



FEDERAL RESERVE BANK  
OF DALLAS

WILLIAM H. WALLACE  
FIRST VICE PRESIDENT  
AND CHIEF OPERATING OFFICER

March 1, 1990

DALLAS, TEXAS 75222

Circular 90-10

**TO:** The Chief Executive Officer of all  
member banks and others concerned in  
the Eleventh Federal Reserve District

**SUBJECT**

**Appraisal Standards for State Member Banks and Bank Holding Companies**

**DETAILS**

The Federal Reserve Board has requested public comment on a proposed regulation that would set standards for appraisals conducted for state member banks and bank holding companies in federally related transactions. The proposed regulation identifies which transactions would require an appraiser, sets forth minimum standards for performing appraisals, and distinguishes those appraisals requiring the services of a state certified appraiser from those requiring a state licensed appraiser. The Board is specifically requesting comment on the following aspects of the proposal:

- (1) the definitions used in the proposal, in particular the definitions of "complex 1-to-4 family residential property appraisal" and "transaction value;"
- (2) the amount below which a state certified or licensed appraiser is not required;
- (3) the criteria that determine when a state certified appraiser is required and when a state licensed appraiser is required; and
- (4) the appraisal standards set forth in the proposed regulation.

Comments should be received by the Board by April 10, 1990, and should be addressed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, N.W., Washington, D.C. 20551. All comments should refer to Docket No. R-0658.

**ATTACHMENTS**

The text of the Board's proposal is attached.

**MORE INFORMATION**

For more information, please contact Gary Krumm at (214) 744-7434. For additional copies of this circular, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

## FEDERAL RESERVE SYSTEM

### 12 CFR Parts 208 and 225

[Regulation H, Regulation Y; Docket No. R-0658]

#### Appraisal Standards for Federally Related Transactions

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** Title XI of the Federal Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA")<sup>1</sup> requires the Board to propose regulations regarding the performance and utilization of appraisals by state member banks and bank holding companies. Title XI and these implementing regulations are intended to protect federal financial and public policy interests in real estate-related financial transactions requiring the services of an appraiser. This proposed regulation, and similar regulations proposed by the other financial institutions regulatory agencies<sup>2</sup> and the Resolution Trust Corporation, provide the affected federal entities with added assurance that real estate appraisals used in connection with federal responsibilities and requirements are performed in accordance with uniform standards by individuals whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. Toward this end, the proposed regulation identifies which transactions require an appraiser, sets forth minimum standards for performing appraisals, and distinguishes those appraisals requiring the services of a State certified appraiser from those requiring a State licensed appraiser.

**DATES:** Comments must be submitted on or before April 10, 1990.

**ADDRESSES:** Comments, which should refer to Docket No. R-0658, may be mailed to the Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, NW., Washington, DC 20551, to the attention of Mr. William W. Wiles, Secretary; or delivered to room B-2223, Eccles Building, between 8:45 a.m. and 5:15 p.m. Comments may be inspected in room B-1122 between 9:00 a.m. and 5:00 p.m., except as provided in § 261.8 of the

Board's Rules Regarding Availability of Information, 12 CFR 261.8.

**FOR FURTHER INFORMATION CONTACT:** Roger Cole, Assistant Director (202/452-2618), Roger H. Pugh, Manager (202/728-5883), or Stanley B. Rediger, Senior Financial Analyst (202/452-2629), Division of Banking Supervision and Regulation, Board of Governors; or Michael J. O'Rourke, Senior Attorney (202/452-3288) or Mark J. Tenhundfeld, Attorney (202/452-3612), Legal Division, Board of Governors. For the hearing impaired *only*, Telecommunication Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson (202/452-3544).

#### SUPPLEMENTARY INFORMATION:

**A. Background.** Title XI of FIRREA requires the Board to establish standards for performing appraisals in connection with federally related transactions within the Board's jurisdiction. In addition, title XI requires the Board to identify those circumstances that require a State certified appraiser from those that require a State certified or licensed appraisers. In response to this legislative mandate, the Board is proposing this regulation which is designed to address problems perceived by Congress and the Board.

Section 1121 of FIRREA defines a "federally related transaction" as a real estate-related financial transaction which, *inter alia*, requires the services of an appraiser. The Board is proposing to require State certified or licensed appraisers to be used for all real estate-related financial transactions except those transactions in which (i) a lien is placed on real property solely through an abundance of caution or (ii) the transaction value (as defined in the proposed regulation) is less than or equal to \$15,000. The Board, acting pursuant to section 1112 of FIRREA, also is proposing to require State certified appraisers to be used for all appraisals except non-complex 1-to-4 family residential property appraisals rendered in connection with a federally related transaction having a transaction value below a specified amount.

In addition, the Board is proposing standards, pursuant to section 1110 of FIRREA, for the performance of appraisals in connection with federally related transactions within the Board's jurisdiction. These standards would require that all such appraisals be written and that they conform to the Uniform Standards of Professional Appraisal Practice ("USPAP") promulgated by the Appraisal

Foundation<sup>3</sup> and the additional standards set forth in this proposal.

This proposed regulation is intended to supplement the Board's appraisal guidelines<sup>4</sup> currently in effect. These guidelines will remain in effect, subject to amendment.

The Board proposes this regulation to improve the safety and soundness of all financial institutions covered by title XI within the Board's jurisdiction. The soundness of real estate loans and investments made by financial institutions covered by title XI depends upon the adequacy of the underwriting or analysis used to support these transactions. A real estate appraisal is one of several essential components of the lending process. Accordingly, through the integration of existing guidance on real estate appraisals with the additional requirements imposed by title XI, this proposal is intended to provide the affected entities with a reasonable degree of assurance that real estate appraisals used in connection with federally related transactions will be reliable.

