

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **10362**]
July 24, 1990]

REAL ESTATE APPRAISAL STANDARDS
Amendments to Regulations H and Y

*To All State Member Banks and Bank Holding Companies
in the Second Federal Reserve District, and Others Concerned:*

The following statement has been issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board has announced approval of amendments to Regulation H (Membership of State Banking Institutions in the Federal Reserve System) and Regulation Y (Bank Holding Companies and Change in Bank Control) to implement provisions in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) regarding real estate appraisal standards.

The amendments are designed to protect Federal financial and public policy interests in real estate transactions requiring the services of an appraiser.

The amendments identify which transactions require an appraiser, set forth minimum standards for performing appraisals, and distinguish those appraisals requiring the services of a State-certified appraiser from those requiring a State-licensed appraiser.

The effective dates are August 9, 1990 for the appraisal standards, and July 1, 1991 for the appraiser certification and licensing requirements.

Enclosed is the text of the Board's official notice, including the text of the amendments, as published in the *Federal Register* of July 5. Questions on this matter may be directed to Albert Toss, Assistant Chief Examiner, of our Domestic Banking Department (Tel. No. 212-720-5895).

E. GERALD CORRIGAN,
President.

Federal Reserve

Thursday
July 5, 1990

Part II

Federal Reserve System

12 CFR Parts 208 and 225
Appraisal Standards for Federally Related
Transactions; Final Rule
(Amendments to Regulations H and Y)

[Enc. Cir. No. 10362]

FEDERAL RESERVE SYSTEM

12 CFR Parts 202 and 225

[Regulation H, Regulation Y; Docket No. R-0685]

Appraisal Standards for Federally Related Transactions

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: Title XI of the Federal Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA")¹ requires the Board to adopt regulations regarding the performance and utilization of appraisals by state member banks, bank holding companies, and nonbank subsidiaries of 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 regulation, and similar regulations adopted by the other financial institutions regulatory agencies² and the Resolution Trust Corporation ("RTC"), provide affected parties with added assurance that real estate appraisals used in connection with federally related transactions 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 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: *Effective Date:* August 9, 1990.

Compliance Dates: Appraisals performed in connection with federally related transactions are to comply with the standards set forth in this regulation by August 9, 1990. State certified or licensed appraisers, as appropriate, must be used for federally related transactions by July 1, 1991, unless this deadline is extended by the Appraisal Subcommittee of the Federal Financial Institutions Examination Council for a given state pursuant to provisions of title XI. Appraisals for real estate-related financial transactions entered

into before August 9, 1990, do not have to comply with the standards of this regulation; moreover, sales of loans that were originated before August 9, 1990, will not require an appraisal to be performed in accordance with this regulation. A transaction will be deemed entered into and a loan will be deemed originated if there is a binding commitment to perform before the effective date of this regulation.

FOR FURTHER INFORMATION CONTACT:

Roger T. Cole, Assistant Director (202/452-2618), Stanley B. Rediger, Senior Financial Analyst (202/452-2629), or Virginia M. Gibbs, Senior Financial Analyst (202/452-2521), Division of Banking Supervision and Regulation; or Michael J. O'Rourke, Senior Attorney (202/452-3288) or Mark J. Tenhundfeld, Attorney (202/452-3612), Legal Division. 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 and those that require a State certified or licensed appraiser. In response to this legislative mandate, the Board has adopted 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 has required 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, (ii) the transaction value (as defined in the proposed regulation) is less than or equal to \$100,000, (iii) the transaction involves a lease that is not the economic equivalent of a purchase or sale; (iv) there is a transaction resulting from a maturing extension of credit under certain circumstances; and (v) there is an acquisition of interests in loans that complied with this regulation. The Board, acting pursuant to section 1112 of FIRREA, has identified which categories of federally related transactions will require a State certified appraiser and

which will require a State licensed appraiser.

In addition, the Board has adopted standards, pursuant to section 1110 of FIRREA, for the performance of appraisals in connection with federally related transactions within the Board's jurisdiction. As mandated by title XI, these standards require that all such appraisals be written and that they conform to the Uniform Standards of Professional Appraisal Practice ("USPAP") promulgated by the Appraisal Standards Board of the Appraisal Foundation.³ Further, the Board has adopted additional standards set forth in this regulation.

This regulation is intended to supplement the Board's appraisal guidelines⁴ currently in effect. These guidelines continue to remain in effect, subject to amendment.

The Board has adopted 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, this regulation, coupled with existing guidance on real estate appraisals, 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.

The appraisal standards set forth herein are required to be effective not later than August 9, 1990. As indicated above, title XI mandates that these standards require compliance with, at a minimum, the USPAP. The Board is awaiting final revisions to relevant provisions of the USPAP, which are currently being prepared by the Appraisal Standards Board. Upon receipt of these changes, the Board intends to solicit comment on the revised USPAP in order to collect the broadest possible comment regarding appraisal standards for federally related transactions, including those standards incorporated by reference. Upon receipt of those comments, the Board thereafter

¹ Pub. L. No. 101-73, 103 Stat. 163 (1989); 12 U.S.C. 3310, 3331-3351.

