APPENDIX A—APPRAISAL EXEMPTIONS

This appendix provides a commentary on the twelve exemptions from the agencies' appraisal regulations. The appendix provides an explanation of the agencies' statutory authority to provide for appraisal regulatory exemptions and the application of these exemptions.

Under title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the agencies were granted the authority to identify categories of real estate–related financial transactions that do not require the services of an appraiser to protect federal financial and public policy interests or to satisfy principles of safe and sound lending. Therefore, in their appraisal regulations, the agencies identified certain real estate–related financial transactions that do not require the services of an appraiser and that are exempt from the appraisal requirement. This appendix provides further clarification on the application of these regulatory exemptions and should be read in the context of each agency's appraisal regulation. If an institution has a question as to whether a particular transaction qualifies for an exemption, the institution should seek guidance from its primary federal regulator. For those transactions qualifying for the appraisal threshold, existing extensions of credit, or the business loan exemptions, an institution is exempted from the appraisal requirement but still must, at a minimum, obtain an evaluation consistent with the guidelines presented in section 4140.1 of this manual.

1. Appraisal Threshold

For transactions with a transaction value equal to or less than $250,000, the agencies' appraisal regulations, at a minimum, require an evaluation consistent with safe and sound banking practices. If an institution enters into a transaction that is secured by several individual properties that are not part of a tract development, the estimate of value of each individual property should determine whether an appraisal or evaluation would be required for that property. For example, an institution makes a loan secured by seven commercial properties in different markets with two properties valued in excess of the appraisal threshold and five properties valued less than the appraisal threshold. An institution would need to obtain an appraisal on the two properties valued in excess of the appraisal threshold and evaluations on the five properties below the appraisal threshold, even though the aggregate loan commitment exceeds the appraisal threshold.

2. Abundance of Caution

An institution may take a lien on real estate and be exempt from obtaining an appraisal if the lien on real estate is taken by the lender in an abundance of caution. This exemption is intended to have limited application, especially for real estate loans secured by residential properties in which the real estate is the only form of collateral. In order for a business loan to qualify for the abundance of caution exemption, the agencies expect the extension of credit to be well supported by the borrower's cash flow or collateral other than real property. The institution's credit analysis should verify and document the adequacy and reliability of these repayment sources and conclude that knowledge of the market value of the real estate on which the lien will be taken as an abundance of caution is unnecessary in making the credit decision.

An institution should not invoke the abundance of caution exemption if its credit analysis reveals that the transaction would not be adequately secured by sources of repayment other than the real estate, even if the contributory value of the real estate collateral is low relative to the entire collateral pool and other repayment sources. Similarly, the exemption should not be applied to a loan or loan program unless the institution verifies and documents the primary and secondary repayment sources. In the absence of verification of the repayment sources, this exemption should not be used merely to reduce the cost associated with obtaining an appraisal, minimize transaction processing time, or offer slightly better terms to a borrower than would be otherwise offered.

In addition, prior to making a final commitment to the borrower, the institution should document and retain in the credit file the analysis performed to verify that the abundance of caution exemption has been appropriately applied. If the operating performance or financial condition of the company subsequently deteriorates and the lender determines that the real estate will be relied upon as a repayment source, an appraisal should then be obtained, unless another exemption applies.

3. Loans Not Secured by Real Estate

An institution is not required to obtain an appraisal on a loan that is not secured by real estate, even if the proceeds of the loan are used to acquire or improve real property. For loans covered by this exemption, the real estate has no direct effect on the institution's decision to extend credit because the institution has no legal security interest in the real estate. This exemption is not intended to be applied to real estate-related financial transactions other than those involving loans. For example, this exemption should not be applied to a transaction such as an institution's investment in real estate for its own use.

4. Liens for Purposes Other Than the Real Estate's Value

This exemption allows an institution to take liens against real estate without obtaining an appraisal to protect legal rights to, or control over, other collateral. Institutions frequently take real estate liens to protect legal rights to other collateral rather than because of the contributory value of the real estate as an individual asset. For example, an institution making a loan to a logging operation may take a lien against the real estate upon which the timber stands to ensure its access to the timber in the event of default. To apply the exemption, the institution should determine that the market value of the real estate as an individual asset is not necessary to support its decision to extend credit.

5. Real Estate-Secured Business Loans

This exemption applies to business loans with a transaction value of $1 million or less when the sale of, or rental income derived from, real estate is not the primary source of repayment. To apply this exemption, the agencies expect the institution to determine that the primary source of repayment for the business loan is operating cash flow from the business rather than rental income or sale of real estate. For this type of exempted loan, under the agencies' appraisal regulations, an institution may obtain an evaluation in lieu of an appraisal.

This exemption will not apply to transactions in which the lender has taken a security interest in real estate, but the primary source of repayment is provided by cash flow or sale of real estate in which the lender has no security interest. For example, a transaction in which a loan is secured by real estate for one project, in which the lender has taken a security interest, but will be repaid with the cash flow from real estate sales or rental income from other real estate projects, in which the lender does not have a security interest, would not qualify for the exemption. (See "Appendix D—Glossary" in this section for a definition of business loan.)

6. Leases

An institution is required to obtain appraisals of leases that are the economic equivalent of a purchase or sale of the leased real estate. For example, an institution must obtain an appraisal on a transaction involving a capital lease, as the real estate interest is of sufficient magnitude to be recognized as an asset of the lessee for accounting purposes. Operating leases that are not the economic equivalent of the purchase or sale of the leased property do not require appraisals.

