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# Basic Federal Requirements

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- Federally related transactions
- Written documentation of collateral value
  - *All loans must be documented*
  - *Unless exempted by regulation*
- Follow uniform standards
- Performed by competent individuals
- Subject to effective state supervision



# 2 document types per reg

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- Appraisal

- Licensed/certified vendors
- Meet USPAP
- Required for certain sizes and repayment reliance

- Evaluations

- No license/certification required
- Does not have to meet USPAP
- Allowed for anything not needing an appraisal

# What Drives Documentation Need?



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- What type of event is involved?
- What loan size?
- What loan purpose?



# Regulatory Event Drivers

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- Valuation documentation is needed every time
- Doc requirement depends the type of “event”
  - New Money Transactions
  - Existing Debt Transactions
  - Problem Loan Transactions
  - Foreclosure



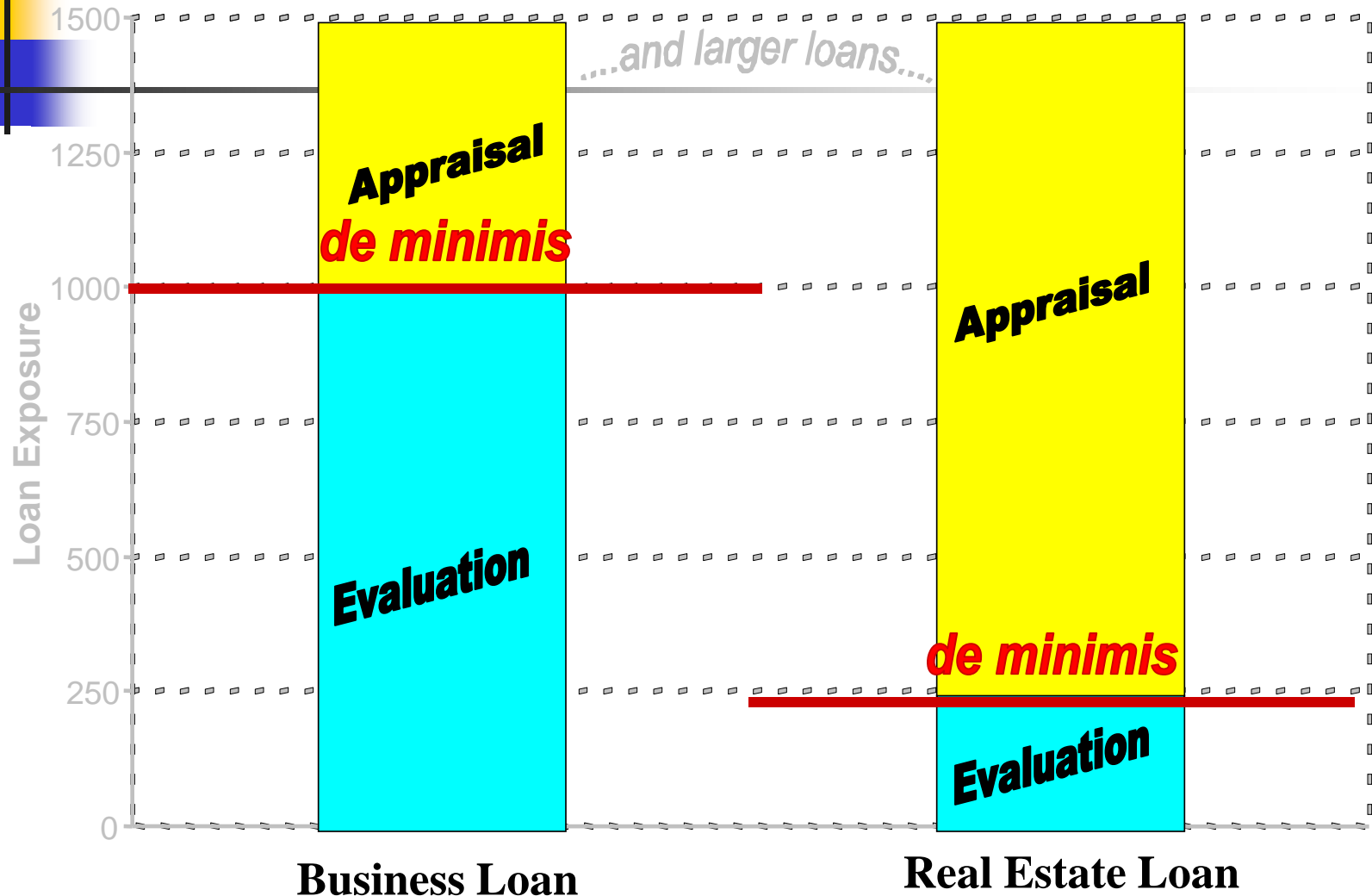
# Size & Purpose Drivers

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- How big is the loan?
  - \$250M de minimis
  - \$1,000M de minimis
- Where does repayment reliance come from?
  - Business loans – repaid from business operations
  - Real estate loans – repaid from rents or unit sales
  - Consumer loans – e.g. home loans, HELOCs, etc.

