Effective Bank Valuation Programs—An Examiner's Perspective

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Abstract

The Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) requires that at least once every ten years federal banking regulatory agencies review their regulations and consider how to reduce the regulatory burden. The second EGRPRA review was submitted to Congress on March 21, 2017. That report identified at least four appraisal-related areas for action by the regulators, including appraisal thresholds, appraiser shortages in rural areas, evaluations, and appraisal management companies. Each identified area has subsequently been subject to change or clarification in bank valuation programs. Professional appraisers must be well-informed about relevant changes in federal valuation regulation and guidance as well as in the administrative program processes pertaining to lender clients and real estate loan underwriting concepts. This article provides insights as to what examiners expect of financial institutions in conducting safe and sound valuation practices under current regulations and guidelines.

Introduction

An appraiser's knowledge of loan underwriting concepts is essential when an appraisal report's intended use is to assist in loan underwriting purposes. Credible valuation information plays a critical role in financial institutions' ability to identify, measure, monitor, and manage credit risk in real estate–related transactions. Institutions that engage in real estate lending are required to have a valuation program that consists of policies and procedures annually reviewed and approved by the board of directors or a designated committee. The key elements of effective valuation programs should be tailored to the type and level of risk in an institution's real estate lending activities and should be consistent with the institution's strategic goals. Such programs facilitate a more comprehensive understanding of the potential loss exposure if a default occurs due to a decline in the primary source of repayment.

Federal and state supervisory banking agencies perform periodic on-site bank examinations. Examinations may be ongoing or there may be as long as eighteen months between exam cycles, depending on the individual banking institution. Regulatory agencies may combine federal and state staffing resources for a joint supervisory examination. Agencies may target a specific area of banking such as real estate loans and have an exam duration of days, weeks, or months, depending on the type and risk of the loan portfolio, size of the institution, and other factors. Examiners have ongoing informal discussions throughout the exam with lending officers, valuation staff, and bank management. These informal discussions during the examination process permit management and examiners to have an open dialogue regarding all aspects of credit risk, including the key elements of effective valuation programs. Federal Deposit Insurance Corporation (FDIC) examinations reflect that institutions' valuation programs are generally satisfactory.[1] That said, it is possible that one or more aspects of a valuation program could be enhanced or better tailored to an institution's real estate lending activities or strategic plan. This article highlights key elements of a valuation program and

1. For information on FDIC bank examinations and safety and soundness criteria, see http://bit.ly/FDIC_examinations.

provides insights on operational issues that may be raised by institution management or observed by examiners during the examination process.

Valuation Policies and Procedures

Real estate lending regulations of federal banking agencies[2] (Agencies) require each institution's board of directors, or a designated committee, "to adopt and maintain written real estate lending policies that are consistent with principles of safety and soundness and reflect consideration of the real estate lending guidelines" related to the Agencies' regulations.[3] The Agencies' supervisory guidance, such as the Interagency Appraisal and Evaluation Guidelines (Guidelines), does not have the force and effect of law. However, when examiners cite violations of law or regulation, or noncompliance with enforcement orders, they may reference the supervisory guidance as examples of "safe and sound conduct" for compliance with laws or regulations.

As explained in more detail in this article, the written policies of institutions should establish procedures that address the key appraisal and evaluation program elements listed in Exhibit 1. The real estate lending policies also should incorporate information contained in the Uniform Standards of Professional Appraisal Practice (USPAP).[4] Management should customize the written procedures based on loan volume, location, property type, collateral complexity, internal expertise, and the availability, expertise, and cost of third-party arrangements. Regardless of whether an institution outsources all or a part of its valuation program through third-party arrangements, management remains responsible for maintaining adequate valuation procedures.

Exhibit 1 Key Valuation Program Elements

- **Maintain** up-to-date written valuation policies and procedures consistent with program elements stated in the *Interagency Appraisal and Evaluation Guidelines* (December 2, 2010), 2–3, and with the institution's strategic goals;
- **Establish** an independent and competent organizational structure and staff;
- **Develop** appropriate processes for procuring a valuator's services and workfile storage systems;
- **Ensure** appraisal and evaluation reviewers are knowledgeable and well-trained;
- **Safeguard** electronic valuation report files and work papers with confidential information or personally identifiable information; and
- **Provide** an appropriate valuation resource library specific to the type of valuation activities performed by internal staff.