7. Renewals, Refinancings, and Other Subsequent Transactions

Under certain circumstances, renewals, refinancings, and other subsequent transactions may be supported by evaluations rather than appraisals. The agencies' appraisal regulations permit an evaluation for a renewal or refinancing of an existing extension of credit at the institution when either

1. there has been no obvious and material

change in market conditions or physical aspects of the property that threatens the adequacy of the institution's real estate collateral protection after the transaction, even with the advancement of new monies; or
2. there is no advancement of new monies, other than funds necessary to cover reasonable closing costs.

A subsequent transaction is exempt from the appraisal requirement if no new monies are advanced (other than funds necessary to cover reasonable closing costs) even when there has been an obvious and material change in market conditions or the physical aspects of the property that threatens the adequacy of the institution's real estate collateral protection. Conversely, when new monies are advanced (other than funds necessary to cover reasonable closing costs) and there has been an obvious and material change in market conditions or the physical aspects of the property that threaten the adequacy of the institution's real estate collateral protection, the institution must obtain an appraisal unless another exemption applies.

For the purposes of these guidelines, an institution is considered to have advanced new monies (excluding reasonable closing costs) when there is an increase in the principal amount of the loan over the amount of principal outstanding before the renewal or refinancing. For example, an institution originated a 15-year term loan for $3 million and, in year 14, the outstanding principal is $2.5 million. In year 14, the borrower seeks to refinance the loan at a lower interest rate and requests a loan of $2.8 million. The $300,000 would be considered new monies. On the other hand, an institution has provided a $5 million revolving line of credit to a borrower for two years and, at the end of year two, renews the $5 million line for another two years. At the time of renewal, the borrower has drawn down $1 million. In this example, the amount of the line remains unchanged even though the amount available on the line is less than the line commitment. Renewing the line of credit at its original amount would not be considered an advancement of new monies. Further, when an institution advances funds to protect its interest in a property, such as to repair damaged property, a new appraisal or evaluation would not be required because these funds would be used to restore the damaged property to its original condition.

To satisfy the condition for no obvious and material change in market conditions or the physical aspects of the property, the current or planned future use of the property should be consistent with the use identified in the existing appraisal or evaluation. For example, if a property has reportedly increased in value because of a planned change in use of the property resulting from rezoning, an appraisal should be performed unless another exemption applies.

If an evaluation is permitted under this exemption, an institution may use an existing appraisal or evaluation as long as the institution verifies and documents that the appraisal or evaluation continues to be valid. (See "Validity of Appraisals and Evaluations" in section 4140.1 of this manual for further discussion.) Even if a subsequent transaction qualifies for this exemption, an institution should consider the risk posed by the transaction and may wish to consider obtaining a new appraisal.

Loan Workouts or Restructurings. Loan workouts, debt restructurings, loan assumptions, and similar transactions involving the addition or substitution of borrowers may qualify for the exemption for renewals, refinancings and other subsequent transactions. Use of this exemption depends on meeting the conditions listed in (1) and (2) at the beginning of the discussion on "Renewals, Refinancings, and Other Subsequent Transactions." An institution also should consider such factors as the quality of the underlying collateral and the validity of the existing appraisal or evaluation.

If a loan workout involves acceptance of new real estate collateral that facilitates the orderly collection of the credit, or reduces the institution's risk of loss, an appraisal or evaluation of the existing and new collateral may be prudent, even if it is obtained after the workout occurs and the institution perfects its security interest.

8. Transactions Involving Real Estate Notes

This exemption applies to appraisal requirements for transactions involving the purchase, sale, investment in, exchange of, or extension of credit secured by a loan or interest in a loan, pooled loans, or interests in real property, including mortgage-backed securities. If each note or real estate interest meets the agencies' regulatory requirements for appraisals at the time the real estate note was originated, the institution need not obtain a new appraisal to support its interest in the transaction. The institution should employ audit procedures and review a representative sample of appraisals supporting pooled loans or real estate notes to determine that the conditions of the exemption have been satisfied.

Principles of safe and sound banking practices require an institution to determine the suitability of purchasing or investing in existing real estate-secured loans and real estate interests. These transactions should have been originated according to secondary market standards and have a history of performance. The information from these sources, together with original documentation, should be sufficient to allow an institution to make appropriate credit decisions regarding these transactions.

An institution may presume that the underlying loans in a marketable, mortgage-backed security satisfy the requirements of the agencies' appraisal regulations whenever an issuer makes a public statement, such as in a prospectus, that the appraisals comply with the agencies' appraisal regulations. A marketable security is one that may be sold with reasonable promptness at a price that corresponds to its fair value.

If the mortgages that secure the mortgage warehouse loan are sold to Fannie Mae or Freddie Mac, the sale itself may be used to demonstrate that the underlying loans complied with the agencies' appraisal regulations. In such cases, the agencies expect an institution to monitor its borrower's performance in selling loans to the secondary market and take appropriate steps, such as increasing sampling and auditing of the loans and the supporting documentation, if the borrower experiences more than a minimal rate of loans being put back by an investor.