# New Money

## Appraisals vs. Evaluations





# New Money Transactions

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- New money loan at the bank
- May represent existing customer but a new loan transaction (typically a new note #)
- Typically represents new collateral at the bank



# Existing Debt Transactions

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- Not only is the customer an existing one, but
- Collateral is already somewhere on the bank's books
- May represent a simple renewal event, or
- A renewal with modifications or terms (rate, amort), or
- An increase in the total debt secured to the RE
  - Collateral renovation/expansion
  - Cash out refinance (money spent on something other than collateral)
  - Crossed relationships with other existing notes



# Problem Loans (by Classification)

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- **Special Mention**
  - Late payments?
  - Covenant violations (e.g. debt/worth; liquidity)
  - Other factors
- **Substandard**
  - Missed payments
  - Significant relationship deterioration
  - May also require Troubled Debt Restructure (TDR)
- **Non-Accrual**
  - Interest no longer charged
  - Charge-off required



# Foreclosure

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- The bank receives title back
  - Deed in lieu
  - Enforced via mortgage suit
  - Enforced via deed of trust provisions
- Foreclosure requirements
  - Appraisals for loan balances  $>$  \$250M
  - Evaluations for loan balances  $\leq$  \$250M



# FAS 114 Compliance

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- What is FAS 114
- What does it call for?
- Fair Value v Market Value
- Disposal and holding costs

# Summary of FAS 114



FINANCIAL ACCOUNTING STANDARDS BOARD

## **Accounting by Creditors for Impairment of a Loan--an amendment of FASB Statements No. 5 and 15 (Issued 5/93)**

This Statement addresses the accounting by creditors for impairment of certain loans. It is applicable to all creditors and to all loans, uncollateralized as well as collateralized, except large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, loans that are measured at fair value or at the lower of cost or fair value, leases, and debt securities as defined in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. It applies to all loans that are restructured in a troubled debt restructuring involving a modification of terms.

# Summary of FAS 114 (Contd.)



FINANCIAL ACCOUNTING STANDARDS BOARD

It requires that impaired loans that are within the scope of this Statement be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent..

# Summary of FAS 114 (Contd.)



FINANCIAL ACCOUNTING STANDARDS BOARD

This Statement amends FASB Statement No. 5, *Accounting for Contingencies*, to clarify that a creditor should evaluate the collectibility of both contractual interest and contractual principal of all receivables when assessing the need for a loss accrual. This Statement also amends FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, to require a creditor to measure all loans that are restructured in a troubled debt restructuring involving a modification of terms in accordance with this Statement.

This Statement applies to financial statements for fiscal years beginning after December 15, 1994. Earlier application is encouraged



# Definition of Fair Market Value

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A term that is, in concept, similar to market value in general usage; used mainly in condemnation, litigation, income tax, and property tax situations. When an appraisal assignment involves developing an opinion of fair market value, the appropriate, requisite, and precise definition of the term depends on the use of the appraisal and the applicable jurisdiction.



# Definition of FMV (contd)

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For example, the Internal Revenue Service defines *fair market value* as follows:

The price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sales price. Nor is the fair market value of an item of property to be determined by the sales price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. (IRS Regulation 20.2051-1.)



# Definition of FMV (contd)

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The California Code of Civil Procedure (Section 1263.320(a)) defines *fair market value* as follows:

The highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.

*The Dictionary of Real Estate Appraisal, Fifth Addition*



# Definition of Broker's Opinion of Value (BOV)

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An opinion of value developed by a real estate agent or broker rather than by a licensed or certified appraiser.

*The Dictionary of Real Estate Appraisal, Fifth Addition*

# Definition of Broker Price Opinion (BPO)



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An opinion of property price rendered by a licensed real estate agent or broker.

*The Dictionary of Real Estate Appraisal, Fifth Edition*

The BPO, or Broker Price Opinion, is a tool used by lenders and mortgage companies to value properties in situations where they believe the expense and delay of an appraisal is not necessary. Real estate brokers are given an order to do a BPO by the lender, mortgage company or loss mitigation company. The broker does either a Drive By BPO or an Internal BPO in most cases.



# Definition of Evaluation

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A term used by the federal financial institution regulatory agencies to mean an estimate of value for certain real estate-related transactions that are exempt from the federal agencies' appraisal requirements. Advisory Opinion 13 (AO-13) from the Appraisal Standards Board of the Appraisal Foundation deals with the performance of evaluations of real property collateral by an appraiser.

*The Dictionary of Real Estate Appraisal, Fifth Addition*