The procedures should include a system of internal controls[5] that monitor and assess the valuation program and functions, including those performed by a third party.[6] The procedures also should implement processes to verify that appraisals, evaluations, and reviews are performed independent of influence by loan production staff and provide credible market values.

Although both appraisals and evaluations must provide credible market values, key differences exist between these products. The Agencies' appraisal regulations require financial institutions to obtain an appraisal completed by a competent and qualified state-licensed or state-certified appraiser who complies with USPAP and meets

2. The federal banking agencies are the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System (FRB), the National Credit Union Administration (NCUA), and the Office of the Comptroller of the Currency (OCC); they will be referred to collectively here as "the Agencies."
3. *Interagency Appraisal and Evaluation Guidelines* (December 2, 2010), 2, available at http://bit.ly/InteragencyGuidelines. Specific agency regulations are as follows: FDIC, Real Estate Lending Standards, 12 CFR part 365; OCC, Real Estate Lending and Appraisals, 12 CFR part 34, subpart C; and FRB, Real Estate Lending Appraisal Standards, and Minimum Requirements for Appraisal Management Companies, 12 CFR part 208, subpart E. All regulations mentioned in this article are available in the Electronic Code of Federal Regulations at http://bit.ly/E-CFR. Regulations are subject to revision and readers should consult the original for updates.
4. See requirement in FDIC, Minimum Appraisal Standards, 12 CFR Part 323.4(a). The Guidelines note that the Agencies' appraiser independence requirements exceed those in USPAP.
5. Section IV., Appraisal and Evaluation Program, *Guidelines*, 3.
6. Section XVI., Third Party Arrangements, *Guidelines*, 19. Outsourced functions may include overseeing the engagement process, ordering appraisals, evaluations, reviews, and obtaining corrections of identified report deficiencies as a part of the review process.

other requirements for federally related transactions, unless an exception applies.[7] Some exceptions permit the use of an evaluation. The Guidelines define an *evaluation* as "A valuation permitted by the Agencies' appraisal regulations for transactions that qualify for the appraisal threshold exemption, business loan exemption, or subsequent transaction exemption."[8] An evaluation is not required to be completed by a state-licensed or state-certified appraiser or to comply with USPAP. However, as appraisal thresholds increase, it is increasingly important that competency of the preparer stands as a focal point of risk mitigation.

Organizational Structure and Staffing: Ensuring Independence and Competence

Credible appraisal and evaluation results require that appraisers and evaluation preparers are independent and competent, and that institutions have sufficient staffing to maintain the integrity of their valuation programs.

Independence

To ensure independence in the appraisal and evaluation functions, an institution's reporting lines for loan production staff and for administration of collateral valuation should be separate and independent.[9] Program standards should ensure that internal valuation staff involved in ordering, performing, reviewing, and approving appraisals and evaluations do not report to an individual who approves real estate loans or whose compensation is associated with real estate loan production. When close physical proximity of valuation staff to loan production staff cannot be avoided, an institution should carefully review the arrangement and establish procedures to avoid potential instances of lender influence, pressure, or coercion on valuation staff. Examiners will review an institution's loan approval processes to ensure that anyone who orders, performs, or reviews valuation assignments abstains from the specific credit approval process.[10]

Competence

Selection of a competent as well as independent valuation provider who supports the market value conclusion is the most critical decision of the valuation process. Credible market value conclusions, which also are referred to as assignment results, begin with engaging a competent appraiser or evaluator. The Guidelines offer specific direction on the selection of appraisers and evaluators and guidance for special circumstances; the Guidelines' key points are summarized below.[11]

Selection of an Appraiser. An institution should have minimum standards for qualifying appraisers for placement on the institution's approved list, and this should include an understanding of and adherence to USPAP's Competency Rule.[12] Institutions should review their approved appraiser list to confirm that appropriate procedures and controls exist to ensure independence in the development, administration, and maintenance of the list.[13] An institution should review an appraiser's geographical and technical work experience. Submission of work samples may assist valuation staff in determining appraiser competency. Institutions should remove appraisers from the approved list when the appraisers refuse to correct issues of noncompliance with USPAP or other significant report deficiencies.