Public comment is solicited on all aspects of the proposed rule. In addition, public comment is specifically requested on the following:

(1) The definitions used in this proposal, in particular the definitions of "complex 1-to-4 family residential property appraisal" and "transaction value;"

(2) The amount and appropriateness of the *de minimis* provision below which a State certified or licensed appraiser is not required;

(3) The criteria that determine when a State certified appraiser is required and when a State licensed appraiser is required; and

(4) The additional appraisal standards set forth in the proposed regulation.

**B. Section-by-section analysis.** Section 225.61—Authority, purpose, and scope. This section identifies title XI of FIRREA as the authority under which this regulation is promulgated. Further, it identifies those institutions, including the Board and institutions primarily or exclusively regulated by the Board ("regulated institutions"), which must comply with the regulation. State member banks, bank holding companies, and nonbank subsidiaries of bank

<sup>3</sup> The Appraisal Foundation was established by several professional appraisal organizations as a not-for-profit corporation under the laws of Illinois in order to enhance the quality of professional appraisals.

<sup>4</sup> See *Guidelines for Real Estate Appraisal Policies and Review Procedures*, distributed by the various divisions of bank supervision at the FDIC, the OCC, and the Board.

<sup>1</sup> Pub. L. No. 101-73, 103 Stat. 183 (1989).

<sup>2</sup> The Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), the Office of Thrift Supervision ("OTS"), and the National Credit Union Administration.

holding companies are specifically covered.

Section 225.62—Definitions. Except where noted below, the definitions set forth in title XI shall apply to the terms used in this regulation.

—“Appraisal.” This definition currently is used by nineteen federal agencies.<sup>6</sup> The Board believes that this widespread use and acceptance will produce consistent appraisals.

—“Complex 1-to-4 family residential property appraisal.” Section 1113 of FIRREA allows the use of a State licensed appraiser for, among other federally related transactions, 1-to-4 family residential property appraisals, “unless the size and complexity requires a State certified appraiser.” The definition of “complex 1-to-4 family residential property appraisal” provides guidance on factors that will determine if the services of a State certified or licensed appraiser are required. This list is illustrative only.

—“Market value.” This definition is commonly used in connection with mortgage lending by a number of government agencies and others. The definition contemplates the consummation of a sale as of a specified date and the passing of title from seller to buyer under open and competitive market conditions requisite to a fair sale. It is designed to provide an accurate and reliable measure of the economic potential of property involved in federally related transactions. Moreover, the Board believes that widespread acceptance and use of this definition will provide consistency to appraisals.

In applying this definition of market value, adjustments to the comparables must be made for special or creative financing or sales concessions. No adjustments are necessary for those costs that are normally paid by sellers as a result of tradition or law in a market area; these costs are readily identifiable since the seller pays these costs in virtually all sales transactions. Special or creative financing adjustments can be made to the comparable property by comparisons to financing terms offered by a third party financial institution that is not already involved in the property or transaction. Any adjustment should not be calculated on a mechanical dollar-for-dollar cost of the financing or concession, but the dollar amount of any adjustment should approximate the market's reaction to the financing or

concessions based on the appraiser's judgment.<sup>6</sup>

—“Real estate-related financial transaction.” This definition is the same as that set forth in section 1121(5) of FIRREA, except that “and” is replaced with “or” throughout so as to clarify the intent of Congress that the safeguards of title XI apply as broadly as possible.<sup>7</sup>

—“State certified appraiser.” This classification applies to appraisers who are recognized by the States as being more knowledgeable of and experienced in appraisals than are licensed appraisers. Section 1116 of FIRREA contemplates that each state or territory will adopt standards and procedures, consistent with the purposes of title XI, for obtaining the designation of “State certified appraiser.” To be consistent with title XI, each state's standards and procedures must require its certified appraisers to meet, at a minimum, the criteria for certification issued by the Appraisal Foundation. Moreover, no state or territory may certify an appraiser under title XI unless that individual passes an examination, administered by the state or territory, that is consistent with the equivalent to the Uniform State Certification Examination issued or endorsed by the Appraisal Foundation. The proposed rule does not prevent a state from establishing additional certification criteria.

Under FIRREA, the Board is authorized to establish certification criteria in addition to those adopted by a given state. Additionally, the Appraisal Subcommittee of the Federal Financial Institutions Examination Council may issue a written finding that the certification criteria of a state or territory are inadequate for specified reasons. Thus, an individual may be a “State certified appraiser” only if (a) the individual complies with all state-imposed criteria and additional criteria, if any, imposed by the Board, and (b) the appraiser certifications and licenses of a state have not been rejected by the Appraisal Subcommittee. As of July 1, 1991, appraisals for federally related transactions must be performed by State certified or licensed appraisers, unless

<sup>6</sup> This paragraph regarding comparables is taken from the standard definition of “market value” used by the Federal Home Loan Mortgage Corporation (“FHLMC”), the Federal National Mortgage Association (“FNMA”), and OTS, among others. By including this paragraph in the preamble rather than the regulation, the Board does not intend to suggest any change in the interpretation or application of the definition of “market value” as this term currently is used.

<sup>7</sup> See, e.g., Report of the House Banking, Finance and Urban Affairs, H.R. Rept. 101-54, part 1, 101st Cong., 1st Sess. (the “House Banking Committee Report”) 480, 481 (1989).

this deadline is extended by the Appraisal Subcommittee for a given state pursuant to provisions of title XI.

—“State licensed appraiser.” Each state may elect to adopt licensing criteria that are less rigorous than certification criteria. However, licensing criteria must be adequate to protect federal financial and public policy interests. For example, simply “grandfathering” all existing appraisers generally would not be acceptable. Rather, the states and territories are to design criteria that will ensure that licensed appraisers will have the experience and training sufficient to perform 1-to-4 family residential property appraisals that are below the dollar thresholds set forth in this proposed regulation and that are not “complex 1-to-4 family residential property appraisals” as this term is defined in this proposal.