² 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 ("NCUA").

³ 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.

⁴ See *Guidelines for Real Estate Appraisal Policies and Review Procedures*, S.R. 87-42 (FIS), adopted by the various divisions of bank supervision at the FDIC, the OCC, and the Board.

may propose amendments to this regulation, should it be deemed appropriate.

B. Comments

On February 6, 1990 (55 FR 4810 (February 9, 1990)), the Board issued for comment proposed rules to implement title XI of FIRREA. The Board received 206 comments from interested individuals and organizations. The principal issues raised by the comments are discussed below. In addition, the ensuing section-by-section analysis addresses many of the specific concerns raised by the comments.

Section 225.61 Authority, Purpose, and Scope

A few commenters suggested that title XI of FIRREA does not specifically authorize the Board to prohibit a regulated institution from selecting an appraiser solely on the basis of membership or lack of membership in an appraisal organization. The Board believes that this provision is consistent with both the letter and the spirit of title XI. Moreover, the Board believes that the safety and soundness of regulated institutions is advanced by this provision. To emphasize this point and to provide an additional authority for this requirement, the Board has amended this section to include a citation to the provisions granting the Board general supervisory authority over State member banks, bank holding companies, and nonbank subsidiaries of bank holding companies.

Section 225.62 Definitions

The Board received a significant number of comments on the following definitions.

"Complex 1-to-4 residential property appraisal." Thirty-four comments raised concerns about this definition. Of these, nine suggested that an appraiser would be required in order to determine whether a given appraisal is complex. Many were concerned that the list of factors suggested in the definition would result in virtually all appraisals being deemed complex. Several others were concerned that the list was too subjective, and that a regulated institution might be found to have violated the rule because an examiner disagreed with the institution's determination. Three people suggested that the Board should eliminate the concept and focus solely on the value of the property, while others suggested the elimination or deletion of various proposed factors.

In response to these comments, the Board has amended this definition. Under the final rule, an appraisal will be

deemed to be complex if the property to be appraised, the form of ownership, or market conditions are atypical. The list of factors that might make an appraisal complex has been moved to the preamble to emphasize that this list is only illustrative. Moreover, the Board has adopted a presumption that appraisals of 1-to-4 family residential property will be non-complex if the transaction value is less than \$1,000,000. However, as discussed more fully below, the regulated institution maintains the ultimate responsibility for determining whether a given appraisal is complex. Finally, appraisals of any type of property rendered in connection with a transaction having a transaction value less than \$250,000 may be performed by a competent licensed appraiser.

"Federally related transaction." Several comments requested that various transactions not be subject to this regulation, because by their nature the transactions would not require the services of an appraiser. As noted below, the Board has expanded the circumstances when a certified or licensed appraiser will not be required, thereby excluding the affected transactions from the definition of "federally related transaction." However, the Board has not amended this definition, which was derived from title XI, in order to remain fully consistent with the intent of the statute.

"Market value." Five people commented on this definition. Several suggested changes to the definition to allow for a going concern value or consideration of favorable financing or special value to a specific user. The remaining comments recommended that market value should be calculated as of the date of consummation, and that the footnote in the preamble should be inserted into the text of the regulation.

The Board believes that this definition, which is widely accepted by mortgage lenders and many government agencies, requires no amendment. The proposed amendments relating to going concern value or consideration of other factors may contribute to a misleading or inaccurate appraisal.

"Real estate-related financial transaction." Several comments suggested that certain transactions not be considered "real estate-related financial transactions," including a refinancing by the same institution, an extension of balloon payments not related to the borrower's inability to repay, and the taking of real estate collateral to protect a bank against losses stemming from credit extended to unrelated third parties. Four comments recommended that "other real estate owned" property be exempt.

The Board agrees that certain transactions do not require the services of an appraiser, as discussed below. However, the Board believes that this definition, which was taken from title XI, is consistent with the intent of the statute. Accordingly, the Board has not amended this definition.

"State certified appraiser." One commenter pointed out that certification criteria will be adopted by the Appraisal Qualifications Board of the Appraisal Foundation. The Board has amended this definition accordingly.

"Transaction value." A comment requested clarification on the transaction value of an interest in pooled loans or mortgage-backed securities. The Board has amended the regulation to provide that this definition applies to each loan in a pool, but not to the pool itself. In addition, the Board has clarified that a purchase of a loan or interest in a loan will not require an appraisal of the property that serves as collateral, provided that the property was appraised in conformance with this regulation. As a consequence, a regulated institution purchasing an interest in a pool will not require each property securing a loan to be reappraised. However, if a regulated institution intends to purchase a pool of loans that do not have conforming appraisals, then appraisals will have to be performed on the nonconforming underlying real estate collateral prior to the purchase. In such instances, the transaction values will be the individual amounts of the loans, not the aggregate amount of the pool.