Appraiser Shortages in Rural Areas. Transactions requiring an appraisal for real estate in rural areas can pose challenges for an institution if a shortage of qualified appraisers exists. Existing appraisals may be used as long as the institution analyzes, verifies, and documents that the appraisal con-

7. Section VIII., Minimum Appraisal Standards, *Guidelines*, 7–9.
8. Appendix D, Glossary of Terms, *Guidelines*, 41.
9. Section V., Independence of the Appraisal and Evaluation Program, *Guidelines*, 3–5.
10. The Guidelines provide additional guidance for small or rural institutions where it may not be possible to separate the valuation program from the loan production process.
11. Section VI., Selection of Appraisers or Persons Who Perform Evaluations, *Guidelines*, 5–6.
12. See Competency Rule, "Being Competent," in Appraisal Standards Board, *Uniform Standards of Professional Appraisal Practice*, 2018–2019 ed. (Washington, DC: The Appraisal Foundation, 2018), Lines 302–313.
13. Section VI. A., Approved Appraiser List, *Guidelines*, 6.

tinues to be valid for the institution's use. This process does not update conclusions of value but establishes criteria for assessing whether an existing appraisal's market value remains valid for use by the institution, specific to the nature of the transaction. The nature of the transaction will be a primary factor in the continued use of the report. As an example, if the nature of the transaction involves a low loan-to-value (LTV) ratio or a high LTV ratio, then different outcomes of the analysis could result. Institutions also may request recommendations from professional appraisal groups and associations to help identify potential qualified appraisers. In the absence of local competent appraisers, institutions also may ask nonlocal appraisers to consider working in rural areas after they take appropriate steps to obtain geographical and market competency as provided under USPAP's Competency Rule. The FDIC's *Interagency Advisory on the Availability of Appraisers* provides more information regarding temporary practice permits, reciprocity, and temporary waivers for appraisers.[14]

Selection of an Evaluator. An institution should establish criteria to select, evaluate, and monitor the performance of persons who perform evaluations.[15] The institution may consider establishing an approved evaluator list, similar to an approved appraiser list. Persons who perform evaluations should possess the appropriate collateral valuation education, expertise, and experience relevant to the type of property being valued. Such persons may include state-licensed or state-certified appraisers, although such credentials are not required.[16] Persons ordering, performing, reviewing, or approving evaluations should be independent of the specific transaction.[17] Examiners may review the institution's documentation to demonstrate that a person performing an evaluation is competent, independent, and has the relevant experience and knowledge for the market, location, and type of real property being valued.[18]

Staffing Analysis. An institution should maintain an appropriate number of valuation staff based on the volume, complexity, and risk of its real estate lending activities. The institution's staffing analysis should include an assessment of the expertise required to perform valuation assignments for diverse market conditions and real estate types as well as the risks, costs, and benefits of internal or external valuation programs. An institution generally uses one of four organizational alternatives to meet its appraisal and evaluation report production and review requirements. These alternatives include

1. internal management, production, and review;
2. internal management with external production, and both internal and external review;
3. external management, production, and review; and
4. external expertise to shadow the institution's management of its internal or external valuation program.

The fourth alternative may be popular with smaller or rural institutions that want to augment limited internal expertise for managing the valuation program. There are many variations of these alternatives, and an institution should implement a program that is appropriate for its real estate lending activities.