As with State certified appraiser criteria, the Board is authorized to impose additional licensing requirements. Moreover, the Appraisal Subcommittee is charged with monitoring state appraiser certifying and licensing agencies, and may reject state certifications and licenses if a state's appraisal policies, practices, or procedures are found to be inconsistent with title XI or this proposed regulation.

—“Tier 1 capital.” This term is applied in determining circumstances when a State certified appraiser is required. The calculation of Tier 1 capital is set forth in appendices to the Board's Regulation H (for state member banks) and Regulation Y (for bank holding companies).

—“Tract development.” A tract development may be units in a subdivision, condominium project, timeshare project, or any similar project meant to be sold as individual units over a period of time.

—“Transaction value.” This definition is intended to clarify certain circumstances under which appraisals must be performed by a State certified appraiser. For example, a State certified appraiser is required when, among other instances, a 1- to 4-family residential property appraisal is performed in connection with a federally related transaction having a transaction value greater than \$1,000,000 or 10 percent of a regulated institution's Tier 1 capital, whichever is less.

Section 225.63—Transaction requiring State certified or licensed appraiser.

(a) *Appraiser not required.* Section 1121(4) of FIRREA defines a federally related transaction as a real estate-related financial transaction that, among other things, requires the services of an

<sup>8</sup> See 49 CFR part 24, “Uniform Relocation Assistance and Real Property Acquisition Regulations for Federal and Federally Assisted Programs,” 54 Federal Register 8,913 (1989).

appraiser. The Board recognizes that not all real estate-related financial transactions will require an appraiser. For instance, an appraisal would not be needed where a lien on real property has been taken as collateral solely through an abundance of caution and where the terms as a consequence have not been made more favorable than they would have been in the absence of the lien. In addition, the Board proposes not to require a State certified or licensed appraiser for real estate-related financial transactions having a transaction value less than or equal to \$15,000. However, the Board does not intend for the *de minimis* exception to discourage any regulated institution from obtaining an appraisal of property even though not otherwise required by law to do so.

(b) *Transactions requiring State certified appraiser.* The legislative history evidences a clear intent that State certified appraisers be used for most appraisals performed in connection with federally related transactions.<sup>8</sup> The proposed regulation accomplishes this goal by requiring State certified appraisers for all federally related transactions that do not involve 1- to 4-family residential property. Moreover, a State certified appraiser is to be used even for appraisals of 1- to 4-family residential properties in three circumstances: first, for federally related transactions entered into by the Board, if the transaction value exceeds \$1,000,000; second, for federally related transactions entered into by regulated institutions, if the transaction value exceeds \$1,000,000 or 10 percent of Tier 1 capital, whichever is less; and third, for federally related transactions that involve a "complex 1- to 4-family residential property appraisal" as this term is defined.

(c) *Transactions requiring either a State certified or licensed appraiser.* Any federally related transaction that does not require the services of a State certified appraiser must be performed by, at a minimum, a State licensed appraiser. State licensed appraisers may perform appraisals rendered in connection with federally related transactions involving only 1- to 4-family residential properties, and only if the transaction value is below the threshold set forth above and the transaction does not involve a "complex 1- to 4-family residential property appraisal."

Section 225.64—Appraisal standards.

(a) *Minimum standards.* Section 1110 of FIRREA instructs the Board to

prescribe appropriate standards for the performance of appraisals made in connection with federally related transactions within its jurisdiction. Further, section 1110 mandates that the standards require, at a minimum, that appraisals be written and that they conform to the generally accepted appraisal standards promulgated by the Appraisal Foundation. The Board is empowered to require compliance with additional appraisal standards if it makes a written determination that such additional standards are required in order to properly carry out its statutory responsibilities. Section 225.63 of the proposed regulation incorporates the minimum standards set forth in the statute, while listing additional criteria that shall apply to all appraisals performed in connection with federally related transactions.

In enacting title XI of FIRREA, Congress was responding to perceived problems in the appraisal industry. These problems were identified by the House Committee on Government Operations during a series of hearings,<sup>9</sup> and have been cited repeatedly in the legislative history of title XI.<sup>10</sup> The Board is proposing to adopt the following standards to further the legislative intent in addressing these problems. These standards are designed to contribute to safe and sound banking practices by requiring reliable appraisal reports. Appraisals performed in connection with federally related transactions are to comply with these standards by August 9, 1990.

—(1) *Compliance with USPAP; departure provision.* This standard incorporates the current standards in the USPAP, and clarifies that the Departure Provisions<sup>11</sup> in the USPAP is inapplicable to appraisals conducted in connection with federally related transactions within the Board's jurisdiction. The Board believes that the Departure Provision allows appraisal services to be performed which produce something different from an "appraisal" as contemplated by title XI of FIRREA. For instance, in accordance with the

Departure Provisions and consistent with current USPAP requirements, a letter opinion might be produced that could be silent about trends of rents, vacancies, or overbuilding. Explanatory comments in the USPAP regarding the Departure Provision in the USPAP cite examples of when the departure provision might apply;<sup>12</sup> however, for purposes of the proposed regulation, such services are not appraisals as this term is used in title XI. The Board believes that the Departure Provision in the USPAP allows for the omission of data that should be included in all appraisals rendered in connection with federally related transactions and, therefore, has proposed that the Departure Provision shall not apply to such appraisals.

Changes in the USPAP will apply to federally related transactions unless the Board has stated in writing that the changes shall not apply to federally related transactions within its primary or exclusive jurisdiction.