Section 225.63 Appraisals Not Required; Transactions Requiring a State Certified or Licensed Appraiser

(a) Appraisals not required.

De minimis test. The comment received most often was a request that the Board raise the *de minimis* figure below which an appraisal performed by a certified or licensed appraiser would not be required. Sixty-five comments requested that the Board raise this figure, with suggested cutoffs ranging from \$25,000 to \$250,000. The figure most often suggested was \$100,000. Twenty-three commenters stated that, in their experience, very few losses could be attributed to improper or fraudulent appraisals of real estate rendered in connection with transactions having a transaction value below the range of *de minimis* amounts proposed.

An argument consistently raised by these commenters was that the increased protection afforded by appraisals would not outweigh the burdens on the regulated institutions

and their customers for comparatively small transactions. Several noted that the proposed rule would have a disproportionate impact on small businesses and people with low and moderate incomes.

In response to these comments, and after consultation with the other financial institutions regulatory agencies and the RTC, the Board has raised the *de minimis* amount to \$100,000. However, the Board has required that transactions falling below this amount (and other transactions not requiring a State certified or licensed appraiser) must comply with the existing inter-agency guidelines regarding appraisals. The Board believes that the \$100,000 *de minimis* figure is appropriate both in light of the absence of evidence that transactions below \$100,000 have posed systemic risks as well as the protections afforded to individual regulated institutions by the inter-agency appraisal guidelines.

Another forty comments proposed alternatives to the *de minimis* test, including exempting transactions if the ratio of the loan amount to the value of collateral was sufficiently small, setting higher *de minimis* cutoffs based on the strength of the institution in question, and exempting either small towns or certain types of transactions altogether. The Board considered the advantages of the alternatives proposed, but has concluded that each presents significant problems. For instance, an appraisal would be necessary in many cases before one could accurately determine the loan-to-value ratio. In addition, an exemption of small towns or certain types of institutions appears to go beyond the intent of title XI. The Board believes that the increased *de minimis* amount addresses many of the concerns underlying such suggestions.

Abundance of caution. A few comments requested clarification of this term. The Board has not amended the regulation, but has clarified in the preamble that this exception is to be applied only in those circumstances where the terms of a transaction have not been made more favorable than they would have been in the absence of a lien on real property.

Leases. Several comments suggested that an appraisal should not be required for many leases. The Board agrees that significant losses arising from leases are likely to occur primarily with leases that are the economic equivalent of the purchase of real estate. Accordingly, the Board has added leases that are not equivalent to a purchase as a category of transactions not requiring the services of a State certified or licensed appraiser.

Renewals, refinancings, etc. A few comments requested the Board to exempt renewals of performing loans from the requirements of the regulation. The Board believes that many such transactions do not require reappraisals, and thus has amended the regulation to exempt transactions resulting from maturing extensions of credit under certain circumstances. This amendment is likely to lessen the burden of complying with this regulation without adding any significant degree of risk.

Purchases of interests in real estate loans. As noted above, the Board received requests for clarification on how the regulation applies to the purchase of interests in real estate loans, such as the purchase of a pool of loans. The Board believes that such purchases should not require additional appraisals on the underlying real estate collateral. Thus, the Board has exempted such transactions from the regulation, provided that the loans being purchased were supported by appraisals conforming to this regulation.

(b) *Transactions requiring State certified appraisers.* Forty-one comments were received related to this subsection. Many of these comments suggested that certified appraisers would be in short supply, particularly in rural areas, and that regulated institutions would have to hire someone from another town or city who might not be familiar with the local market. Others stated that the Board should allow licensed appraisers to appraise some commercial property. A few comments maintained that the proposed Tier 1 test would place smaller institutions at a competitive disadvantage. Others noted that title XI requires a certified appraiser only when the size, complexity, and type of transaction so warrants, and requested greater flexibility in using licensed appraisers for complex appraisals rendered in connection with small transactions.

In response to these comments, the Board has amended the provision governing when State certified appraisers are required. Under the revised rule, a certified appraiser will be required in three instances: First, for all transactions having a transaction value of \$1,000,000 or more; second, for transactions involving an interest in real estate other than a 1-to-4 family residence, if the transaction value is \$250,000 or more; and third, for transactions involving an interest in 1-to-4 family residential real estate if the transaction value is \$250,000 or more and the appraisal is complex.

As noted above, the Board also has established a presumption that

appraisals of 1-to-4 family residential properties are non-complex. Procedures are provided for completing an appraisal inappropriately begun by a licensed appraiser.

(c) *Transactions requiring either a State certified or licensed appraiser.* Consistent with the changes outlined above, licensed or certified appraisers will be permitted to perform all appraisals rendered in connection with a transaction having a transaction value less than \$250,000, and for all non-complex appraisals of 1-to-4 family residential properties if the transaction value is below \$1,000,000.

Section 225.64 Appraisal Standards.