An institution's staffing analysis should consider all the long-term consequences of a third-party arrangement. The Guidelines state the decision to outsource any part of the valuation function "should not be unduly influenced by any short-term cost savings."[19] Anecdotal evi-

14. See FDIC Financial Institution Letter FIL-19-2017, *Advisory on the Availability of Appraisers* (May 31, 2017), http://bit.ly/FIL-19-2017.
15. Section VI., Selection of Appraiser or Persons Who Perform Evaluations, *Guidelines*, 5.
16. An institution may use state-certified or state-licensed appraisers to perform evaluations. Institutions and appraisers should refer to USPAP Advisory Opinion 13 (AO-13), "Performing Evaluations of Real Property Collateral to Conform with USPAP" for guidance on USPAP requirements related to appraisers performing evaluations of real property collateral. AO-13 states, "An evaluation, when performed by an individual acting as an appraiser, is an appraisal" [Lines 127–128]; and "[A]n appraiser who is required to comply with USPAP must meet both the Agencies' requirements for an evaluation and the requirements of STANDARDS 1 and 2 and other applicable parts of USPAP" [Lines 44–45].
17. See additional guidance for small or rural institutions in Section V., Independence of the Appraisal and Evaluation Program, *Guidelines*, 3.
18. Section VI., Selection of Appraiser or Persons Who Perform Evaluations, *Guidelines*, 6.
19. Section XVI., Third-Party Arrangements, *Guidelines*, 19.

dence suggests, however, that short-term cost savings due to lower staffing expenses is often a primary consideration in an institution's third-party arrangement. A potentially overlooked component of an institution's analysis may be the expenses associated with maintaining internal managerial expertise and the associated costs for effectively monitoring the third-party arrangement on an ongoing basis. Examiners may request documentation of the analysis supporting any outsourced functions of the valuation program.[20] Examiners may also request institutions to demonstrate how they effectively manage the risk associated with any third-party arrangement.

Valuation Assignments: Orders and Completion

Individuals managing the ordering process for assignments should be knowledgeable about banking regulations and guidance, USPAP, and differences relating to property types, locations, markets, and valuation methodologies. As detailed in the following discussion, such individuals should implement and monitor procedures for maintaining independence in appraisal-related communications and the bidding and selection processes; using engagement letters effectively; obtaining evaluations when permitted; maintaining an assignment tracking system; and resolving difficulties encountered during the valuation process.

Monitoring Communications

Institutions should monitor appraisal-related communications to ensure that comments do not influence the independence of the valuation provider. Internal and external written, electronic, and oral communications occur among borrowers, loan officers, selecting officials, reviewers, and valuation product providers. Borrowers and loan officers are typically involved in such communications during the gathering of essential preassignment property information. This information may include addresses, sales contracts, income and expense statements, leases, building plans and specifications, contractor cost data, governmental approvals and permit achievement, environmental issues, and property access for inspection purposes. Direct communications between borrowers and valuation providers should be limited, however, to avoid any real or perceived influence from the borrower. Any such communications should only be associated with non-value-related needs, such as appointments for property inspection. Borrower communications should be channeled through lending officials or other bank officers not involved with performing the appraisal or evaluation. In appropriately managed valuation programs, appraisers are not subject to assignment conditions that require them to gather data directly from the borrower. An institution should implement adequate internal controls to ensure communications between appraisal or evaluation reviewers and those who performed the appraisals or evaluations do not result in any coercion or undue influence when resolving deficiencies in a report.[21] Institutions also should be cautious in limiting the scope of the appraiser's inspection, research, or other information used to determine the property's condition and relevant market factors, which could affect the credibility of the appraisal.[22] Such actions could be perceived as undue influence on the appraiser to affect the assignment results.

Bidding Procedures

An institution's valuation assignment bidding procedures should ensure the process is independent. The person responsible for accepting a bid and ordering an appraisal or evaluation should be independent from the loan production staff. Institutions should establish policies and procedures that foster appropriate communications, including prebid discussions between staff and appraisers to clarify assignment details that could impact their bid. The Guidelines provide that for residential transactions, loan production staff can use a revolving, preapproved appraiser list to initiate an assignment, provided the development and maintenance of the list is not under

20. Section XVI., Third-Party Arrangements, states, "Prior to entering into any arrangement with a third party for valuation services, an institution should compare the risks, costs, and benefits of the proposed relationship to those associated with using another vendor or conducting the activity in-house."