—(2) *Disclosure of competency.* An appraiser is required to have the appropriate knowledge and experience that will be required to complete an assignment competently. If such knowledge and experience is initially lacking, the appraiser must disclose in the appraisal both this fact and the steps taken to comply with the Competency Provision in the USPAP.

—(3) *Market value.* This standard requires an appraisal to document an appraiser's opinion of a property's "market value" as this term is defined. The definition of "market value" was developed by FNMA and FHLMC with the input of many professional appraisal organizations. Without such a standard, a lender might select a definition of value that allows the value of real property to be increased by favorable financing, going concern value, or special value to a specific user. This standard proposes to provide to interested parties the information necessary to determine the value of a property.

—(4) *Written appraisals; forms.* This standard sets forth the legislative mandate that all appraisals be written. Moreover, it requires an appraisal to be sufficiently descriptive to enable a reviewer to readily ascertain the estimated value reported and the rationale for that estimate. The appraisal may be in a narrative format

<sup>8</sup> House Comm. on Government Operations, *Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in the Secondary Market*, H.R. 99-891, 99th Cong., 2d Sess. (1986).

<sup>10</sup> See, e.g., 135 Cong. Rec. S4004 (daily ed. April 17, 1989) (statement of Sen. Dodd); H.R. Rep. No. 100-3001, 100th Cong. 2d Sess. pt. 1, at 19, 21-28; 133 Cong. Rec. H10709 (daily ed. Nov. 20, 1987) (statement of Cong. Barnard); 132 Cong. Rec. H3452 (daily ed. June 8, 1986) (statement of Cong. Barnard).

<sup>11</sup> The Departure Provision enables appraisers to "perform an assignment that calls for something less than or different from the work that would otherwise be required by the [USPAP]." USPAP at IV.

<sup>12</sup> These examples include introducing into evidence during a judicial proceeding a one page summary that incorporates by reference an appraiser's file or preparing a brief update of a previously prepared appraisal.

<sup>9</sup> See, e.g., House Banking Committee Report at 481.

or on a form chosen by an appraiser, but the appraisal must comply with all other provisions of the regulation. A form not initially designed for use in connection with federally related transactions may be used provided that it is modified as necessary to comply with the requirements of Title XI and this proposed regulation. Regardless of the format selected, the appraisal must be readily understood by a third party and must reflect the complexity of the property that is appraised. This will enable the reader of the appraisal to independently determine its adequacy based upon the characteristics of the collateral appraised.

—(5) *Sales history.* This standard is designed to enable a reviewer to compare an appraiser's opinion of a property's market value with recent sales prices. In addition to giving the reviewer a basis by which to evaluate the accuracy of the subject property appraisal, it also will assist the reviewer in identifying recent trends in market prices. For instance, a sales history may identify a single sale or a series of sales at artificially inflated prices.

Sales histories are required for one year for 1-to-4 family residential property and for three years for all other types of property. A more demanding reporting standard for nonresidential property is appropriate because larger loan amounts are generally granted, and hence larger risk to the regulated institution incurred, when the loan security is not a 1-to-4 family dwelling.

—(6) *Rents and vacancies.* An appraisal should disclose current income produced by a property if the property will continue to be used to generate income after a transaction is consummated. This information is essential for an accurate picture of the market value of an income-producing property. Appraisal values should be predicted upon current rents and current vacancies for property utilized in such a manner. That is, appraisals should be based upon income that can realistically be earned under current market and economic conditions (in light of rents being earned on comparable properties), rather than upon estimated or projected income that cannot be supported by current market conditions. If an appraiser reports a high current vacancy, this condition may require a lender to impose special conditions on the loan.

—(7) *Marketing period.* This standard requires an appraiser to employ a marketing period that is reasonable in light of a given property's characteristics and market conditions, and to disclose the assumptions used. An appraiser's opinion of market value will depend in

part on the appraiser's estimate of how long a given piece of property will remain for sale. For instance, an appraisal using a long marketing period is likely to produce a higher market value than would an appraisal using a shorter marketing period. This information will better enable the reader of the appraisal to assess its accuracy.

—(8) *Trend analysis.* An appraisal should inform the reader of any market trends, regardless of whether the trend reflects rising or declining values. Such trends might include, for example, increasing vacancy rates, greater use of rent concessions, or declining sales prices. Identification of negative trends is particularly important so that a regulated institution may avoid extending credit on the basis of insufficient collateral. Market trends may be indicated in market activity on the subject property, such as listings, options, or sales agreements; accordingly, such activity should be disclosed.

—(9) *Deductions and discounts.* This standard is designed to avoid having appraisals prepared using unrealistic assumptions. For federally related transactions, the subject property must always be valued in its "as is" condition as of the date of valuation. Further, appropriate deductions or discounts are to be made from an estimated retail or stabilized value to arrive at the market value as of the date of valuation identified in the appraisal. Unsold units or unleased space poses a significant risk to an owner, buyer, or lender. For this reason, the impact of such risks must be reflected in the market value estimate.

—(10) *Prohibited influences.* All appraisals are to be performed without pressure from someone who desires a specific value. Accordingly, every appraisal rendered in connection with a federally related transaction shall include a statement to the effect that employment of the appraiser was not conditioned upon the appraisal producing a specific value or a value within a given range. Similarly, future employment prospects should not be dependent upon an appraisal producing a specified value. Employment and compensation should not be based on whether a loan application is approved, as this, too, would exert pressure on an appraiser to render whatever appraisal is necessary for the loan to be approved.