9. Transactions Insured or Guaranteed by a U.S. Government Agency or U.S. Government-Sponsored Agency

This exemption applies to transactions that are wholly or partially insured or guaranteed by a U.S. government agency or U.S. government-sponsored agency. The agencies expect these transactions to meet all the underwriting requirements of the federal insurer or guarantor, including its appraisal requirements, in order to receive the insurance or guarantee.

10. Transactions That Qualify for Sale to, or Meet the Appraisal Standards of, a U.S. Government Agency or U.S. Government-Sponsored Agency

This exemption applies to transactions that either

(i) qualify for sale to a U.S. government agency or U.S. government-sponsored agency,[1] or
(ii) involve a residential real estate transaction in which the appraisal conforms to Fannie Mae or Freddie Mac appraisal standards applicable to that category of real estate.

An institution may engage in these transactions without obtaining a separate appraisal conforming to the agencies' appraisal regulations. Given the risk to the institution that it may have to repurchase a loan that does not comply with the appraisal standards of the U.S. government agency or U.S. government-sponsored agency, the institution should have appropriate policies to confirm its compliance with the underwriting and appraisal standards of the U.S. government agency or U.S. government-sponsored agency.

- An institution that relies on exemption 10(i) should maintain adequate documentation that confirms that the transaction qualifies for sale to a U.S. government agency or U.S. government-sponsored agency. If the qualification for sale is not adequately documented, the transaction should be supported by an appraisal that conforms to the agencies' appraisal regulations, unless another exemption applies.
- To qualify for this exemption, transactions that do not conform to all Fannie Mae or Freddie Mac underwriting standards, such as jumbo or other residential real estate loans, must be supported by an appraisal that meets these government-sponsored agencies' appraisal standards for the applicable property

1. These government-sponsored agencies include Banks for Cooperatives, Federal Agriculture Mortgage Corporation, Federal Farm Credit Banks, Federal Home Loan Banks, Freddie Mac, Fannie Mae, and Tennessee Valley Authority.

type and is documented in the credit file or reproducible.

11. Transactions by Regulated Institutions as Fiduciaries

An institution acting as a fiduciary is not required to obtain appraisals under the agencies' appraisal regulations if an appraisal is not required under other laws governing fiduciary responsibilities in connection with a transaction. For example, if no other law requires an appraisal in connection with the sale of a parcel of real estate to a beneficiary of a trust on terms specified in a trust instrument, an appraisal is not required under the agencies' appraisal regulations. However, when a fiduciary transaction requires an appraisal under other laws, that appraisal should conform to the agencies' appraisal requirements.

12. Appraisals Not Necessary to Protect Federal Financial and Public Policy Interests or the Safety and Soundness of Financial Institutions

The agencies retain the authority to determine when the services of an appraiser are not required in order to protect federal financial and public policy interests or the safety and soundness of financial institutions. This exemption is intended to apply to individual transactions on a case-by-case basis rather than broad categories of transactions that would otherwise be addressed by an appraisal exemption. An institution would need to seek a waiver from its supervisory federal agency before entering into the transaction.

APPENDIX B—EVALUATIONS BASED ON ANALYTICAL METHODS OR TECHNOLOGICAL TOOLS

This appendix provides a discussion of the agencies' expectations for evaluations that are based on analytical methods and technological tools, including the use of automated valuation models and tax assessment valuations.

The agencies' appraisal regulations permit an institution to use an evaluation in lieu of an appraisal for certain transactions. An institution may use a variety of analytical methods and technological tools for developing an evaluation, provided the institution can demonstrate that the valuation method is consistent with safe and sound banking practices and the December 2010 Interagency Appraisal and Evaluation Guidelines (Interagency Guidelines) (see "Evaluation Development" and "Evaluation Content" in section 4140.1 of this manual for further discussion).[2] An institution should not select a method or tool solely because it provides the highest value, the lowest cost, or the fastest response or turnaround time.

An institution should establish policies and procedures that provide a sound process for using various methods or tools. Such policies and procedures should:

- Ensure staff has the requisite expertise and training to manage the selection, use, and validation of an analytical method or technological tool. If an institution does not have the in-house expertise relative to a particular method or tool, then an institution should employ additional personnel or engage a third party. (See "Third-Party Arrangements" in section 4140.1 of this manual.)
- Address the selection, use, and validation of the valuation method or tool.
- Establish criteria for determining whether a particular valuation method or tool is appropriate for a given transaction or lending activity, considering associated risks. These risks include, but are not limited to, transaction size and purpose, credit quality, and leverage tolerance (loan-to-value).
- Specify criteria when a market event or risk factor would preclude the use of a particular method or tool.
- Address standards for the use of multiple methods or tools, if applicable, for valuing the same property or to support a particular lending activity.
- Provide criteria for ensuring that the institution uses a method or tool that produces a reliable estimate of market value that supports the institution's decision to engage in a transaction.

2. For example, the sole use of data from the Internet or other public sources would not be an evaluation under the Interagency Guidelines in section 4140.1. Additionally, valuation methods that do not contain sufficient information and analysis or provide a market value conclusion would not be acceptable as evaluations.

- Address the extent to which:
  - An inspection or research is necessary to ascertain the property's actual physical condition and
  - Supplemental information is needed to assess the effect of market conditions or other factors on the estimate of market value.

