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M E M O R A N D U M

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To Our Clients and Friends

Re: Independent Appraisal and Evaluation Functions

The Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision and the National Credit Union Association (the “Agencies”) have issued a statement to remind regulated institutions that there needs to be an effective, independent real estate appraisal and evaluation program for all of their lending functions. This reminder clarifies, and is to be read in conjunction with, the agencies’ appraisal and real estate lending regulations and the Interagency Appraisal and Evaluation Guidelines (the “Guidelines”) issued in 1994.

SCOPE

The statement applies to all real estate-related financial transactions originated or purchased by a regulated institution for its own portfolio or as assets held for sale. An institution’s board of directors is responsible for reviewing and adopting policies and procedures that establish and maintain an effective, independent real estate appraisal and evaluation program for all its lending functions. Real estate lending functions include commercial real estate mortgage departments, capital market groups, and asset securitization and sales units. An institution’s lending functions should not have undue influence that might compromise the independence of the appraisal process.

SELECTING INDIVIDUALS TO PERFORM APPRAISALS OR EVALUATIONS

Selection and Engagement

- Selection criteria must provide for the independence of the individual performing the appraisal or evaluation. The person must not have either a direct nor indirect, interest, financial or otherwise, in the property or transaction.
- Selection criteria must ensure that the individual is competent to perform the assignment.
- Appraisal or development work should not commence until the institution finalizes the selection process.
- Institutions are encouraged to use written engagement letters when ordering appraisals, especially for large, complex, or out-of-area commercial real estate properties. A copy of the engagement letter should be in the permanent loan file.

Appraiser Independence

- An institution, or its agent, must directly engage the appraiser. However, an institution may use an appraisal prepared for another financial services institution, provided that the institution determines that the appraisal conforms to the agencies' appraisal regulations and is otherwise acceptable.
- Independence is compromised when an institution uses an appraiser who is recommended by the borrower or allows the borrower to select the appraiser from the institution's approved list.
- Institutions may not use an appraisal prepared by an individual who was selected or engaged by a borrower.
- Institutions may not use "readdressed appraisals," appraisal reports that are altered by the appraiser to replace references to the original client with the institution's name.

Safeguards Against Internal Influence

- Individuals independent from the loan production area should oversee the selection of appraisers and individuals performing loan evaluation services.
- Loan officials, officers or directors with responsibility for ordering appraisals and evaluation should not have sole approval authority for granting the loan request.

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APPRAISAL AND EVALUATION COMPLIANCE REVIEWS

- An institution's appraisal and evaluation program must maintain effective internal controls that promote compliance with agencies' regulations and the Guidelines.
 - These internal controls should confirm that appraisals and evaluations are reviewed by qualified and adequately trained individuals who are not involved in the loan production process.
 - The institution's standards and depth of reviews should reflect the risk of the transaction and the process through which the appraisal or evaluation is obtained.
 - Even in small institutions, no single person should have sole authority to make credit decisions involving loans on which they ordered or reviewed the appraisal or evaluation.
 - Lending officials, officers, or directors should abstain from any vote or approval involving loans for which they performed the appraisal or evaluation.

SUPERVISORY APPROACH

- Examiners will review an institution's standards of independence and will consider whether policies and procedures are applied uniformly to all areas engaged in lending transactions
- If an institution suspects that a licensed or certified appraiser is violating applicable laws or engaging in unethical or unprofessional conduct, the institution should make referrals to the appropriate state appraiser regulatory authorities.
- Institutions, lenders, staff and fee appraisers could be subject to enforcement actions for violations of the agencies' appraisal and real estate lending regulations.

The Agencies' statement can be found at
http://www.schwartzandballen.com/whats_new.html.

If you have any questions concerning the statement, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.