Review (compliance with regulations and policies.)
X	Procedures Review (including forms and standard engagement letters)
X	Determination of Independency of Valuation Function
X	Chief Appraiser/Valuation Department Interview
X	Staff Credentials/Qualifications Review
X	Approved Appraisers List Competency and Licensing Review
X	Valuation product sampling
X	Complaint referrals process, written policy and procedure, historical occurrences
X	HPML involvement and bank policy

Valuation Program Exam Specifics

Examiners will: Review written internal policies and procedures relating to the institution's appraisal and evaluation program. Determine if policies address concepts including:

- The independence of the persons ordering, performing, and reviewing appraisals or evaluations.
- Selection of qualified and competent appraisers and persons who perform evaluations for an assignment, as well as procedures for evaluating and monitoring their performance.
- Compliance with the appraisal regulation, supervisory guidance and the institution's policies.

Organizational Structure

- Examiners will review the bank's organizational structure to understand whether its appraisal and evaluation program is isolated from influence by the loan production staff. If absolute lines of independence cannot be achieved, identify the safeguards the bank has instituted to isolate its collateral valuation program from influence or interference from the loan production process.
- Does the bank's real estate lending program justify a need for in-house appraisal expertise?

In-House Expertise/Examiner Adjustments

- A key component to a successful valuation program is an institution's level of expertise available to appraise, review, and monitor real estate collateral.
- NOTE: FDIC instructions to examiners regarding an institution's ability to address weaknesses in the valuation process include the following: "...if the institution is unable or unwilling to address these deficiencies in a timely manner, examiners will have to assess the degree of protection that the collateral affords in analyzing and classifying a credit. This may result in examiners making adjustments, if applicable, to collateral's value to reflect current market conditions and events. Examiners should document any adjustments to the value....when the examiner can establish that any underlying facts or assumptions are inappropriate or can support alternative assumptions. Examiners should discuss any adjustments to a value conclusion with management."

Appraisal and Evaluation Review

FDIC examiners will determine that the appraisal and evaluation program establishes comprehensive analytical review procedures that at minimum:

- Address the independence, educational and training qualifications, and role of the reviewer.
- Reflect a risk-focused approach for determining the depth of the review.
- Utilize and underscore a value judgment culture regarding assessment of value and underlying assumptions rather than a checklist mindset. (Do they avoid hiring in-house expertise?)
- Establish a process for resolving any deficiencies in appraisals or evaluations.
- Set forth documentation standards for the review and the resolution of noted deficiencies.

Third Party Justification

- Prior to entering into an arrangement with a third party for valuation services, has the bank compared risks, costs, and benefits of the proposed relationship to those associated with conducting the activity in-house? (Will ask for written support and evidence. IAEG §XVI, paragraph 4)

Third Party Arrangements (Cont'd)

- Determine that the bank has adequate procedures governing the selection, use and oversight of a third party that performs appraisal management services for the bank. (Bank authored engagement contract is recommended.)
- Does the bank document the results of its ongoing monitoring and periodic assessment of the third party's compliance with regs and guidance?

Monitoring Collateral Values and Market Conditions

- Determine that the bank has policies to monitor collateral risk on a portfolio and an individual credit basis, including when to obtain a new appraisal or an evaluation.
- Does the bank have policy governing deterioration in the credit, material changes in market conditions, loan modifications and workouts and documentation of such in the loan file? Is policy being followed?

Internal Controls

- Determine that the bank has policies to ensure that no person has authority to render credit decisions involving loans on which they ordered or reviewed the appraisal or evaluation.
- Determine if the program provides for completion of appraisals, evaluations and reviews by those who are familiar with the appraisal regulations, and guidance and have appropriate training, experience, and are independent of the transaction. **Critical!**

Prior to Final Credit Decision

- The appraisal and evaluation program requires the receipt and review of appraisal reports and evaluations prior to making the final credit decision.
- FDIC examiners will review dates of loan approvals, loan approval contingencies, and appraisal/evaluation review dates.

Chief Appraiser/Collateral Officer Interview

1. Reporting Structure / description of staff and # of employees? Physical location in relation to loan staff? Adequate resources? Pressure to reach values?
2. What job responsibilities come with your position? Periodic credit monitoring, real estate sector analysis and reporting, environmental risk assessment? Special Assets and OREO?
3. Any other banks under the corporate banner and how they interact with valuation needs and policy?
4. Focus of real estate lending?

Chief Appraiser/Collateral Officer Interview

5. Ordering of Appraisals/ Evaluations Process?
Computer Tracking System for Valuation Requests? Involvement by loan officers?
6. Review process for Appraisals and Evaluations?
Use of brokers opinion of value?
7. Third Party reports handling?
8. AMC usage and management? Written audits?
9. Who makes policy changes and recommendations? Are they qualified?
10. # of residential and commercial appraisal and evaluation assignments per year and required associated reviews?