An institution should establish an effective system of controls for verifying that a valuation method or tool is employed in a manner consistent with internal policies and procedures. Moreover, the institution's staff responsible for internal controls should have the skills commensurate with the complexity or sophistication of the method or tool. Examiners will review an institution's policies, procedures, and internal controls to ensure that an institution's use of a method or tool is appropriate and consistent with safe and sound banking practices.

AUTOMATED VALUATION MODELS

Automated valuation models (AVMs) are computer programs that estimate a property's market value based on market, economic, and demographic factors. Institutions may employ AVMs for a variety of uses such as loan underwriting and portfolio monitoring. An institution may not rely solely on the results of an AVM to develop an evaluation unless the resulting evaluation is consistent with safe and sound banking practices and these guidelines. (See ''Evaluation Development'' and ''Evaluation Content'' in section 4140.1 of this manual.) For example, to be consistent with the standards for an evaluation, the results of an AVM would need to address a property's actual physical condition and, therefore, could not be based on an unsupported assumption, such as a property that is in ''average'' condition.

Institutions should establish policies and procedures that govern the use of AVMs and specify the supplemental information that is required to develop an evaluation. When the supplemental information indicates the AVM is not an acceptable valuation tool, the institution's policies and procedures should require the use of an alternative method or tool.

Selecting AVMs

When selecting an AVM or multiple AVMs, an institution should:

- Perform the necessary level of due diligence on AVM vendors and their models, including how model developers conducted performance testing as well as the sample size used and the geographic level tested (such as, county level or zip code).
- Establish acceptable minimum performance criteria for a model prior to and independent of the validation process.
- Perform a detailed validation of the model(s) considered during the selection process and document the validation process.
- Evaluate underlying data used in the model(s), including the data sources and types, frequency of updates, quality control performed on the data, and the sources of the data in states where public real estate sales data are not disclosed.
- Assess modeling techniques and the inherent strengths and weaknesses of different model types (such as hedonic, index, and blended), as well as how a model(s) performs for different property types (such as condominiums, planned unit developments, and single family detached residences).
- Evaluate the vendor's scoring system and methodology for the model(s). Determine whether the scoring system provides an appropriate indicator of model reliability by property types and geographic locations.

Following the selection of one or more AVMs, an institution should develop policies and procedures to address their appropriate use, monitoring, and ongoing validation processes.

Determining AVM Use

An institution should establish policies and procedures for determining whether an AVM can be used for a particular transaction. The institution should

- Maintain AVM performance criteria for accuracy and reliability in a given transaction, lending activity, and geographic location.[3]

3. For example, an institution should establish a level of

- Establish internal confidence score[4] minimums, or similar criteria, for when each model can be used.
- Implement controls to preclude "value shopping" when more than one AVM is used for the same property.
- Establish procedures for obtaining an appraisal or using a different valuation method to develop an evaluation when an AVM's resulting value is not reliable to support the credit decision. For example, in areas that have experienced a high incidence of fraud, the institution should consider whether the AVM may be relied upon for the transaction or another valuation method should be used.
- Identify circumstances under which an AVM may not be used, including:
  - When market conditions warrant, such as during the aftermath of a natural disaster or a major economic event;
  - When a model's performance is outside of specified tolerances for a particular geographic market or property price-tier range; or
  - When a property is nonhomogeneous, such as atypical lot sizes or property types.

Validating AVM Results

An institution should establish standards and procedures for independent and ongoing monitoring and model validation, including the testing of multiple AVMs, to ensure that results are credible.[5] An institution should be able to demonstrate that the depth and extent of its validation processes are consistent with the materiality of the risk and the complexity of the transaction. Validation can be performed internally or with the assistance of a third party, as long as the validation is conducted by qualified individuals that are independent of the model development or sales functions. An institution should not rely solely on validation representations provided by an AVM vendor. An institution should perform appropriate model validation regardless of whether it relies on AVMs that are supported by value insurance or guarantees. If there are insurance or guarantee components of any particular AVM, the institution is responsible for understanding the extent and limitations of the insurance policy or guarantee, and the claim process and financial strength of the insurer.

An institution should ensure that persons who validate an AVM on an ongoing basis are independent of the loan production and collection processes and have the requisite expertise and training. In the AVM validation procedures, an institution should specify, at a minimum,

- expectations for an appropriate sample size,
- level of geographic analysis,
- testing frequency and criteria for re-testing,
- standards of performance measures to be used, and
- range of acceptable performance results.

To ensure unbiased test results, an institution should compare the results of an AVM to actual sales data in a specified trade area or market prior to the information being available to the model. If an institution uses more than one AVM, each AVM should be validated. To assess the effectiveness of its AVM practices, an institution should verify whether loans in which an AVM was used to establish value met the institution's performance expectations relative to similar loans that used a different valuation process. An institution should document the results of its validation and audit findings. An institution should use these findings to analyze and periodically update its policies and procedures for an AVM when warranted.

TAX ASSESSMENT VALUATIONS

An institution may not rely solely on the data provided by local tax authorities to develop an evaluation unless the resulting evaluation is consistent with safe and sound banking practices and the Interagency Guidelines. (See "Evaluation Development" and "Evaluation Content" in section 4140.1 of this manual for further discussion.) Since analytical methods

acceptable core accuracy and limit exposure to a model's systemic tendency to over value properties (commonly referred to as "tail risk").

