

September 3, 2020

**Memorandum to:** The Board of Directors

**From:** Doreen R. Eberley  
Director  
Division of Risk Management and Supervision

**Subject:** Final Rule on Real Estate Appraisals

**Summary of Recommendation:**

Staff are presenting to the Board of Directors (the Board) of the Federal Deposit Insurance Corporation (the FDIC) for approval the attached final rule titled Real Estate Appraisals: Final Rule (12 CFR Part 323). The final rule is joint with the Office of Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (FRB), collectively referred to as the Agencies.

The final rule would adopt as final an interim final rule that was published in the *Federal Register* on April 17, 2020, that created a new exception to general appraisal requirements. The new exception defers the requirement to obtain an appraisal or evaluation for up to 120 days following the closing of a transaction for certain residential and commercial real estate transactions.<sup>1</sup> This exception, which will expire on December 31, 2020, was provided to allow insured depository institutions (regulated institutions) to expeditiously extend liquidity to creditworthy households and businesses in light of recent strains on the U.S. economy as a result of the coronavirus disease 2019 (COVID-19), while reaffirming the safety and soundness principle that valuation of collateral is an essential part of the lending decision. Under the exception, a regulated institution is still encouraged to make best efforts to obtain a reliable valuation of real property collateral before a loan closing, consistent with the principles in the Agencies' Standards for Safety and Soundness and Real Estate Lending Standards. The only change from the rule text of the interim final rule would be the addition of a definition of acquisition, development, and construction transactions to provide more clarity.

CONCUR: \_\_\_\_\_

Nicholas J. Podsiadly  
General Counsel

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<sup>1</sup> 85 Federal Register 21312, Apr. 17, 2020.

## **Summary**

### *Impact of COVID-19 on Appraisals and Evaluations*

Due to the impact of COVID-19, businesses and individuals have had a heightened need for additional liquidity. In addition, the spread of COVID-19 has greatly increased the difficulty of performing real estate appraisals and evaluations in a timely manner.

### *Title XI and the Appraisal Regulations*

Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 directs each Federal financial institutions regulatory agency to publish appraisal regulations for federally related transactions within its jurisdiction. The purpose of Title XI is to protect federal financial and public policy interests in real estate-related transactions by requiring that real estate appraisals used in connection with federally related transactions (Title XI appraisals) are performed in writing, in accordance with uniform standards, by individuals whose competency has been demonstrated and whose professional conduct will be subject to effective supervision.

Title XI directs the Agencies to prescribe appropriate standards for Title XI appraisals under the Agencies' respective jurisdictions. At a minimum, the statute provides that a Title XI appraisal must be: (1) performed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP); (2) a written appraisal, as defined by the statute; and (3) subject to appropriate review for compliance with USPAP. While appraisals are ordinarily completed before a lender and borrower close a real estate transaction, there is no specific requirement in USPAP that appraisals be completed at a specific time relative to the closing of a transaction.

All federally related transactions must have Title XI appraisals. Title XI defines a federally related transaction as a real estate-related financial transaction that the Agencies or a financial institution regulated by the Agencies engages in or contracts for, that requires the services of an appraiser. The Agencies have authority to determine which real estate-related financial transactions do not require the services of an appraiser and thus are not required to have Title XI appraisals. The Agencies have exercised this authority by exempting certain categories of real estate-related financial transactions from the Agencies' appraisal requirements.

The Agencies have used their safety and soundness authority to require evaluations for a subset of transactions for which an appraisal is not required. Under the appraisal regulations, for these transactions, financial institutions that are subject to the Agencies' appraisal regulations (regulated institutions) must obtain an appropriate evaluation of real property collateral that is consistent with safe and sound banking practices.