—(11) *Self-contained appraisals.* This standard requires an appraisal to contain all information necessary to enable a reader of an appraisal to understand the appraiser's opinion. The appraisal should not incorporate by reference a document that is not readily

available to the reader. Studies prepared by a third party should be verified to the extent his or her assumptions or conclusions are used. In addition, the appraiser's acceptance or rejection of a third party study and its impact on value should be fully explained. The appraisal itself should enable the reader to understand the conclusion without having to refer to numerous other documents. Moreover, the conclusion must be reasonable in light of the information set forth in the appraisal. These requirements will force an appraiser to obtain adequate data before issuing an opinion of value.

—(12) *Legal description.* A legal description of the property is to be included in an appraisal so as to avoid confusion that may arise from less precise identification. This requirement enables a reader to compare the legal description in the appraisal to the legal description in the loan documents. The legal description is to be provided in addition to, and not in lieu of, the description required in the USPAP.

—(13) *Personal property, fixtures, and intangible items.* An appraisal is to include a separate assessment of personal property, fixtures, or intangible items that are attached to or located on real property if the personal property, fixture, or intangible item affects the market value of the real property. Furniture and fixtures should have separate valuations because their economic life is shorter than real property improvements and may require special lending or investment considerations. If the personal property, fixture, or intangible item is not a part of the transaction, then this fact should be stated and the impact on market value should be disclosed. Favorable loan financing or any business interest or other intangible item should be valued separately within the appraisal. These requirements will help provide a reader with a more complete understanding of the market value of the real property as it will be at the time the transaction is entered into.

—(14) *Use of recognized appraisal approaches.* At the request of clients, some appraisers have not prepared cost estimates of value, estimates of value based on the capitalization of income, or value estimates based on direct sales comparisons. This standard requires an appraiser to employ each of these recognized approaches to market value and explain how each approach was used. However, if one or more approaches cannot be used, an appraiser is to explain the elimination of any approach. This requirement is intended to produce appraisals made

only after the three major approaches to market value have been considered and reconciled, thereby improving the accuracy of the appraisal. Disclosure of the fact that an approach was not used will assist the reader in evaluating the adequacy of the appraisal.

(b) *Unavailability of information.* The Board realizes that some information required by the USPAP or this regulation to be in an appraisal may, on occasion, be unavailable. For example, historic rents will not exist for a building under construction at the time of appraisal. However, an appraisal should inform the reader of any material information that is unavailable and why such information could not be obtained, so as to assist the reader in reviewing the appraisal.

(c) *Additional standards.* The standards required by this regulation are the minimum standards to be met by every appraisal made in connection with a federally related transaction. However, the Board and regulated institutions may employ additional standards if circumstances so warrant.

Section 225.65—Appraiser independence. An appraiser's goal should be to produce an objective opinion about the market value of a property. This objectivity may be compromised if the appraiser is involved in the transaction, such as deciding whether to extend credit to be secured by such property. Similarly, a direct or indirect interest in the property appraised may undermine the accuracy of the appraisal. A direct interest would arise, for example, by owning all or part of property being appraised. An indirect interest would arise if, for example, an appraiser owns property adjacent to the parcel being appraised. This indirect interest would extend to any property whose value is likely to be affected by an appraisal, if the appraisal is the proximate cause for the effect. Moreover, the interest may be nonpecuniary, such as a desire to help an associate obtain a loan.

To further the goal of appraiser independence, the Board proposes to require that fee appraisers (that is, appraisers not permanently employed by a given regulated institution) be hired by a regulated institution or its agent rather than the borrower. In order to avoid potential conflicts of interest, staff appraisers (appraisers that are permanently employed by a regulated institution) should not be supervised, controlled, or influenced by loan underwriters, loan officers, or collection officers.

The Board recognizes that in certain cases it may be necessary for loan officers and directors to perform

appraisals. Such cases would depend on a bank's particular circumstances; an example would be a small rural bank where the only qualified individual to perform appraisals is a loan officer, and separating this person from the loan and collection departments is impossible. In such situations, the Board recommends that this individual perform appraisal work on loans in which he or she is not otherwise involved. In cases where loan officers or directors perform appraisals, regulated institutions are expected to ensure that the appraisers are qualified and that appraisal reports are adequate.<sup>13</sup> Directors and officers should abstain from any vote and/or approval involving assets on which they had performed an appraisal. In all, sufficient safeguards should be in place to permit appraisers to exercise independent judgment, thereby ensuring the validity of the appraisal process.

Section 225.66—Professional association membership; competency.

(a) *Membership in appraisal organizations.* The legislative history of title XI evidences an intent to prohibit discrimination against appraisers solely by virtue of membership or lack of membership in a particular appraisal organization.<sup>14</sup> Accordingly, this regulation prohibits any entity covered by Title XI from basing decisions regarding the employment of appraisers solely on membership or lack of membership in an appraisal organization. An institution should review the qualifications of appraisers rather than the qualifications of appraisal organizations to insure that a qualified individual is being employed. Membership in an organization may be considered; however, it may not be the sole determining factor in accepting or rejecting an appraiser.

(b) *Competency.* Not all appraisers are competent to perform every type of appraisal that will be needed in connection with federally related transactions. For instance, an appraiser who is experienced in appraising shopping centers may not possess sufficient expertise to appraise a golf course. A financial institution should look beyond an individual's title to determine if he or she has the experience and training needed to perform the appraisal. This provision is not intended to prohibit, in every circumstance, an individual from appraising a type of property with which

he or she is not familiar. However, in such instances, an appraiser may perform the appraisal only in accordance with the Competency Provision in the USPAP. In addition, an individual who is not a State certified or licensed appraiser may assist in the preparation of an appraisal if he or she is directly supervised by a licensed or certified appraiser (as appropriate), and the appraisal is approved and signed by a certified or licensed appraiser.

