

FEDERAL RESERVE BANK OF NEW YORK

NEW YORK, N.Y. 10045

AREA CODE 212 720-5545

FREDERICK C. SCHADRACK
EXECUTIVE VICE PRESIDENT

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January 13, 1988

TO THE CHIEF EXECUTIVE OFFICERS OF ALL STATE
MEMBER BANKS AND BANK HOLDING COMPANIES
IN THE SECOND FEDERAL RESERVE DISTRICT

SUBJECT: Guidelines for Real Estate Appraisal
Policies and Review Procedures

The three federal bank regulatory agencies have jointly adopted guidelines for real estate appraisal policies and review procedures. The guidelines reaffirm the agencies' long-standing policies on real estate appraisals and emphasize the importance of sound appraisal policies and practices.

Specifically, the guidelines make clear that directors must ensure that their organizations' written lending policies and procedures include a well-defined and effective appraisal program; that examiners will review each organization's appraisal policies and procedures when they review individual credits; that organizations are expected to obtain appraisals by independent, qualified appraisers which reflect current market conditions at the inception of a loan and during its life; and that the absence of fair market appraisals may be considered an unsafe and unsound banking practice.

Enclosed is the text of the guidelines. If you have any questions regarding this matter, please contact Gerald P. Minehan, Assistant Chief Examiner, Multinational Banking Department (Tel. No. 212-720-5881), or Gregory K. Carroll, Supervising Bank Examiner, Multinational Banking Department (Tel. No. 212-720-5887).

Sincerely,

Frederick C. Schadrack

Enclosure

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
FEDERAL DEPOSIT INSURANCE CORPORATION
OFFICE OF THE COMPTROLLER OF THE CURRENCY

GUIDELINES FOR REAL ESTATE APPRAISAL POLICIES
AND REVIEW PROCEDURES

PURPOSE

These guidelines remind bank boards of directors and managements of the importance of sound real estate appraisal policies and procedures and reaffirm supervisory policies regarding acceptable appraisal practices.

BACKGROUND

Analyzing real estate collateral at a loan's inception and over its life requires a sufficient understanding of the appraisal process and report to identify inconsistencies or irregularities in the valuation of real property. While the appraisal plays an important role in the loan approval process, undue reliance should not be placed upon the collateral value in lieu of an adequate assessment of the borrower's repayment ability. However, when a credit becomes troubled, the primary source of repayment often shifts from the borrower's capacity to repay to the value of the collateral. For these reasons, it is important that banks have sound appraisal policies and procedures.

APPRAISAL STANDARDS

The objective of an appraisal report is to communicate the appraiser's reasoning and conclusions in a logical manner so that the reader is led to the appraiser's estimation of market value. The contents of appraisal reports should generally conform to the accepted and established professional standards of the nationally recognized professional appraisal organizations. The form, length and content of appraisal reports may vary, depending on the type of property being appraised and the nature of the assignment. Therefore, appraisals should:

- Be performed by a qualified, independent staff or fee-paid appraiser selected by the bank who is competent and knowledgeable of relevant markets. An independent appraisal is one in which the appraiser is not involved in the lending and collection functions and has no interest, financial or otherwise, in the property.
- Result in a market value as defined by the major appraisal associations.

- Follow a reasonable valuation method which addresses all recognized approaches to market value unless the appraiser fully explains and documents the elimination of an approach.
- Support the current valuation of the real estate. All assumptions and projections should be supported and conform to current market conditions. In the case of income property, the capitalization rate, discount rate, net income and/or loss projections, cash flow, financing terms, and absorption rate should be reasonable.
- Document and explain how discount and capitalization rates used in generating present value estimates were derived.
- Take into consideration and make provision for all appropriate deductions and discounts for any development-type property.
- Include a sales history analysis in cases where values have increased significantly over a short period of time.
- Address a proposed project's marketability and feasibility prospects. Studies prepared by a party other than the appraiser must be verified to the extent assumptions are utilized. The appraiser's acceptance or rejection of the third party study and its impact on value must be fully explained.

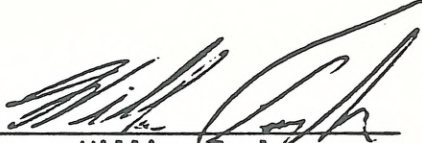
BANK APPRAISAL POLICIES AND PROCEDURES

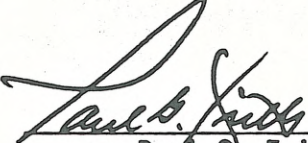
The board of directors has the responsibility to ensure that a bank's written lending policy includes a well-defined and effective appraisal program. The program should include acceptable standards regarding appraiser qualifications and independence; ensure adequate appraisals are obtained and proper appraisal procedures are followed; and include a process for reviewing new appraisal reports for adequacy and for ordering reappraisals where needed. The need for reappraisals should receive particular attention in the case of loan renewals, extensions and problem credits. Nonproblem credits with amortizing repayment programs may need to be included in the review procedures in certain circumstances. For example, deteriorating economic conditions in an overbuilt area may prompt a bank to conduct an overall review of its real estate collateral. Or, as an audit procedure, the bank may reappraise a sample of properties to compare the results to the original appraisal reports to identify overvaluation of collateral or unsatisfactory appraisers.

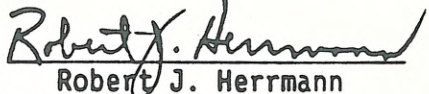
SUPERVISORY POLICY

A bank's appraisal policies and procedures will be reviewed as part of the examination of an institution's overall lending activities. When analyzing individual credits, examiners will review appraisal reports to determine that the appraiser's methods, assumptions, findings and conclusions are reasonable.

Significant failures to meet standards and procedures as outlined above will be criticized and corrective action required. In addition, inadequate appraisal procedures may be considered an unsafe and unsound banking practice if the failure to accurately reflect the value of assets on a timely basis misrepresents the bank's financial condition. In this situation, the institution of formal corrective measures will be pursued as appropriate.


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