Chief Appraiser/Collateral Officer Interview

11. Résumé / qualifications of those involved in appraisals, evaluations, reviews, ordering.
12. Complaint Referrals Made? Process in policy or procedure document?
12. Placement / removal / monitoring of Board Approved Appraisers List
13. Participation Loans? Do they follow guidelines?
14. Is borrower information and property information safeguarded, locked up after hours?
15. HPML involvement with written policy support?

Chief Appraiser/Collateral Officer Interview

16. Technical Quality vs. Administrative Reviews. Does the bank regularly test the validity and appropriateness of the data used by the appraisers and evaluators? Is there a policy for a reasonable level of site inspections as a part of the reviewer's scope of work? Bumping up a checklist review to a higher quality review sampling.
17. Is there an appraisal review and evaluation review audit program? Are the results in writing and available for review?
18. Follow-up questions.

Valuation Program Compliance Questions

- Q = Does the FDIC require that an evaluation be USPAP compliant?
- A = No, except as required of state licensed or certified appraisers.
- Q = May a licensed appraiser perform a review on a non-appraiser's evaluation report?
- A = Yes, but do not opine on aspects of value and no USPAP certification statement needed. Otherwise compliance with USPAP Standard 1 and 2 may be required.
- Q = What specific controls, oversight, actions, and resources are expected of the bank in monitoring AMC's or third parties?
- A = Periodic assessment of valuation functions of the third party. File notes & call logs, email.

Valuation Program Compliance Questions (cont'd)

Q = Are reviews required for all appraisals and all evaluations for FDIC insured lenders?

A = Yes*. The depth of the review depends on the type, risk, and complexity of the transaction, and if the report was ordered through another financial services institution. We expect more than a concurring signature.

*Loan monitoring products do not require review. Certain residential exemptions may be obtained. (See IAEG §XV, B, 1-4 Family Real Estate)

Valuation Program Compliance Questions (cont'd)

Q = What is a review of a review and when is it required?

A = Lenders should assess the quality of the reviews they receive through a random audit sampling of review reports. The lender's appraisal policy could address an established written procedure for testing the quality of the appraisal and evaluation review process. (See IAEG Section XVII, Program Compliance, bullet point four.)

See next page.

Valuation Program Compliance Questions (cont'd)

The Interagency Appraisal and Evaluation Guidelines' Section XVII, bullet point four states:

The compliance process should:

- ***Establish procedures to test the quality of the appraisal and evaluation review process.***

Audit areas to include: Reviewer qualifications, depth of review, problem identification, resolution of deficiencies, email communications, adequate access to appraisal files and accompanying reviews, documentation.

Valuation Program Compliance Questions (cont'd)

A major finding in recent examinations by FDIC's appraisal review specialist:

- ***The exclusive use of checklist reviews often results in an institution's lack of assessment of the credibility of the appraisal results. When contract appraisers do not receive feedback the quality of work becomes increasingly sloppy to the point of non-compliance with USPAP and lacking credible results.***

Valuation Program Compliance Questions (cont'd)

Question from a banker:

We have a commercial transaction where the loan amount is just over a million dollars and the primary piece of collateral does not sufficiently secure the loan so we are talking a second piece of real estate as collateral. Is it a violation of regulation if we do an Evaluation instead of an Appraisal on the second piece of real estate because the loan amount is over a million dollars?

Valuation Program Compliance Questions (cont'd)

Answer:

Appendix A, Section 1, Appraisal Threshold, states the following: *“For example, an institution makes a loan secured by seven commercial properties in different markets with two properties valued in excess of the appraisal threshold and five properties valued less than the appraisal threshold. An institution would need to obtain an appraisal on the two properties valued in excess of the appraisal threshold and evaluations on the five properties below the appraisal threshold, even though the aggregate loan commitment exceeds the appraisal threshold.”*

Answer (cont'd)

There are two “threshold” value amounts mentioned in the regulations. The first is \$250,000 which is applicable to all non-business loans. The second is \$1 million as applicable to business loans only. These thresholds are applicable when the loan transaction value is equal to or less than the threshold value. The question raised does not provide sufficient detail to determine which of the two thresholds is applicable (non-business or business). If we assume the loan is not a business loan, then an estimate of value of the second property, being equal to or less than \$250,000, would not require an appraisal and an evaluation would suffice. If the second property is believed to have a value greater than \$250,000, (or \$1 million for a business loan), then an appraisal would be required.

Insight: What other issues concern bank examiners?

- Lack of in-house expertise
- USPAP & IAEG
- Scope of Work
- Independency of the valuation program (influence and isolated physical proximity)
- Competency
- Property Access
- Excluded Approaches
- Highest & Best Use
- Depth of Review (technical vs. administrative) and failure to recognize the need for a greater degree of review
- Construction loan issues
- Adjustments – Qualitative and Quantitative support
- Dramatic Increase in Value
- Comparable Sales & Rentals
- Low fees, engagement detail
- Environmental

Questions / Answers



Everything perfectly clear?