21. Section XV. C., Resolution of Deficiencies, *Guidelines*, 18.

22. Section VIII., Minimum Appraisal Standards, *Guidelines*, 8.

their control.[23] The use of such a list generally does not circumvent the independence of the appraiser selection and appraisal ordering process, as loan production staff does not have discretion to select and order an appraisal from another appraiser. Borrowers are not to be involved in recommending or selecting those involved in performing appraisals and evaluations because this would compromise the independence of the valuation program.

Engagement Letters

Engagement letters can facilitate communications with appraisers and document the parties' expectations for appraisal assignments. Effective engagement letters facilitate communications best when they

- Convey the expectation that the written appraisal or evaluation report must contain sufficient information to support the market value conclusion
- Identify any known assignment conditions that could affect the scope of work to be performed by the appraiser[24]
- Provide the appraiser with the real property's interest (fee simple, leasehold, or leased fee), the Agencies' definition of *market value*, the intended users and intended use of the report, and the valuation scenarios needed, such as prospective or as is market values
- Specify the need to clearly allocate the value of different asset components, such as real estate, furniture, fixtures, equipment, and going-concern or other intangible assets
- Provide instructions when unanticipated property or assignment changes are encountered by appraisers and evaluators
- Refrain from the use of outdated terminology that has been revised or retired in USPAP
- Encourage the identification and reporting of potential areas of risk affecting the appraised property over the proposed term of the loan, such as historical capitalization rate volatility, change in supply, occupancy, or other unique property factors. The credibility of assignment results is not limited to value.

Evaluations of Collateral

Institutions may want to obtain evaluations,[25] which potentially could be used to value the real estate collateral for a significant portion of their loan transactions. Individuals preparing evaluation reports should be competent and may choose to comply with USPAP but are not required to do so. In addition, evaluations are not required to be prepared by state-licensed or state-certified appraisers, though they can be. Institutions should not overlook or avoid this experienced category of provider, as qualified state-licensed and state-certified appraisers have demonstrated training and experience, and frequently have access to reliable informational resources that assist in developing credible market values in this growing segment of evaluation reports.

Regardless of the provider's credentials, evaluations must contain sufficient information to support the value conclusion.[26] A valuation product must provide a property's market value and sufficient information and analysis to support the value conclusion to be acceptable as an evaluation.[27] The increased availability of automated data and processes provides valuation professionals with analytical tools and valuation reports, and facilitates the ordering of property condition reports. However, obtaining an automated valuation report along with a property condition report would not constitute an evaluation that meets regulatory requirements.[28] Credible assignment results require not only sufficient market-based data, but adjustment for logic-based analyses of factors that affect market value. These factors, such as property amenities, often are unmeasured by electronically captured sales and income property data. For example, automated valuation reports may fail to consider any value differences between nearly identical residential

23. Section VI., Selection of Appraiser or Persons Who Perform Evaluations, *Guidelines*, 6.

24. See Advisory Opinion 28 (AO-28), Scope of Work Decision, Performance, and Disclosure, "Problem Identification," Lines 15–41, in Appraisal Standards Board, *USPAP Advisory Opinions*, 2018–2019 ed. (Washington, DC: The Appraisal Foundation, 2018).

25. An evaluation is permitted in lieu of an appraisal for certain loans that fall below specified levels; see 12 CFR part 323.3(b), Evaluations required; and *Guidelines*, Section XI., Transactions that Require Evaluations, 11, and Appendix A., Appraisal Exemptions, 24.