4. A "confidence score" generally refers to a vendor's own method of quantifying how reliable a model value is by using a rank ordering process. The scale and components of a confidence score are not standardized. Therefore, an institution needs to understand how a confidence score was derived and the extent to which a confidence score correlates to model accuracy. If multiple AVMs are used, an institution should understand how the combination of models affects overall accuracy.

5. See, for example, OCC Bulletin 2000-16, "Risk Modeling—Model Validation" (May 30, 2000).

such as tax assessment valuations (TAVs) generally need additional support to meet the Interagency Guidelines, institutions should develop policies and procedures that specify the level and extent of supplemental information that should be obtained to develop an evaluation. Such policies and procedures also should require the use of an alternate valuation method when such information does not support the transaction.

An institution may use a TAV in developing an evaluation when it can demonstrate that a valid correlation exists between the tax assessment data and the market value. In using a TAV to develop an evaluation, an institution should

- determine and document how the tax jurisdiction calculates the TAV and how frequently property revaluations occur,
- perform an analysis to determine the relationship between the TAV and the property market values for properties within a tax jurisdiction, and
- test and document how closely TAVs correlate to market value based on contemporaneous sales at the time of assessment and revalidate whether the correlation remains stable as of the effective date of the evaluation.

APPENDIX C—DEDUCTIONS AND DISCOUNTS

Appendix C is a discussion on appraisal standards for determining the market value of a residential tract development, including an explanation of the requirement to analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, nonmarket lease terms, and tract developments with unsold units.

The agencies' appraisal regulations require an appraiser to analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, nonmarket lease terms, and tract developments with unsold units. For such transactions, an appraisal must include the market value of the property, which should reflect the property's actual physical condition, use, and zoning designation (referred to as the "as is" value of the property), as of the effective date of the appraisal. Therefore, if the highest and best use of the property is for development to a different use, the cost of demolition and site preparation should be considered in the analysis.

Proposed Construction or Renovation

For properties where improvements are to be constructed or rehabilitated, an institution may request a prospective market value upon completion and a prospective market value upon stabilization. While an institution may request the appraiser to provide the sum of retail sales for a proposed development, the result of such calculation is not the market value of the property for purposes of the agencies' appraisal regulations.

Partially Leased Buildings

For proposed and partially leased rental developments, the appraiser must make appropriate deductions and discounts to reflect that the property has not achieved stabilized occupancy. The appraisal analysis also should include consideration of the absorption of the unleased space. Appropriate deductions and discounts should include items such as leasing commission, rent losses, tenant improvements, and entrepreneurial profit, if such profit is not included in the discount rate.

Nonmarket Lease Terms

For properties subject to leases with terms that do not reflect current market conditions, the appraisal must clearly state the ownership interest being appraised and provide a discussion of the leases that are in place. If the leased fee interest is being appraised and contract rent is less than market rent on one or more long term lease(s) to a highly rated tenant, the market value of the leased fee interest would be less than the market value of the unencumbered fee simple interest in the property.[6] In these situa-

6. Fee simple interest refers to the most complete ownership unencumbered by any leases or other interests. It is subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat. Leased fee interest, on the other hand, refers to a landlord's ownership that is encumbered by one or more leases.

tions, the market value of the leased fee interest should be used.

Tract Developments with Unsold Units

A tract development is defined in the agencies' appraisal regulations as a project of five units or more that is constructed or is to be constructed as a single development. Appraisals for these properties must reflect deductions and discounts for holding costs, marketing costs, and entrepreneurial profit supported by market data. In some cases entrepreneurial profit may be included in the discount rate. The applicable discount rate is developed based on investor requirements and the risk associated with the physical and financial characteristics of the property. In some markets, entrepreneurial profit is treated as a line item deduction while in other markets it is reflected as a component of the discount rate.

Regardless of how entrepreneurial profit is handled in the appraisal analysis, an appropriate explanation and discussion should be provided in the appraisal report. The projected sales prices and absorption rate of units should be supported by anticipated demand at the time the units are expected to be exposed for sale. Anticipated demand for the units should be supported and presented in the appraisal. A reader of the appraisal report should be able to understand the risk characteristics associated with the subject property and the market, including the anticipated supply of competing properties.

- *Raw Land.* The appraiser must provide an opinion of value for raw land based on its current condition and existing zoning. If an appraiser employs a developmental approach to value the land that is based on projected land sales or development and sale of lots, the appraisal must reflect appropriate deductions and discounts for costs associated with developing and selling lots in the future. These costs may be incurred during the permitting, construction, or selling stages of development. Appropriate deductions and discounts should include items such as feasibility studies, permitting, engineering, holding costs, marketing costs, and entrepreneurial profit and other costs specific to the property. If sufficient market data exist to perform both the sales comparison and developmental approaches to value, the appraisal report should detail a reconciliation of these two approaches in arriving at a market value conclusion for the raw land.
- *Developed Lots.* For existing or proposed developments of five or more residential lots in a single development, the appraiser must analyze and report appropriate deductions and discounts. Appropriate deductions and discounts should reflect holding costs, marketing costs, and entrepreneurial profit during the sales absorption period for the sale of the developed lots. The estimated sales absorption period should reflect the appraiser's estimate of the time frame for the actual development and sale of the lots, starting on the effective date of value and ending as of the expected date of the last lot sale. The absorption period should be based on market demand for lots in light of current and expected competition for similar lots in the market area.
- *Attached or Detached Single-Family Homes.* For proposed construction and sale of five or more attached or detached single-family homes in the same development, the appraiser must analyze and report appropriate deductions and discounts. Appropriate deductions and discounts should reflect holding costs, marketing costs, and entrepreneurial profit during the sales absorption period of the completed units. If an institution finances construction on an individual unit basis, an appraisal of the individual units may be used if the institution can demonstrate through an independently obtained feasibility study or market analysis that all units collateralizing the loan can be constructed and sold within 12 months. However, the transaction should be supported by an appraisal that analyzes and reports appropriate deductions and discounts if any of the individual units are not completed and sold within the 12-month time frame.
- *Condominiums*. For proposed construction and sale of a condominium building with five or more units, the appraisal must reflect appropriate deductions and discounts. Appropriate deductions and discounts should include holding costs, marketing costs, and entrepreneurial profit during the sales absorption period of the completed units. If an institution finances construction of a single condominium building with less than five units or a condominium project with multiple buildings with less than five units per building, the institution may rely