(a) *Minimum standards.* (1) *Compliance with USPAP; departure provision.* Several comments expressed concern that the Appraisal Foundation is not representative of the entire appraisal industry, and thus the Board should not adopt the Appraisal Foundation's standards. Two others questioned whether the public has had an adequate opportunity to comment on the standards set forth in the USPAP. Six comments requested that the Board allow the use of the Departure Provision in the USPAP for federally related transactions.

The Board's rule requires compliance with the USPAP and additional standards established by the Board. This is consistent with the requirement of title XI that institutions regulated by the Board must have appraisals that conform, at a minimum, to the USPAP for all federally related transactions. Thus, the Board has not deleted the reference to the Appraisal Foundation, although the Board has clarified that the standards have been adopted by the Appraisal Standards Board of the Appraisal Foundation.

As noted above, the Appraisal Standards Board of the Appraisal Foundation currently is revising the USPAP. Upon completion of the revisions to the USPAP standards that are relevant to federally related transactions, the Board will solicit public comment on those revised standards, and may amend this regulation in response to comments received.

For the reasons stated in the section-by-section analysis of the appraisal standards, the Board remains of the opinion that the Departure Provision in the USPAP is inconsistent with the intent of title XI, and therefore has not amended this part of the standard.

(5) *Prior sales history.* One comment recommended that disclosure of prior sales of a given property be required

only if this information is reasonably available. The Board believes that this information is vital to an accurate understanding of the appraisal, and has not amended this standard.

(6) *Revenues, expenses, and vacancies.* The Board received a comment requesting that an appraiser be allowed to use projected future rents and vacancies in determining market value. The Board believes that such projections may result in an inaccurate or misleading appraisal, and therefore has not amended the regulation. Another comment suggested that the Board also require an analysis of current expenses as well as revenues and vacancies. The regulation has been changed to incorporate this suggestion. Finally, the term "rents" has been changed to "revenues" to clarify that income may be generated from sources other than rents.

(9) *Deductions and discounts.* Five commenters expressed their concern that requiring an "as is" value of the appraised property would severely restrict the ability of a regulated institution to make construction loans. The Board has clarified in the preamble discussion of this standard that an "as is" value is only one component of an appraisal, and that it is necessary to enable the regulated institution to adequately protect its interests under differing scenarios.

(12) *Legal description.* Two comments sought clarification on how to define "legal description." The Board has amended the preamble to this standard to clarify that the description contained in a deed is sufficient.

(13) *Personal property, fixtures, and intangible items.* The Board received one comment requesting that an appraiser not be required to value personal property that is located on the real estate. The Board remains of the view that certain items of personal property may affect the market value of real estate, and therefore has not amended this standard.

(14) *Use of recognized appraisal approaches.* A few comments stated that it is unnecessary to use all three recognized approaches for every appraisal. The Board agrees with these comments, and has amended the preamble language to clarify that a given approach may be inapplicable for a particular appraisal. However, the standard still requires an appraiser to explain why an approach was not used.

Section 225.65 Appraiser Independence

Twenty-one comments raised questions concerning this provision. Four stated that complete separation of

in-house appraisers from loan officers is impossible in small banks. Another four comments suggested that a bank should be allowed to decide when to use in-house appraisers, while several others proposed that in-house appraisers should be allowed for transactions with values up to suggested limits. Two others requested that banks be allowed to provide a customer with a list of preapproved appraisers and let the borrower select the appraiser. Several requested that the borrower be allowed to hire the appraiser. Other comments requested that an appraisal performed for one regulated institution be able to be used by another institution.

Several comments requested that the Board require greater separation than the proposed rule required. Two suggested that a bank not be allowed to pay bonuses based on loan production. One recommended that individuals who are vested with the authority to hire, discipline, or promote staff appraisers should not be appointed by individuals who are involved in the lending, investment, or collection function.

The Board agrees that a borrower who has contacted several banks about obtaining a loan should not have to pay for different appraisals prepared at the request of the lending institutions. For this reason, the Board has amended the provision regarding fee appraisers to permit an appraisal to be used by more than one regulated institution under certain circumstances. However, the Board has not made any additional amendments to this provision. The Board recognizes that different regulated institutions may comply with this standard in differing ways. For instance, one institution may engage fee appraisers to perform all appraisals, while another may establish a separate in-house department. The Board also recognizes that in certain instances creating an in-house appraisal department is not feasible, and in such instances the Board allows the separation of the appraisal and lending functions in a manner best suited to a particular institution. The Board believes that this section provides regulated institutions with enough flexibility to design solutions that will comply with the regulation while not having to implement any one structure. Accordingly, the Board has not otherwise amended this provision.

Section 225.66 Membership in Appraisal Organizations

As noted above, the Board received a number of comments questioning whether title XI empowered the financial institution regulatory agencies to preclude hiring based solely on

membership or lack of membership in a particular appraisal organization. The Board believes that this subsection of the regulation properly implements the protections provided by section 1122(c) of FIRREA. Moreover, the Board believes that the safety and soundness of regulated institutions is best protected by requiring an institution to look beyond the designation of an individual to his or her education and experience when determining competency. Accordingly, this provision has not been amended.