26. Section XIII., Evaluation Content, *Guidelines*, 13.

27. Section XII., Evaluation Development, *Guidelines*, 12.

28. 12 CFR part 323.3(b).

properties that are three blocks apart in the same subdivision, even though one property has a waterfront view and the other is adjacent to a busy highway. However, evaluators can use automated valuation reports and property condition reports in developing a market value conclusion. Evaluators also can use alternative valuation methods and other locally acceptable techniques for valuation assignments, especially for properties in rural areas that may be more challenging to value due to the lack of comparable sales. These methodologies could include the cost approach, trending older sales information forward to current market conditions, and adjusting out-of-area sales for differences in location.[29]

Documentation

An effective valuation program requires documentation and tracking of each phase of the appraisal and evaluation process, including the resolution of deficiencies. The documentation should provide an audit trail that details the resolution of noted deficiencies or the reasons for relying on a second opinion of market value.[30] An institution should be able to demonstrate that sufficient information is available for monitoring individual and portfolio collateral, and the performance of appraisers, evaluators, and reviewers.[31] The assignment tracking system's sophistication should be commensurate with the volume and risk of real estate lending activities and should assist an institution in fulfilling its responsibility of establishing effective internal controls.[32] Institutions may develop internal tracking systems tailored to meet their needs or use external vendor-developed systems for ordering, tracking, and storing appraisal and evaluation results. To ensure independence, loan production staff should be able to initiate valuation assignment requests through the institution's tracking system but should not be involved in either the selection process or the awarding or placing of contracts. Access to those areas of the institution's tracking system should only be permitted by authorized individuals in the valuation program.

Flexibility

An effective valuation program can handle unexpected difficulties that arise during the valuation process. Unanticipated changes in property and markets, illnesses, weather, legal issues, and other post-assignment award conditions may result in delays and additional costs. Many institutions do not permit appraisers, evaluators, reviewers, or other valuation vendors to make changes to contract terms without advance discussion and written permission. Effective valuation programs maintain flexibility with such conditions, make appropriate accommodations on a timely basis, and document changes in the assignment tracking system.

Appraisal and Evaluation Review Process

An effective review process promotes credible market value conclusions prior to loan approval; facilitates the institution's decision to engage in the transaction; and provides the institution with an opportunity to identify deficiencies in a valuation report and bring them to the preparer's attention. An institution may use the review findings to monitor and assess the competency and ongoing performance of appraisers and evaluators who are included on its approved appraiser and evaluator lists. Existing regulatory guidance addresses the vetting process to ensure individuals reviewing appraisals and evaluations are competent.[33] Outsourcing appraisal reviews may be necessary when in-house expertise is not available. Many institutions preclude the use of third-party reviewers who unsuccessfully participated in the initial appraisal assignment bidding pool from performing the subsequent appraisal review.

Institutions should implement a risk-focused approach for determining the depth of review for appraisals and evaluations that is commensurate with the size, type, and complexity of the transaction. Reviews can be less technical in nature, such as administrative or checklist approaches,

29. See *Supervisory Expectations for Evaluations: Interagency Advisory on Use of Evaluations for Real Estate–Related Financial Transactions* (FIL-16-2016), available at http://bit.ly/FIL-16.

30. Section XV. D., Documentation of the Review, *Guidelines*, 18.

31. An institution may use review findings to monitor and evaluate the competency and ongoing performance of appraisers and persons who perform evaluations.

32. Section XVII., Program Compliance, *Guidelines*, 20.

33. Section XV. A., Reviewer Qualifications, *Guidelines*, 16.

for lower-risk transactions, and may include the use of automated tools and sampling methodologies for certain residential transactions.[34] However, reviewers should conduct more comprehensive technical reviews when required according to the institution's parameters for expanded depth of a review. The range of reviews available includes the following:

- **Administrative or Checklist Reviews.** Administrative or checklist reviews should be a meaningful and productive use of the institution's resources, not just a "file-papering" exercise to address regulatory requirements. Reviewers should have an appropriate level of expertise to recognize issues and conditions that may require a higher technical quality level of review for appraisals and evaluations.[35] All appraisal reviewers should be able to recognize USPAP deficiencies. Attending training courses after updates to USPAP have been released help both appraisers and non-appraisers perform satisfactory reviews.
- **Automated Tools and Sampling Methodologies.** With prior approval from the relevant primary federal regulator, automated tools and sampling methodologies can be used in the valuation review of lower-risk residential mortgages and can be an effective use of an institution's resources. However, appropriate care should be taken when placing full reliance on reviews generated by automated tools and sampling methodologies. The sole use of computerized screening software for reviewing government-sponsored enterprises' residential appraisal reports or other types of residential reports may result in the failure to identify issues that affect the value conclusion, such as functional and external obsolescence, verification and selection of sales, or value-enhancing amenities specific to a property. Institutions should periodically sample the review results from automated tools or sampling techniques to test the quality of the review process.
- **Technical Reviews.** Institutions should establish risk-focused criteria for expanding the depth of a review. Such criteria may include large dollar credits, complex or specialized properties, property types unfamiliar to persons typically reviewing appraisals, properties outside the institution's traditional lending market, and appraisals obtained from another financial services institution.[36] An institution may allow a technical quality review, performed by an appropriately state-licensed or state-certified appraiser, to include the development of his or her own opinion of value as a part of the review. This second opinion of value is most often applicable when material deficiencies remain uncorrected by the appraiser who performed the original assignment. On occasion, the credibility of such value conclusions may benefit from the preparer performing field inspections of the subject property or comparable sales and rentals.

An effective appraisal and evaluation review process includes quality testing.[37] Testing may consist of an assessment of credible assignment results from a meaningful sample of appraisals, evaluations, and their accompanying reviews. The testing procedures should also include the review of communications between appraisers, evaluators, and individuals performing the reviews to ensure the absence of any coercion or undue influence on the appraiser or evaluator. The reviewed communications could include phone calls, emails, and other electronic communications, including communications from third-party providers, such as appraisal management companies.

Information Safeguards and Resources

Institutions must take reasonable steps to safeguard confidential information and personally identifiable information contained in appraisal reports. An effective valuation program takes appropriate measures to prevent unauthorized access to physical and electronic appraisal results, transmissions, and communications.[38] In addi-

34. Section XV. B., Depth of Review, 1-to-4 Family Residential Real Estate, *Guidelines*, 17.
35. A technical quality review, sometimes referred to as a "USPAP Standards 3 and 4 compliance review," is to be completed by an appropriately state-licensed or state-certified appraiser.
36. Section XV. B., Depth of Review, *Guidelines*, 16–17.
37. Section XVII., Program Compliance, *Guidelines*, 20.
38. See, for example, FDIC, 12 CFR part 332, Privacy of Consumer Financial Information, and 12 CFR part 364, Appendix B, Interagency Guidelines Establishing Information Security Standards.

tion, USPAP's Ethics Rule requires appraisers to comply with all confidentiality and privacy laws and regulations applicable in an assignment.[39]

An appropriate in-house valuation resource library, needed by an institution to competently perform valuation program oversight activities, is an often-overlooked component when institutions outsource significant parts of valuation programs. Institutions frequently perform internal valuation activities, such as reviewing, verifying, and validating use of existing appraisals and evaluations, as well as validating automated valuation models, monitoring collateral values, and performing portfolio collateral risk assessments. An internal or external valuation program benefits from access to and maintenance of on-site resources such as those listed in the Core Valuation Program Resources appendix at the end of this article.

Conclusion

Credible valuation information continues to be an important part of the overall credit process. An effective valuation program enhances institutions' ability to identify, measure, monitor, and manage credit risk. The examination process provides an opportunity for bank management and examiners to have informal discussions regarding the challenges of ordering, tracking, performing, and reviewing credible valuation products. Such discussions can enhance the effectiveness of an institution's real estate lending activities by ensuring the key elements are tailored to the type and level of risk in the portfolio and are consistent with the institution's strategic goals. Appraisers should be knowledgeable of loan underwriting concepts when the intended use is for loan underwriting purposes. They and their clients will be well served as they identify elements of risk, assisting lending institutions in their valuation programs.

Lending institutions can continue to meet safe and sound conduct requirements by employing and contracting those individuals who are appropriately licensed and have demonstrated training, knowledge, competency, and judgment in producing valuation assignments. While financial institutions can outsource portions of their valuation programs, they cannot outsource their responsibility of oversight. Though evaluations and electronic data programs can be useful tools in real estate lending programs, independent and competent licensed and certified appraisers continue to be the key resource provider of valuation assignments. Federal examiners recognize the need for sound professional judgment in all valuation activities. Core principles of oversight, management, independency, competency, and credible assignment results have not changed.