on appraisals of the individual units if the institution can demonstrate through an independently obtained feasibility study or market analysis that all units collateralizing the loan can be constructed and sold within 12 months. However, the transaction should be supported by an appraisal that analyzes and reports appropriate deductions and discounts if any of the individual units are not completed and sold within the 12-month time frame.

APPENDIX D—GLOSSARY

Appendix D provides definitions of terms related to real estate lending, appraisals, and regulations to aid in the reading of the guidelines.

Agent. The agencies' appraisal regulations do not specifically define the term ''agent.'' However, the term is generally intended to refer to one who undertakes to transact business or manage business affairs for another. According to the agencies' appraisal regulations, fee appraisers must be engaged directly by the federally regulated institution or its agent,[7] and have no direct or indirect interest, financial or otherwise, in the property or transaction. The agencies do not limit the arrangements that federally regulated institutions have with their agents, provided those arrangements do not place the agent in a conflict of interest that prevents the agent from representing the interests of the federally regulated institution.

Appraisal. As defined in the agencies' appraisal regulations, a written statement independently and impartially prepared by a qualified appraiser (state licensed or certified) 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.

Appraisal Management Company. The agencies' appraisal regulations do not define the term appraisal management company. For purposes of these guidelines, an ''appraisal management company'' includes, but is not limited to, a third-party entity that provides real property valuation-related services, such as selecting and engaging an appraiser to perform an appraisal based upon requests originating from a regulated institution. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) has a specific definition for this term in connection with transactions secured by a consumer's principal dwelling or mortgage secondary-market transactions. (See ''Third-Party Arrangements'' in section 4140.1 of this manual.)

Appraisal Report Options. Refer to the definitions for *Restricted Use Appraisal Report*, *Self-contained Appraisal Report*, and *Summary Appraisal Report*.

Appraisal Threshold. An appraisal is not required on transactions with a transaction value of $250,000 or less. As specified in the agencies' appraisal regulations, an institution must obtain an evaluation of the real property collateral, if no other appraisal exemption applies.

Approved Appraiser List. A listing of appraisers who an institution has determined to be generally qualified and competent to perform appraisals and may address the appraiser's expertise in a particular market and property type.

''As Completed'' Market Value. Refer to the definition for *Prospective Market Value*.

''As Is'' Market Value. The estimate of the market value of real property in its current physical condition, use, and zoning as of the appraisal's effective date.

''As Stabilized'' Market Value. Refer to the definition for *Prospective Market Value*.

Automated Valuation Model. A computer program that estimates a property's market value based on market, economic, and demographic factors. *Hedonic* models generally use property characteristics (such as square footage and room count) and methodologies to process information, often based on statistical regression. *Index* models generally use geographic repeat sales data over time rather than property characteristic data. *Blended or hybrid* models use elements of both hedonic and index models.

Broker Price Opinion (BPO). An estimate of the probable sales or listing price of the subject

7. Except that the regulated institution also may accept an appraisal that was prepared by an appraiser engaged directly by another financial services institution in certain circumstances as set forth in the agencies' appraisal regulations.

property provided by a real estate broker, sales agent, or sales person. A BPO generally provides a varying level of detail about a property's condition, market, and neighborhood, as well as comparable sales or listings. A BPO is not by itself an appraisal or evaluation, but could be used for monitoring the collateral value of an existing loan, when deemed appropriate. Further, the Dodd-Frank Act provides "[i]n conjunction with the purchase of a consumer's principal dwelling, broker price opinions may not be used as the primary basis to determine the value of a piece of property for the purpose of loan origination of a residential mortgage loan secured by such piece of property."[8]

Business Loan. As defined in the agencies' appraisal regulations, a loan or extension of credit to any corporation, general or limited partnership, business trust, joint venture, syndicate, sole proprietorship, or other business entity. A business loan includes extensions to entities engaged in agricultural operations, which is consistent with the agencies' real estate lending guidelines definition of an improved property loan that includes loans secured by farmland, timberland, and ranchland committed to ongoing management and agricultural production.

Business Loan Threshold. A business loan with a transaction value of $1,000,000 or less does not require an appraisal if the primary source of repayment is not dependent on the sale of, or rental income derived from, real estate. As specified in the agencies' appraisal regulations, an institution must obtain an evaluation of the real property collateral.