C. 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 regulated by the Board ("regulated institutions"), which must comply with the regulation. State member banks, bank holding companies, and nonbank subsidiaries of bank 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.⁵

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 Board deems a "complex 1-to-4 family residential property appraisal" to be one in which the property to be appraised, form of ownership, or market conditions are atypical. Examples of atypical factors may include age of improvements, architectural style, size of improvements, size of lot, neighborhood land use, potential environmental hazard liability, leasehold interests, or other unusual factors. This list is illustrative only.

—"Market value." This definition is commonly used in connection with

⁵ 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).

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.⁶

—“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 comply with the intent of Congress.

—“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 Qualifications Board of 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 and equivalent to the Uniform State Certification Examination issued or endorsed by the Appraisal Foundation. The final regulation 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.

—“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 appraisals that comply with this regulation.

As with State certified appraiser criteria, the Board is authorized to impose additional licensing requirements. Moreover, as noted above 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.

—“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. A project will be deemed to be a tract development if it is currently, or is intended to be, offered for sale as a single development.

“Transaction value.” This definition is used to determine in part which transactions require a State certified appraiser and which require a State licensed appraiser. The Board will consider a series of related transactions as one transaction if it appears that a regulated institution is attempting to evade the requirements of title XI of FIRREA or this regulation.

Section 225.63 Transactions Requiring State Certified or Licensed Appraiser

(a) *Appraisal 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 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. Collateral will be deemed to be taken in an abundance of caution where the loan terms as a consequence have not been made more favorable than they would have been in the absence of the lien. Accordingly, this exception is intended to have very limited application. In addition, the Board does not require a State certified or licensed appraiser for real estate-related financial transactions having a transaction value less than or equal to \$100,000.

A third instance where a State certified or licensed appraiser is not required is a lease that is not the economic equivalent of a purchase or sale of real estate. An example of such a lease is a sublease by a bank of a portion of its premises to an unrelated third party. On the other hand, an assignment of a lease as collateral for the extension of credit would be an example of the economic equivalent of a purchase or sale.

Fourth, the Board will not require a State certified or licensed appraiser for transactions resulting from a maturing extension of credit, provided that the borrower has made all scheduled payments under the note, no new funds are advanced, the borrower remains creditworthy, and the market conditions and collateral have not significantly deteriorated.

Finally, a State certified or licensed appraiser will not be required if a regulated institution purchases an interest in property or in a loan secured by real property if the property has been appraised in accordance with this regulation. If the property was not adequately appraised, then the

⁶ 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.

regulated institution must order an appraisal for that property.

Any real estate-related financial transaction that does not require a State certified or licensed appraiser still will have to comply with the Board's Guidelines for Real Estate Appraisal Policies and Review Procedures (the "Guidelines"), if applicable. The Board expects that such transactions will be supported by evaluations of real estate collateral in a manner that is consistent with safe and sound banking practices. Determinations regarding when a regulated institution shall require a reappraisal, updated appraisal, or new appraisal of property are governed by the Guidelines. These Guidelines identify concerns relevant to making such a determination.

(b) *Transactions requiring State certified appraiser.* Title XI requires a State certified appraiser to be used if the size of the transaction and the complexity of the appraisal warrants the expertise of the State certified appraiser. The Board's regulation requires a State certified appraiser to be used in three instances. First, all appraisals rendered in connection with federally related transactions having a transaction value of \$1,000,000 or more require a State certified appraiser, regardless of complexity. Second, all federally related transactions having a transaction value equal to or greater than \$250,000, except those involving appraisals of 1-to-4 family residential properties, require a State certified appraiser. Third, 1-to-4 family residential property appraisals require a State certified appraiser if the transaction value is \$250,000 or more and the appraisal will be complex.

Before hiring an appraiser, the institution should assess the property to determine the qualifications that an appraiser will need to complete the appraisal assignment and whether the transaction, due to its complexity, would require a certified appraiser. A regulated institution may presume that appraisals of 1-to-4 family residential property are not complex, unless the institution has readily available information that a given appraisal will be complex. Such information may be provided, for instance, on a loan application. If a licensed appraiser discovers during the assignment that the appraisal is complex or beyond the appraiser's expertise, then he or she is required to disclose this situation to the institution and take the necessary action to remedy the deficiency. A certified appraiser could then be employed or the licensed appraiser could complete the appraisal and have a certified appraiser review and co-sign the appraisal report.

(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 any federally related transaction having a transaction value up to, but not including, \$250,000. In addition, State licensed appraisers may perform appraisals of 1-to-4 family residential property for transactions with a value up to, but not including, \$1,000,000 if the appraisal will not be complex.

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 Standards Board of 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. This section includes the minimum standards set forth in the statute, while listing additional standards 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,⁷ and have been cited repeatedly in the legislative history of title XI.⁸ The Board has adopted the following standards to further the intent of title XI in addressing these problems. These standards are designed to contribute to safe and sound banking practices by requiring reliable appraisals.