About the Author

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39. FDIC, Minimal Appraisal Standards, 12 CFR part 323.4.

Appendix Core Valuation Program Resources

The items listed here are recommended resources for institutions' valuation programs. The FDIC-cited regulation sources have corresponding OCC, FRB, and NCUA regulations in the Code of Federal Regulations.

Regulatory Resources

Regulations

- 12 CFR part 323, Appraisals, http://bit.ly/FDIC_Appraisals
- 12 CFR part 365, Real Estate Lending Standards, http://bit.ly/FDIC_realestate
- Regulation Z (Truth in Lending), §1026.42, Valuation independence, http://bit.ly/2M3ybYQ

Financial Institution Letters (see http://bit.ly/FIL-INDEX for a complete listing of letters)

- FIL-20-2005, *Frequently Asked Questions on the Appraisal Regulations and the Interagency Statement on Independent Appraisal and Evaluation Functions*, http://bit.ly/2EpluRV
- FIL-90-2005, *Frequently Asked Questions on Residential Tract Development Lending*, http://bit.ly/2WYnrfg
- FIL-44-2008, *Guidance for Managing Third-Party Risk*, http://bit.ly/2WjRlhc
- FIL-82-2010, *Interagency Appraisal and Evaluation Guidelines*, http://bit.ly/InteragencyGuidelines
- FIL-19-2015, *Minimum Requirements for Appraisal Management Companies*, http://bit.ly/2wdWzMQ
- FIL-16-2016, *Supervisory Expectations for Evaluations*, http://bit.ly/2Qj1Vj8
- FIL-19-2017, *Advisory on the Availability of Appraisers*, http://bit.ly/2VERrM2
- FIL-49-2018, *Interagency Statement Clarifying the Role of Supervisory Guidance*, http://bit.ly/2Er7APo
- FIL-62-2018, *Appraisal Regulations: Frequently Asked Questions*, http://bit.ly/2LZNIc9

***Supervisory Insights* Newsletter** (see http://bit.ly/SupervisoryInsights for a complete listing of articles)

- FDIC, "Navigating the Real Estate Valuation Process," *Supervisory Insights* 8, no. 2 (Winter 2011), 3–13, http://bit.ly/30CePNF
- FDIC, "Overview of Selected Regulations and Supervisory Guidance," *Supervisory Insights* 15, no. 2 (Winter 2018), 8–19, http://bit.ly/2HP0FjY

Supplemental Resources

Valuation programs may utilize the following helpful resources:

- Assignment ordering and tracking software
- Engineering and environmental resources
- Expense manuals
- Legal description tracing software (if needed for real estate with lengthy legal descriptions)
- Professional journals, dictionaries, and instructional textbooks
- Residential and non-residential costing manuals
- Sales, rentals, listing data service subscriptions
- Specialty manuals, such as for storage units, lodging, "green" valuation, market analysis, statistics, and others
- *The Uniform Standards of Professional Appraisal Practice* (historical and current editions)

SEE NEXT PAGE FOR ADDITIONAL RESOURCES >

Additional Resources

Suggested by the Y. T. and Louise Lee Lum Library

American Bankers Association—Compliance
https://www.aba.com/Compliance/Pages/default.aspx

Appraisal Institute
Lum Library External Resources [Login Required]
Information Files—Appraisal Practice

Board of Governors of the Federal Reserve System—Supervision and Regulation
https://www.federalreserve.gov/supervisionreg.htm

Federal Deposit Insurance Corporation—Regulations and Examinations
https://www.fdic.gov/regulations/

National Credit Union Administration—Regulation and Supervision
https://www.ncua.gov/regulation-supervision

Office of the Comptroller of the Currency (OCC)

- **Comptroller's Handbook, Residential Real Estate**
  http://bit.ly/comptrollers-handbook
- **Laws and Regulations**
  https://www.occ.gov/topics/laws-regulations/index-laws-regulations.html