Client. According to the Uniform Standards of Professional Appraisal Practice (USPAP), the party or parties who engage(s) an appraiser by employment or contract for a specific appraisal assignment. For the purposes of these guidelines, the appraiser should be aware that the client is the regulated institution. (Refer to "Third-Party Arrangements" in section 4140.1 of this manual.)

Credible (Appraisal) Assignment Results. According to USPAP, credible means "worthy of belief" used in the context of the Scope of Work Rule. Under this rule, credible assignment results depend on meeting or exceeding both (1) the expectations of parties who are regularly intended users for similar assignments and (2) what an appraiser's peers' actions would be in performing the same or a similar assignment.

Credit File. A hardcopy or electronic record that documents all information necessary to (1) analyze the credit before it is granted and (2) monitor the credit during its life. An institution may use a computerized or manual system to manage the information in its credit files.

Date of the Appraisal Report. According to USPAP, the date of the appraisal report indicates when the appraisal analysis was completed.

Effective Date of the Appraisal. USPAP requires that each appraisal report specifies the effective date of the appraisal and the date of the report. The date of the report indicates the perspective from which the appraiser is examining the market. The effective date of the appraisal establishes the context for the value opinion. Three categories of effective dates—retrospective, current, or prospective—may be used, according to the intended use of the appraisal assignment.

Effective Date of the Evaluation. For the purposes of the agencies' appraisal regulations and these guidelines, the effective date of an evaluation is the date that the analysis is completed.

Engagement Letter. An engagement letter between an institution and an appraiser documents the expectations of each party to the appraisal assignment. For example, an engagement letter may specify, among other items: (i) the property's location and legal description; (ii) intended use and users of the appraisal; (iii) the requirement to provide an opinion of the property's market value; (iv) the expectation that the appraiser will comply with applicable laws and regulations, and be consistent with supervisory guidance; (v) appraisal report format; (vi) expected delivery date; and (vii) appraisal fee.

Evaluation. A valuation permitted by the agencies' appraisal regulations for transactions that qualify for the appraisal threshold exemption, business loan exemption, or subsequent transaction exemption.

Exposure Time. As defined in USPAP, the estimated length of time the property interest

8. Dodd-Frank Act, section 1473(r).

being appraised would have been offered on the market prior to the hypothetical consummation of a sale at market value on the effective date of the appraisal. Exposure time is always presumed to precede the effective date of the appraisal. Exposure time is a function of price, time, and use—not an isolated opinion of time alone. (See USPAP Standard 1-2(c) and Statement 6.)

Extraordinary Assumption. As defined in USPAP, an assumption, directly related to a specific assignment, which, if found to be false, could alter the appraiser's opinions or conclusions regarding the property's market value. An example of an extraordinary assumption is when an appraiser assumes that an application for a zoning change will be approved and there is no evidence to suggest otherwise.

Federally Regulated Institution. For purposes of the agencies' appraisal regulations and these guidelines, an institution that is supervised by a federal financial institutions regulatory agency. This includes a national or a state-chartered bank and its subsidiaries, a bank holding company and its non-bank subsidiaries, a federal savings association and its subsidiaries, a federal savings and loan holding company and its subsidiaries, and a credit union.

Federally Related Transaction. As defined in the agencies' appraisal regulations, any real estate–related financial transaction in which the agencies or any regulated institution engages or contracts for, and that requires the services of, an appraiser.

Financial Services Institution. The agencies' appraisal regulations do not contain a specific definition of the term ''financial services institution.'' The term is intended to describe entities that provide services in connection with real estate lending transactions on an ongoing basis, including loan brokers.

Going Concern Value. The value of a business entity rather than the value of the real property. The valuation is based on the existing operations of the business and its current operating record, with the assumption that the business will continue to operate.

Hypothetical Condition. As defined in USPAP, a condition that is contrary to what exists but is supposed for the purpose of analysis. An example of a hypothetical condition is when an appraiser assumes a particular property's zoning is different from what the zoning actually is.

Loan-Production Staff. Generally, all personnel responsible for generating loan volume or approving loans, as well as their subordinates and supervisors. These individuals would include any employee whose compensation is based on loan volume (such as processing or approving of loans). An employee is not considered loan-production staff just because part of their compensation includes a general bonus or profit-sharing plan that benefits all employees. Employees responsible solely for credit administration or credit-risk management are not considered loan-production staff.

Marketing Time. According to USPAP Advisory Opinion 7, the time it might take to sell the property interest at the appraised market value during the period immediately after the effective date of the appraisal. An institution may request an appraiser to separately provide an estimate of marketing time in an appraisal. However, this is not a requirement of the agencies' appraisal regulations.

Market Value. As defined in the agencies' appraisal regulations, 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 are the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby

- buyer and seller are typically motivated;
- both parties are well informed or well advised, and acting in what they consider their own best interests;
- a reasonable time is allowed for exposure in the open market;
- payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
- 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.

Presold Unit. A unit may be considered presold if a buyer has entered into a binding contract to purchase the unit and has made a substantial and non-refundable earnest money deposit. Further, the institution should obtain sufficient documentation that the buyer has entered into a legally binding sales contract and has obtained a written prequalification or commitment for permanent financing.