Section 225.67—Enforcement. Section 1120 of FIRREA vests the Board with the authority to bring an action for civil money penalties against a regulated institution within the agency's primary jurisdiction. The proposed regulation makes clear that additional enforcement remedies available to the Board under section 8 of the Federal Deposit Insurance Act also apply. These can include civil money penalties and cease and desist orders, as well as orders of removal and prohibitions against institutions and institution-affiliated parties. FIRREA specifically provides that "Institution-affiliated parties" includes, but is not limited to, appraisers.<sup>15</sup>

*Differences Between the Agencies.* The federal financial institutions regulatory agencies and the RTC have attempted to develop uniform regulations regarding the appraisal requirements for federally related transactions. However, the agencies and the RTC have proposed different approaches on the following points:

(1) *De minimis* test. The Board proposes not to require a State certified or licensed appraiser for real estate-related financial transactions having a transaction value less than or equal to \$15,000.

(2) Tier 1 capital. The Board proposes to adopt the definition of Tier 1 capital as set forth in appendices to the Board's Regulation H (for state member banks) and Regulation Y (for bank holding companies).

(3) Bridge banks operating under 12 U.S.C. 1821(n) and depository institutions operated by the FDIC or the RTC as receiver, liquidator, or conservator are not addressed in the Board's proposal.

#### Regulatory Flexibility Act Analysis

Title XI of FIRREA requires the Board to establish standards for performing appraisals in connection with federally related transactions within the Board's jurisdiction. In addition, title XI requires the Board to distinguish those transactions that require State certified

<sup>13</sup> It should be noted that directors and officers who perform appraisals in connection with federally related transactions must be licensed or certified, as appropriate.

<sup>14</sup> See, e.g., House Banking Committee Report at 484; see also H.R. Conf. Rep. No. 101-222, 101st Cong., 1st Sess., at 457 (1989).

<sup>15</sup> See FIRREA, section 204(f)(6) and 901(b)(1).

appraisers from those that require State certified or licensed appraisers. This proposed regulation is in response to this legislative mandate.

Title XI provides no exemption for small business entities. However, the Board has attempted to alleviate the economic impact on small businesses, including small regulated institutions, by not requiring a State certified or licensed appraiser for transactions in which (i) the transaction value is below the *de minimis* cutoff established in the regulation, or (ii) a lien on real estate is taken as collateral solely as an abundance of caution.

The Board invites comments on the costs and benefits of the proposed regulation with regard to the operation of depository institutions, the provision of real estate credit, the impact on loan losses, and the cost of appraisals.

The Board anticipates that the proposed regulation may increase, to some degree, costs for borrowers and member banks and bank holding companies of all sizes. However, increased costs should be mitigated by savings resulting from decreased loan losses. The cost increase may stem from at least two aspects of the rule. First, since member banks and bank holding companies are required to use certified or licensed appraisers, the cost of an appraisal may rise somewhat. Some borrowers may resist the increased appraisal cost and decide not to take out a loan secured by real estate. On the other hand, some banking organizations may elect to absorb all or a portion of any increased appraisal cost, thereby reducing lending profits. Second, the proposed regulation includes certain items that go beyond the Federal Reserve's existing appraisal guidelines. Those items could add to appraisal costs.

The Board also expects the proposed regulation to decrease costs to member banks and bank holding companies of all sizes. Such banking organizations will have better information about the value of the real estate involved in federally related transactions and can better ensure that each loan is collateralized adequately. As a result, the events of default should be reduced, with a correspondent reduction in loan losses. In addition, for those organization that already have strong appraisal policies or procedures that exceed minimum supervisory standards, the marginal costs of the proposed regulation should be limited. On balance, the Board believes that adoption of this proposal would not have a significant adverse economic impact on a substantial number of small business entities, in accordance with the

spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*).

#### List of Subjects

##### 12 CFR Part 208

Agricultural loan losses, Applications, Appraisals, Banks, Banking, Branches, Capital adequacy, Federal Reserve System, Flood insurance, Publication of reports of condition, Reporting and recordkeeping requirements, Securities, State member banks.

##### 12 CFR Part 225

Administrative practice and procedure, Appraisals, Banks, Banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

For the reasons set forth in this notice, the Board proposes to amend 12 CFR parts 208 and 225 as follows:

#### PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM

1. The authority citation for part 208 is revised to read as follows:

Authority: Sections 9, 11(a), 11(c), 19, 21, 25, and 25(a) of the Federal Reserve Act, as amended (12 U.S.C. 321-338, 248(a), 248(c), 461, 481-486, 601, and 611, respectively); sections 4 and 13(j) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1814 and 1823(j), respectively); section 7(a) of the International Lending Supervision Act of 1978 (12 U.S.C. 3105); sections 907-910 of the International Banking Act of 1983 (12 U.S.C. 3906-3909); sections 2, 12(b), 12(g), 12(i), 15B(c)(5), 17, 17A, and 23 of the Securities Exchange Act of 1934 (15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o-4(c)(5), 78q, 78q-1, and 78w, respectively); section 5155 of the Revised Statutes (12 U.S.C. 36) as amended by the McFadden Act of 1927; and sections 1101-1122 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (12 U.S.C. 3310 and 3331-3351).

2. Section 208.18 is added to read as follows:

##### § 208.18 Appraisal standards for federally related transactions.

The standards applicable to appraisals rendered in connection with federally related transactions entered into by member banks are set forth in subpart G of the Board's Regulation Y, 12 CFR part 225.

#### PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

1. The authority citation for Part 225 is revised to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1843(c)(8), 1844(b), 3106, 3108, 3907, and 3909; and sections 1101-1122 of the Financial Institutions Reform, Recovery and

Enforcement Act of 1989 (12 U.S.C. 3310 and 3331-3351).