(1) *Compliance with USPAP; departure provision.* This standard requires compliance with the USPAP, and clarifies that the Departure Provision⁹ in the USPAP is inapplicable

⁷ 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).

⁸ See, e.g., 135 Cong. Rec. S4004 (daily ed. April 17, 1989) (statement of Sen. Dodd); H.R. Rep. No.

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 Provision 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;¹⁰ 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 could allow for the omission of data that should be included in developing and reporting appraisals rendered in connection with federally related transactions and, therefore, has determined that the Departure Provision shall not apply to such appraisals.

The Board (or other appropriate body) will solicit comment on any revisions to the USPAP that are relevant to federally related transactions. Changes to the USPAP made after the date this regulation is published shall not be applicable to federally related transactions until there has been notice of the changes and the opportunity for interested persons to comment.

(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

100-1001, 100th Cong. 2d Sess. pt. 1, at 19, 21-26; 133 Cong. Rec. H10709 (daily ed. Nov. 20, 1987) (statement of Conq. Barnard); 132 Cong. Rec. H3452 (daily ed. June 6, 1986) (statement of Conq. Barnard).

⁹ 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]."

¹⁰ 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.

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 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 regulation. Regardless of the format selected, the appraisal must be able to 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 reader of an appraisal to compare an appraiser's opinion of a property's market value with recent sales prices. In addition to giving the reader a basis by which to evaluate the accuracy of the subject property appraisal, it also will assist the reader 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 in view of (i) the typically lower frequency of turnover of such properties and (ii) the fact that 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) *Revenues, expenses, 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 predicated upon current revenues, expenses, and vacancies for properties 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 revenues 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, an appraisal is to include, among other values, an "as is" value; this is the value of the property in its current physical condition and subject to the zoning in effect as of the date of the appraisal. For properties where improvements are to be constructed or rehabilitated, the regulated institution may also request a value based on stabilized occupancy or a value based on the sum of retail sales. However, the sum of retail sales for a proposed development is not the market value of the development. For proposed developments that involve the sale of individual houses, units, or lots, the

appraiser must analyze and report appropriate deductions and discounts for holding costs, marketing costs and entrepreneurial profit. For proposed and rehabilitated rental developments, the appraiser must make appropriate deductions and discounts for items such as leasing commissions, rent losses, and tenant improvements from an estimate based on stabilized occupancy.

(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. The description of real property contained in a deed will satisfy this requirement. 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 may be 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 address each of these recognized approaches to market value. If in the judgment of the appraiser one or more approaches is not appropriate, then the appraiser is to explain the decision to use a particular approach. This requirement is intended to produce appraisals made only after the three major approaches to market value have been considered and (where appropriate) 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 USPA 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, 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 requires that fee appraisers (that is, appraisers hired by a regulated institution for a particular appraisal assignment) be hired by a regulated institution or its agent rather than the borrower. An appraisal performed at the request of one regulated institution may be used by another if the latter institution has adequately reviewed the appraisal, documented such review, and found the appraisal to have complied with this regulation. In order to avoid potential conflicts of interest, staff appraisers (appraisers that are employees of a regulated institution) should not be supervised, controlled, or influenced by loan underwriters, loan officers, or collection officers within the institution.

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, this individual should perform appraisals only of real property serving as collateral for loans with 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.¹¹

¹¹ It should be noted that directors and officers who perform appraisals in connection with federally related transactions must be licensed or certified, as appropriate.

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.¹² 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 designation or affiliation 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

¹² 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).

action for civil money penalties against a regulated institution within the agency's primary jurisdiction. The regulation makes clear that additional enforcement remedies also are available to the Board under the Federal Deposit Insurance Act and other applicable statutes. 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 the phrase "institution-affiliated parties" includes, but is not limited to, appraisers.¹³

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, as of the date of publication of this regulation, the agencies and the RTC have the following principal differences.

1. *De minimis* test. The Board does not require a State certified or licensed appraiser for real estate-related financial transactions having a transaction value less than or equal to \$100,000. The OTS provides for no *de minimis* test.

2. *Use of licensed appraisers.* The Board allows State licensed appraisers to perform appraisals of property not involving 1-to-4 family residential property ("nonresidential property") if the transaction value is less than \$250,000. The NCUA requires any appraisal of nonresidential property to be performed by a State certified appraiser.

Regulatory Flexibility Act Analysis

Title XI of FIRREA requires the Board to establish standards for performing appraisals in connection with federally related transactions and to distinguish those transactions that require State certified appraisers from those that require State certified or licensed appraisers. This regulation is in response to this statutory requirement.

The Board anticipates that the proposed regulatory changes will increase the cost of federally related

transactions for regulated institutions, to the extent that the institutions are required to perform appraisals that they otherwise would not undertake or are required to perform appraisals in a different manner. Since FIRREA contains no exception for small institutions, the Board expects that their costs will rise somewhat under these circumstances if the costs are not passed on to their customers. Weighed against these increased costs should be savings to the regulated institutions that might arise from better loan documentation generated under the regulation, which may enable the institution to improve its risk evaluation and avoid potential loan losses.