### *Authority to Defer Appraisals and Evaluations*

Pursuant to the interim final rule, deferrals of appraisals and evaluations are allowed for expeditious access to credit. These deferrals are only temporary. The deferrals were offered in response to a national emergency and incorporate the principles in the Agencies' Standards for Safety and Soundness and Real Estate Lending Standards that focus on the ability of a borrower to repay a loan and other relevant factors. These deferrals were not an exercise of the Agencies' waiver authority, given that appraisals and evaluations were deferred, not waived. The deferrals also did not waive USPAP requirements, since USPAP does not address the completion of an

appraisal assignment with the timing of a lending decision. The interim final rule provided that USPAP must be followed when an appraisal is conducted within 120 days after the closing of the transaction for which the appraisal is required.

The deferral of evaluations reflects the same considerations relating to COVID-19. The Agencies require evaluations for certain exempt transactions as a matter of safety and soundness. Evaluations do not need to comply with USPAP, but must be sufficiently robust to support a valuation conclusion. An evaluation can be less complex than an appraisal and usually takes less time to complete than an appraisal, but also commonly involves physical property inspections. For these reasons, the Agencies also used their safety and soundness authority to defer evaluations.

By the end of the deferral period, regulated institutions will be required to obtain appraisals or evaluations that are consistent with safe and sound banking practices as required by the Agencies' appraisal regulations.

### *The Interim Final Rule*

The interim final rule temporarily deferred requirements for appraisals and evaluations for all residential and commercial real estate secured transactions, including loans for new money or refinancing transactions. The deferral did not apply to real estate secured loans for the acquisition, development, and construction of commercial or residential property.

Under the interim final rule, regulated institutions may close a real estate loan without a contemporaneous appraisal or evaluation, subject to a requirement that institutions obtain the appraisal or evaluation, as would have been required under the appraisal regulations without the deferral, within a grace period of 120 days after closing of the transaction. While appraisals and evaluations can be deferred, the Agencies would continue to expect regulated institutions to adhere to internal underwriting standards for assessing borrowers' creditworthiness and repayment capacity, and to develop procedures for initially estimating the collateral's value upon which to extend or refinance credit.

The Agencies expect that a regulated institution would have a remediation plan in place to supplement its collateral position if the appraisal or evaluation ultimately reveals a market value significantly lower than the expected market value. In addition, the Agencies expect that regulated institutions would develop remediation plans that take into account mitigation of financial harm and burden to COVID-19-affected borrowers.

The temporary provision permitting regulated institutions to defer an appraisal or evaluation for eligible transactions expires on December 31, 2020, unless extended by the Agencies.

### **Summary of Comments Received**

The Agencies collectively received eleven comments from trade associations representing banks, appraisers, and from individuals in response to the interim final rule. The majority of commenters supported the Agencies' action and stated that appraisal and evaluation deferrals would be helpful to businesses and consumers during the COVID-19 event. Commenters also requested clarification of certain aspects of the interim final rule. Two commenters requested that the Agencies add a definition of acquisition, development and construction transactions for

purposes of this rule and that the Agencies clarify risk management practices after the deferral period. Two commenters asked the Agencies to reconsider the interim final rule, mainly over concern that delayed appraisals and evaluations might not support the related credit extensions and that properties would be overleveraged. One commenter asked the Agencies to make the deferral permanent as a way to address the ongoing problem of appraiser shortages in rural areas.

In response to a comment, the proposed final rule would provide a regulatory definition of the term “acquisition development and construction transactions.” For purposes of the final rule, transactions for the “acquisition, development, and construction” of real estate excluded from the 120-day deferral period mean those loans described in the Instructions for Schedule RC-C, “Loans and Lease Financing Receivables,” Part I, “Loans and Leases,” item 1.a, “Construction, land development, and other land loans” of the FFIEC Call Report. This line item includes loans secured by real estate made to finance: (a) land development (i.e., the process of improving land – laying sewers, water pipes, etc.) preparatory to erecting new structures; (b) the on-site construction of industrial, commercial, residential, or farm buildings (including not only construction of new structures, but also additions or alterations to existing structures and the demolition of existing structures to make way for new structures); (c) loans secured by vacant land, except land known to be used or useable for agricultural purposes, such as crop and livestock production; (d) loans secured by real estate the proceeds of which are to be used to acquire and improve developed and undeveloped property; and (e) loans made under Title I or Title X of the National Housing Act that conform to the definition of construction stated above and that are secured by real estate.