Prospective Market Value "as Completed" and "as Stabilized." A prospective market value may be appropriate for the valuation of a property interest related to a credit decision for a proposed development or renovation project. According to USPAP, an appraisal with a prospective market value reflects an effective date that is subsequent to the date of the appraisal report. Prospective value opinions are intended to reflect the current expectations and perceptions of market participants, based on available data. Two prospective value opinions may be required to reflect the time frame during which development, construction, and occupancy will occur. The prospective market value "as completed" reflects the property's market value as of the time that development is expected to be completed. The prospective market value "as stabilized" reflects the property's market value as of the time the property is projected to achieve stabilized occupancy. For an income-producing property, stabilized occupancy is the occupancy level that a property is expected to achieve after the property is exposed to the market for lease over a reasonable period of time and at terms and conditions comparable to other similar properties. (See USPAP Statement 4 and Advisory Opinion 17.)

Put Back. Represents the ability of an investor to reject mortgage loans from a mortgage originator if the mortgage loans do not comply with the warranties and representations in their mortgage-purchasing agreement.

Raw Land. A parcel or tract of land with no improvements, for example, infrastructure or vertical construction. When an appraisal of raw land includes entitlements, the appraisal should disclose when such entitlements will expire if improvements are not completed within a specified time period and the potential effect on the value conclusion.

Real Estate–Related Financial Transaction. As defined in the agencies' appraisal regulations, any transaction involving

- the sale, lease, purchase, investment in or exchange of real property, including interests in property, or the financing thereof;
- the refinancing of real property or interests in real property; or
- the use of real property or interests in property as security for a loan or investment, including mortgage-backed securities.

Regulated Institution. Refer to the definition for *Federally Regulated Institution.*

Restricted Use Appraisal Report. According to USPAP Standards Rule 2-2(c), a restricted use appraisal report briefly states information significant to solve the appraisal problem and includes references to the existence of specific work-file information in support of the appraiser's opinions and conclusions. The agencies believe that the restricted use appraisal report will not be appropriate to underwrite a significant number of federally related transactions due to the lack of supporting information and analysis in the appraisal report. However, it may be appropriate to use this type of appraisal report for ongoing collateral monitoring of an institution's real estate transactions and other purposes.

Sales Concessions. A cash or noncash contribution that is provided by the seller or other party to the transaction and reduces the purchaser's cost to acquire the real property. A sales concession may include, but is not limited to, the seller paying all or some portion of the purchaser's closing costs (such as prepaid expenses or discount points) or the seller conveying to the purchaser personal property which is typically not conveyed with the real property. Sales concessions do not include fees that a seller is customarily required to pay under state or local laws. In developing an opinion of market value, an appraiser must take into consideration the effect of any sales concessions on the market value of the real property. (See "Market Value" above and USPAP Standards Rule 1-2(c).)

Sales History and Pending Sales. According to USPAP Standards Rule 1-5, when the value opinion to be developed is market value, an appraiser must, if such information is available to the appraiser in the normal course of business, analyze: (1) all current agreements of sale, options, and listings of the subject property as of the effective date of the appraisal, and (2) all sales of the subject property that occurred within three years prior to the effective date of the appraisal.

Scope of Work. According to the USPAP Scope of Work Rule, the type and extent of research and analyses in an appraisal assignment. (See the Scope of Work Rule in USPAP.)

Self-contained Appraisal Report. According to USPAP Standards Rule 2-2(a), a self-contained appraisal report is the most complete and detailed appraisal report option.

Sum of Retail Sales. A mathematical calculation of the sum of the expected sales prices of several individual properties in the same development to an individual purchaser. The sum of retail sales is not the market value for purposes of meeting the minimum appraisal standards in the agencies' appraisal regulations.

Summary Appraisal Report. According to USPAP Standards Rule 2-2(b), the summary appraisal report summarizes all information significant to the solution of an appraisal problem while still providing sufficient information to enable the client and intended user(s) to understand the rationale for the opinions and conclusions in the report.

Tract Development. As defined in the agencies' appraisal regulations, a project of five units or more that is constructed or is to be constructed as a single development. For purposes of these guidelines, "unit" refers to: a residential or commercial building lot, a detached single-family home, an attached single-family home, and a residence in a condominium, cooperative, or time-share building.

Transaction Value. As defined in the agencies' appraisal regulations:

- for loans or other extensions of credit, the amount of the loan or extension of credit;
- for sales, leases, purchases, and investments in or exchanges of real property, the market value of the real property interest involved; and
- for the pooling of loans or interests in real property for resale or purchase, the amount of the loan or market value of the real property calculated with respect to each such loan or interest in real property.

For purposes of this definition, the transaction value for loans that permit negative amortization should be the institution's total committed amount, including any potential negative amortization.

Uniform Standards of Professional Appraisal Practice (USPAP). USPAP identifies the minimum set of standards that apply in all appraisal, appraisal review, and appraisal consulting assignments. These standards are promulgated by the Appraisal Standards Board of the Appraisal Foundation and are incorporated as a minimum appraisal standard in the agencies' appraisal regulations.

Unsold Units. An unsold unit is a unit that does not meet the conditions listed in the definition of *Presold Units.*

Value of Collateral (for Use in Determining Loan-to-Value Ratio). According to the agencies' real estate lending standards guidelines, the term "value" means an opinion or estimate set forth in an appraisal or evaluation, whichever may be appropriate, of the market value of real property, prepared in accordance with the agencies' appraisal regulations and the December 2010 Interagency Guidelines in section 4140.1. For loans to purchase an existing property, "value" means the lesser of the actual acquisition cost or the estimate of value.