2. Subpart G, consisting of §§ 225.61 through 225.67, is added immediately following Subpart F to read as follows:

#### Subpart G—Appraisal Standards for Federally Related Transactions

- 225.61 Authority, purpose, and scope.
- 225.62 Definitions.
- 225.63 Transactions requiring State certified or licensed appraiser.
- 225.64 Appraisal standards.
- 225.65 Appraiser independence.
- 225.66 Professional association membership; competency.
- 225.67 Enforcement.

#### Subpart G—Appraisal Standards for Federally Related Transactions

##### § 225.61 Authority, purpose, and scope.

(a) *Authority.* This subpart is issued by the Board of Governors of the Federal Reserve System (the "Board") under title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") (Pub. L. No. 101-73, 103 Stat. 183 (1989)).

(b) *Purpose and scope.* (1) Title XI provides protection for federal financial and public policy interests in real estate related transactions by requiring real estate appraisals used in connection with federally related transactions to be performed in writing, in accordance with uniform standards, by appraisers whose competency has been demonstrated and whose professional conduct is subject to effective supervision. This subpart implements the requirements of title XI, and applies to all federally related transactions entered into by the Board or by institutions primarily or exclusively regulated by the Board ("regulated institutions").

(2) This subpart:

- (i) Identifies which real estate-related financial transactions require the services of an appraiser;
- (ii) Prescribes which categories of federally related transactions shall be appraised by a State certified appraiser and which by a State licensed appraiser; and

(iii) Prescribes minimum standards for the performance of real estate appraisals in connection with federally related transactions under the jurisdiction of the Board.

##### § 225.62 Definitions.

(a) "Appraisal" means a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately described property as of a specific date(s), supported by the

presentation and analysis of relevant market information.

(b) "Appraisal Foundation" means the Appraisal Foundation established on November 30, 1987, as a not-for-profit corporation under the laws of Illinois.

(c) "Appraisal Subcommittee" means the Appraisal Subcommittee of the Federal Financial Institutions Examination Council ("FFIEC").

(d) "Complex 1-to-4 family residential property appraisal" means one in which the property to be appraised is atypical of its market. For example, atypical factors may include:

- (1) Age of improvements;
- (2) Architectural style;
- (3) Size of improvements;
- (4) Size of lot;
- (5) Neighborhood land use;
- (6) Potential environmental hazard liability;
- (7) Leasehold interests;
- (8) Limited readily available comparable sales data; or
- (9) Other unusual factors.

(e) "Federally related transaction" means any real estate-related financial transaction that:

- (1) The Board or any regulated institution engages in or contracts for; and
- (2) Requires the services of an appraiser.

(f) "Market value" means 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 is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- (1) Buyer and seller are typically motivated;
- (2) Both parties are well informed or well advised, and acting in what they consider their best interests;
- (3) A reasonable time is allowed for exposure in the open market;
- (4) Payment is made in terms of cash in United States dollars or in terms of financial arrangements comparable thereto; and
- (5) 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.

(g) "Real estate-related financial transaction" means any transaction involving:

- (1) The sale, lease, purchase, investment in or exchange of real property, including interests in real property, or the financing thereof; or

(2) The refinancing of real property or interests in real property; or

(3) The use of real property or interests in real property as security for a loan or investment, including mortgage-backed securities.

(h) "State certified appraiser" means any individual who has satisfied the requirements for State certification in a State or territory whose criteria for certification as a real estate appraiser currently meets the minimum criteria for certification issued by the Appraiser Qualifications Board of the Appraisal Foundation. No individual shall be a State certified appraiser unless such individual has achieved a passing grade upon a suitable examination administered by a State or territory that is consistent with and equivalent to the Uniform State Certification Examination issued or endorsed by the Appraiser Qualification Board of the Appraisal Foundation. In addition, the Appraisal Subcommittee must not have issued a finding that the State's policies, practices, or procedures are inconsistent with title XI of FIRREA. The Board may, from time to time, impose additional qualification criteria for certified appraisers performing appraisals in connection with federally related transactions within the Board's jurisdiction.

(i) "State licensed appraiser" means any individual who has satisfied the requirements for State licensing in a State or territory where the licensing procedures are consistent with Title XI of FIRREA and where the Appraisal Subcommittee has not issued a finding that the State's appraisal policies, practices, or procedures are inconsistent with title XI. The Board may, from time to time, impose additional qualification criteria for licensed appraisers performing appraisals in connection with federally related transactions within the Board's jurisdiction.

(j) "Tier 1 capital" means such capital for year-end 1992, as set forth in appendix A to part 208 of the Board's Regulation H for state-chartered banks that are members of the Federal Reserve System and in appendix A to part 225 of the Board's Regulation Y for bank holding companies. Tier 1 capital shall be calculated as of the date of the regulated institution's latest call report.

(k) "Tract development" means a project of five units or more that is constructed as a single development.

(l) "Transaction value" means:

- (1) For loans or other extensions of credit, the amount of the loan or extension of credit; and
- (2) For sales, leases, purchases, and investments in or exchanges of real

property, the market value of the real property involved.

#### § 225.63 Transactions requiring State certified or licensed appraiser.

(a) *Appraiser not required.* An appraisal performed by a State certified or licensed appraiser is not required for:

(1) Any real estate-related financial transaction in which the transaction value is \$15,000 or less; or

(2) Any real estate-related financial transaction in which a lien on real property has been taken as collateral solely through an abundance of caution and where the terms of the transaction as a consequence have not been made more favorable than they would have been in the absence of a lien.

(b) *Transactions requiring State certified appraiser.*

(1) All federally related transactions, other than those involving appraisals of 1- to 4-family residential properties, shall require an appraisal performed by a State certified appraiser.