The proposed final rule would also find good cause to make the final rule immediately effective. The proposed final rule states that because the final rule relieves a restriction, the final rule is exempt from the Administrative Procedure Act’s delayed effective date requirement. In addition, the proposed final rule states that the public interest would be best served by implementing the final rule as soon as possible. As discussed in the final rule, recent events have suddenly and significantly affected global economic activity, increasing businesses’ and households’ need to have timely access to liquidity from real estate equity. In addition, the spread of COVID-19 has greatly increased the difficulty of performing real estate appraisals and evaluations in a timely manner. The relief provided by the final rule would continue to allow regulated institutions to better focus on supporting lending to creditworthy households and businesses in light of recent strains on the U.S. economy as a result of COVID-19, while reaffirming the safety and soundness principle that valuation of collateral is an essential part of the lending decision. Finally, the proposed final rule states that implementing the final rule as soon as possible, with its clarifying language, would be consistent with the Agencies’ intent to continue to grant expedited relief to the regulated entities.

In response to a comment, the proposed final rule would also clarify in the final rule that the Agencies generally expect that, after the COVID event, banks should continue to adhere to practices consistent with the established safety and soundness standards and should refer to risk management guidance for managing loans that have been issued during the COVID event. Existing flexibilities in appraisal standards and the interagency appraisal regulations are described in the *Interagency Statement on Appraisals and Evaluations for Real Estate Related*

*Financial Transactions Affected by the Coronavirus.*<sup>2</sup> Institutions should also consider the *Joint Statement on Additional Loan Accommodations Related to COVID-19*<sup>3</sup> (Joint Statement), issued by the FFIEC member agencies.<sup>4</sup> The Joint Statement provides guidance on managing loans as they approach the end of COVID event-related accommodation periods. The Joint Statement also provides guidance on offering additional accommodations.

Commenters also requested that the Agencies provide a remedy for loans with deferred appraisals when the appraised value is lower than expected. In response, the proposed final rule would clarify that the Agencies did not prescribe methods or documentation standards for valuations estimated during the deferral period, but prudent institutions should retain information that was used to support a best estimate. Institutions should continue to develop a loan-to-value estimate in accordance with real estate lending standards and overall standards for safety and soundness. As stated in the interim final rule, the Agencies would clarify in the final rule that they expect each institution to develop an appropriate risk mitigation strategy if the appraisal or evaluation ultimately determines a market value for a property that is significantly lower than expected when the loan was made, and to take appropriate action to mitigate the risk.

A commenter requested guidance on what effective date appraisers should use for appraisals that are deferred for 120 days. The proposed final rule would clarify that the effective dates for these transactions would be left to the discretion of the institution as established by the scope of work of the appraisal engagement.

#### **Recommendation:**

Staff recommends that the Board approve the publication of the attached final rule titled “Real Estate Appraisals: Final Rule” in the *Federal Register*, and that it find good cause to make the rule effective upon publication in the *Federal Register*.

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#### Attachments

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<sup>2</sup> Press Release: *Interagency Statement on Appraisals and Evaluations for Real Estate Related Financial Transactions Affected by the Coronavirus* (Apr. 14, 2020).

<sup>3</sup> *Joint Statement on Additional Loan Accommodations Related to COVID-19* (Aug. 3, 2020), Financial Institution Letter FIL-74-2020.

<sup>4</sup> The FFIEC is composed of the following: a member of the FRB, appointed by the Chairman of the FRB; the Chairman of FDIC; the Chairman of the National Credit Union Administration; the Comptroller of the OCC; the Director of the Bureau of Consumer Financial Protection; and, the Chairman of the State Liaison Committee.