After considering the comments received, the Board has made a number of significant changes to the initial draft that should help to reduce costs, particularly for smaller institutions, and to focus the regulation on those transactions where appraisal standards are most important. The principal changes are as follows:

1. The *de minimis* cutoff has been raised to \$100,000, thus eliminating smaller loans from the requirements of this regulation and focusing the regulation on those large transactions where the possibility of loss is large. Because many of these latter transactions would normally involve an appraisal under current practices, the marginal cost of mandatory appraisals is likely to be relatively insignificant, at least after a period of adjustment to the new requirements.

2. The revised regulation permits competent State licensed appraisers, rather than only State certified appraisers, to perform any type of appraisal in transactions involving amounts up to \$250,000. This should help minimize the costs to smaller institutions that concentrate on these smaller loans.

3. The revised regulation also expands the number of instances when licensed appraisers may be used, first, by allowing licensed appraisers to be used for all non-complex appraisals of 1-to-4 family residential property with transaction values up to \$1,000,000 and, second, by eliminating the proposed additional criterion that the transaction

value be below the lesser of \$1,000,000 or 10 percent of Tier I capital.

4. The revised regulation clarifies that most appraisals of 1-to-4 family residential property will be presumed to be non-complex, and therefore appropriate for State licensed appraisers to perform, provided that the transaction value is less than \$1,000,000.

5. Finally, the revised regulation exempts from appraisal requirements under this regulation certain additional types of transactions, including transactions resulting from a maturing extension of credit under certain circumstances, leases that are not the economic equivalent of a purchase, and purchases of pooled loans or interests in real property if conforming appraisals have been performed.

Paperwork Reduction Analysis

The revisions to Regulation H and Regulation Y in this rulemaking that relate to recordkeeping requirements were approved by the Board under authority delegated to it by the Office of Management and Budget, in accordance with section 3507 of the Paperwork Reduction Act of 1980, 44 U.S.C. chapter 35, and part 1320 of title 5, Code of Federal Regulations, 5 CFR part 1320.

In developing these revisions, the Board has consulted with the OCC, the FDIC, the OTS, the NCUA, and the RTC; under title XI, those agencies must adopt substantially similar regulations. These revisions to Regulations H and Y implement the provisions of title XI of FIRREA and affect state member banks ("SMBs"), bank holding companies, and the nonbank subsidiaries of bank holding companies ("BHC subs"), which must review and evaluate the required appraisals for federally related transactions.

The Federal Reserve System estimates that 1,183 institutions will be affected by these recordkeeping requirements. Each federally related transaction is expected to require, on average, 15 minutes for review and recordkeeping. The total reporting burden is estimated to be 31,930 hours, as calculated below, which represents less than one percent of total annual System reporting burden.

	Number of respondents	×	Annual frequency	×	Estimated average number of hours per response	=	Total annual burden hours
SMBs	1,073		86		25		23,070
BHC subs	110		322		25		8,855
Total	1,183						31,925

¹³ See FIRREA, §§ 204(f)(6) and 901(b)(1).

List of Subjects

12 CFR Part 208

Accounting, Agricultural loan losses, Applications, Appraisals, Banks, Banking, Branches, Capital adequacy, Confidential business information, Dividend payments, 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, Capital adequacy, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities, State member banks.

For the reasons set forth in this document, the Board amends 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, 461–466, 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 Banking Act of 1978 (12 U.S.C. 3105); sections 907–910 of the International Lending Supervision 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, 781(b), 781(g), 781(i), 780–4(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 state 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

The authority citation for part 225 is revised to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1831i, 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—Appraisals

Sec.

225.61 Authority, purpose, and scope.

225.62 Definitions.

225.63 Appraisals not required; transactions requiring a State certified or licensed appraiser.

225.64 Appraisal standards.

225.65 Appraiser independence.

225.66 Professional association membership; competency.

225.67 Enforcement.

Subpart G—Appraisals

§ 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)), 12 U.S.C. 3310, 3331–3351, and section 5(b) of the Bank Holding Company Act, 12 U.S.C. 1844(b).

(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 will be 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 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.

(d) **Complex 1-to-4 family residential property appraisal** means one in which the property to be appraised, the form of ownership, or market conditions are atypical.

(e) **Federally related transaction** means any real estate-related financial transaction entered into on or after August 9, 1990, 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 own best interests;

(3) A reasonable time is allowed for exposure in the open market;

(4) Payment is made in terms of cash in U.S. 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 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 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 certification in a State or territory whose criteria for certification as a real estate appraiser currently meet or exceed 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 Qualifications Board of the Appraisal Foundation. In addition, the Appraisal Subcommittee must not have issued a finding that the policies, practices, or procedures of the State or territory 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 its jurisdiction.