(2) All appraisals of 1- to 4-family residential properties made in connection with federally related transactions shall require a State certified appraiser if:

(i) For federally related transactions entered into by the Board, the transaction value exceeds \$1,000,000; or

(ii) For federally related transactions entered into by regulated institutions, the transaction value exceeds:

- (A) 10 percent of the regulated institution's Tier 1 capital; or
- (B) \$1,000,000, whichever is less.

(3) All complex 1- to 4-family residential property appraisals rendered in connection with federally related transactions shall require a State certified appraiser. The regulated institution shall determine whether the property is complex and shall make available, if requested by the Board, appropriate evidence to support the determination.

(c) *Transactions requiring either a State certified or licensed appraiser.* All appraisals for federally related transactions not requiring the services of a State certified appraiser shall be performed by either a State certified appraiser or a State licensed appraiser.

#### § 225.64 Appraisal standards.

(a) *Minimum standards.* For federally related transactions, all appraisals as defined in § 225.62(a) of this subpart shall, at a minimum:

- (1) Conform to the current Uniform Standards of Professional Appraisal Practice ("USPAP") as adopted by the



Appraisal Foundation,<sup>16</sup> except that the Departure Provision of the USPAP shall not apply to federally related transactions;

(2) If appropriate, disclose any steps taken to comply with the Competency Provision of the USPAP;

(3) Be based upon the conditions specified in the definition of market value as set forth in § 225.62(f) of this subpart;

(4) Be written and presented in a narrative format, or on forms that satisfy all the requirements of this section, be sufficiently descriptive to enable the reader to ascertain the estimated market value and the rationale for the estimate, and provide detail and depth of analysis that reflects the complexity of the real estate appraised;

(5) Analyze and report in reasonable detail any prior sales of the property being appraised that occurred within the following time periods:

(i) For 1- to 4-family residential property, one year preceding the date when the appraisal was prepared; and

(ii) For all other property, three years preceding the date when the appraisal was prepared;

(6) Analyze and report data on current rents and current vacancies for the property if it is and will continue to be income-producing;

(7) Analyze and report a reasonable marketing period for the subject property;

(8) Analyze and report on current market conditions and trends that will affect projected income or the absorption period to the extent they affect the value of the subject property;

(9) Analyze and report appropriate deductions and discounts for:

(i) Any proposed construction;

(ii) Any completed properties that are partially leased or are leased at other than market rents as of the date of the appraisal; or

(iii) Any tract developments with unsold units;

(10) Include in the certification required by the USPAP an additional statement that the appraisal assignment was not based on a requested minimum

valuation, a specific valuation, or approval of a loan;

(11) Contain sufficient supporting documentation with all pertinent information reported so that the appraiser's logic, reasoning, judgment, and analysis in arriving at a final conclusion indicate to the reader the reasonableness of the market value reported;

(12) Include a legal description of the real estate being appraised in addition to the description required by the USPAP;

(13) Identify and separately value any personal property, fixtures, or intangible items that are not real property but are included in the appraisal, and discuss the impact of their inclusion or exclusion on the estimate of market value; and

(14) Follow a reasonable valuation method that addresses the direct sales comparison, income, and cost approaches to market value, and reconciles those approaches; if one or more approach cannot be used, explain the elimination of each approach not used.

(b) *Unavailability of information.* If information required or deemed pertinent to the completion of an appraisal is unavailable, that fact shall be disclosed and explained in the appraisal report.

(c) *Additional standards.* Nothing contained herein shall prevent a regulated institution from requiring additional appraisal standards if deemed appropriate.

#### § 225.65 Appraiser independence.

(a) *Staff appraisers.* If an appraisal is prepared by a staff appraiser, that appraiser must:

(i) Be independent of the lending, investment, or collection functions and not involved, except as an appraiser, in the federally related transaction; and

(ii) Have no direct or indirect interest, financial or otherwise, in the property.

If the only qualified persons available to perform an appraisal are involved in the lending, investment, or collection functions of the regulated institution, the regulated institution shall take appropriate steps to insure that the appraisers exercise independent judgment and that the appraisal is

adequate. Such steps include, but are not limited to, prohibiting an individual from performing an appraisal in connection with federally related transactions in which the appraiser is otherwise involved and prohibiting directors and officers from participating in any vote or approval involving assets on which they had performed an appraisal.

(b) *Fee appraisers.* If an appraisal is prepared by a fee appraiser, the appraiser shall be employed directly by the regulated institution or its agent, and have no direct or indirect interest, financial or otherwise, in the property or transaction.

#### § 225.66 Professional association membership; competency.

(a) *Membership in appraisal organizations.* A State certified appraiser or a State licensed appraiser may not be excluded from consideration for an assignment for a federally related transaction solely by virtue of membership or lack of membership in any particular appraisal organization.

(b) *Competency.* All staff and fee appraisers performing appraisals in connection with federally related transactions must be State certified or licensed, as appropriate. However, a State certified or licensed appraiser may not be considered competent solely by virtue of being certified or licensed. Any determination of competency shall be based upon the individual's experience and educational background as they relate to the particular appraisal assignment for which he or she is being considered.

#### § 225.67 Enforcement.

Institutions and institution-affiliated parties, including staff appraisers and fee appraisers, may be subject to removal and/or prohibition orders, cease and desist orders, and the imposition of civil money penalties pursuant to Section 8 of the Federal Deposit Insurance Act, 12 U.S.C. 1818, as amended.

Board of Governors of the Federal Reserve System, February 5, 1990.

William W. Wiles,

Secretary of the Board.

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BILLING CODE 6210-01-M

<sup>16</sup> Amendments to the USPAP made after the effective date of a final rule shall apply to federally related transactions unless disapproved in writing by the Board.