(i) *State licensed appraiser* means any individual who has satisfied the requirements for licensing in a State or territory where the licensing procedures comply with title XI of FIRREA and where the Appraisal Subcommittee has not issued a finding that the policies, practices, or procedures of the State or territory 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) *Tract development* means a project of five units or more that is constructed

or is to be constructed as a single development.

(k) *Transaction value* means:

(1) For loans or other extensions of credit, the amount of the loan or extension of credit;

(2) For sales, leases, purchases, and investments in or exchanges of real property, the market value of the real property interest involved; and

(3) For the pooling of loans or interests in real property for resale or purchase, the amount of the loan or the market value of the real property calculated with respect to each such loan or interest in real property.

§ 225.63 Appraisals not required; transactions requiring a State certified or licensed appraiser.

(a) *Appraisals not required.* An appraisal performed by a State certified or licensed appraiser is not required for any real estate-related financial transaction in which:

(1) The transaction value is \$100,000 or less;

(2) 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;

(3) A lease of real estate is entered into, unless the lease is the economic equivalent of a purchase or sale of the leased real estate;

(4) There is a subsequent transaction resulting from a maturing extension of credit, provided that:

(i) The borrower has performed satisfactorily according to the original terms;

(ii) No new monies have been advanced other than as previously agreed;

(iii) The credit standing of the borrower has not deteriorated; and

(iv) There has been no obvious and material deterioration in market conditions or physical aspects of the property which would threaten the institution's collateral protection; or

(5) A regulated institution purchases a loan or interest in a loan, pooled loans, or interests in real property, including mortgage-backed securities, provided that the appraisal prepared for each pooled loan or real property interest met the requirements of this regulation, if applicable.

Any transaction for which a State certified or licensed appraiser is not required nevertheless must have an appropriate evaluation of real property collateral that is consistent with the Board's Guidelines for Real Estate

Appraisal Policies and Review Procedures.

(b) *Transactions requiring a State certified appraiser.*—

(1) *All transactions of \$1,000,000 or more.* All federally related transactions having a transaction value of \$1,000,000 or more shall require an appraisal prepared by a State certified appraiser.

(2) *Nonresidential transactions of \$250,000 or more.* All federally related transactions having a transaction value of \$250,000 or more, other than those involving appraisals of 1-to-4 family residential properties, shall require an appraisal prepared by a State certified appraiser.

(3) *Complex residential transactions of \$250,000 or more.* All complex 1-to-4 family residential property appraisals rendered in connection with federally related transactions shall require a State certified appraiser if the transaction value is \$250,000 or more. A regulated institution may presume that appraisals of 1-to-4 family residential properties are not complex, unless the institution has readily available information that a given appraisal will be complex. The regulated institution shall be responsible for making the final determination of whether the appraisal is complex. If during the course of the appraisal a licensed appraiser identifies factors that would result in the property, form of ownership, or market conditions being considered atypical, then either:

(i) The regulated institution may ask the licensed appraiser to complete the appraisal and have a certified appraiser approve and co-sign the appraisal; or

(ii) The institution may engage a certified appraiser to complete the appraisal.

(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 prepared by either a State certified appraiser or a State licensed appraiser.

§ 225.64 Appraisal standards.

(a) *Minimum standards.* For federally related transactions, all appraisals shall, at a minimum:

(1) Conform to the Uniform Standards of Professional Appraisal Practice ("USPAP") adopted by the Appraisal Standards Board of the Appraisal Foundation, except that the Departure Provision of the USPAP shall not apply to federally related transactions;

(2) Disclose any steps taken that were necessary or appropriate to comply with the Competency Provision of the USPAP;

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

(4)(i) Be written and presented in a narrative format or on forms that satisfy all the requirements of this section;

(ii) Be sufficiently descriptive to enable the reader to ascertain the estimated market value and the rationale for the estimate; and

(iii) Provide detail and depth of analysis that reflect 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 revenues, expenses, and 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 any proposed construction, or any completed properties that are partially leased or leased at other than market rents as of the date of the appraisal, or 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 the 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 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, reconciles those approaches, and explains 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.

(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 be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transaction, and 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 ensure 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 appraisals 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 performed an appraisal.

(b) *Fee appraisers.* If an appraisal is prepared by a fee appraiser, the appraiser shall be engaged directly by the regulated institution or its agent, and

have no direct or indirect interest, financial or otherwise, in the property or transaction. A regulated institution may accept an appraisal that was prepared by an appraiser engaged directly by another institution subject to title XI of FIRREA, if the regulated institution that accepts the appraisal has:

(1) Established procedures for review of real estate appraisals;

(2) Reviewed the appraisal under the established review procedures, finding the appraisal acceptable; and

(3) Documented the review in writing.

§ 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 the Federal Deposit Insurance Act, 12 U.S.C 1811 *et seq.*, as amended, or other applicable law.

Board of Governors of the Federal Reserve System, June 27, 1990.

William W. Wiles,
Secretary of the Board.

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