Part 722 – Appraisals Final Rule

Board Presentation

July 18, 2019

Legislative Background

- 1989: FIRREA directed regulatory agencies to prescribe appropriate appraisal standards and required certified appraisers for federally related transactions of $1 million or more.
- 1992: FIRREA amended to expressly authorize agencies to set thresholds levels at which no appraisal is required.
- 2010: Dodd Frank Act amended the threshold provision to include concurrence from the Consumer Financial Protection Bureau.
- 2018: S. 2155 established an appraisal threshold exempting certain rural federally related transactions with values of less than $400,000.

Regulatory Appraisal Thresholds

NCUA thresholds compared to Other Banking Agencies

Year	NCUA	Other Banking Agencies
1992	$50,000	$100,000
1994	$50,000	**$250,000 (non-QBL and residential)** **$1,000,000 (QBLs)**
1995	$100,000	$250,000 (non-QBL and residential) $1,000,000 (QBLs)
2002	**$250,000**	$250,000 (non-QBL and residential) $1,000,000 (QBLs)
April 2018	$250,000	$250,000 (residential) **$500,000 (non-QBL) – Final Rule** $1,000,000 (QBLs)
Sept 2018	$250,000 (residential) **$1,000,000 (commercial) - NPR**	$250,000 (residential) $500,000 (non-QBL) $1,000,000 (QBLs)
Dec 2018		**$400,000 (residential) - NPR**

QBL = Qualifying Business Loan - not dependent on sale/rental of real estate as primary source of repayment for loan.

Appraisal Rule Objectives

- Update commercial real estate appraisal standards for credit unions to reflect changes in bank standards and for inflation.
- Restructure the regulation to make it easier to determine what is required.
- Incorporate the rural exemption provided by the Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155).
- Make various other conforming adjustments.

Key Changes and Enhancements

Appraiser Requirement*			
	NCUA Current Rule	NCUA Final Rule	OBA Rule
Commercial			
<$250K	Written Estimate	Written Estimate	Written Estimate
$250K - $500K	Certified	Written Estimate	Written Estimate
$500K - $1M	Certified	Written Estimate	Certified (non-QBL) Written Estimate (QBL)
≥$1M	Certified	Certified	Certified
Residential			
Complex, ≥$250K	Certified	Certified**	Certified
Not Complex, $250K - $1M	Licensed or Certified	Licensed or Certified**	Licensed or Certified
Not Complex, ≥$1M	Certified	Certified	Certified

*Under current and final rule, transactions below thresholds for appraisals require written estimates of market value, unless specifically exempted.

**Under the final rule, residential thresholds are tied to the unguaranteed or uninsured portion of loan amount instead of overall loan amount.

Considerations

- **Cash-flow (ability to repay) and resiliency of the business are the primary determinants of loan success.**
  - Collateral valuation is not a primary driver of risk.
  - Portfolio management discipline, underwriting, and analysis of cash flows are better risk mitigants than collateral value estimates.
  - Financial crisis of 2008 was fueled by a lack of prudent underwriting, not appraisals.
- **Written estimates of market value provide reasonable assurance of real estate value and transaction integrity.**
  - Enhanced standards for written estimates of market value.
  - Performed by independent and qualified person, contains sufficient information to support credit decision.
  - Refer to *December 2010 Interagency Appraisal and Evaluation Guidelines.*
  - Greater market transparency and technological advances over the last 20 years provide significant and precise information about rental and sales market trends.

Considerations

- Credit unions should exercise sound judgement and get appraisals (even if not required) based on safety & soundness and transaction risks.
- Many CUs have a successful history of CRE lending and expertise comparable to community banks involved in CRE lending.
- Non-QBL’s are not necessarily more risky than QBL’s.
- Credit unions currently have limited CRE exposure. The level of CRE activity has remained relatively consistent.

Regulatory Relief Estimate

Commercial Real Estate Transactions				
Property Type	Transactions Exempted at the $250K Threshold	Additional Transactions Exempted at the $500K Threshold	Additional Transactions Exempted at the $1MM Threshold	Total Transactions Exempted at the $1MM Threshold
Land for Development	34.24%	20.22%	19.19%	73.65%
Non-Owner Occupied CRE	21.62%	17.01%	21.88%	60.51%
Owner Occupied CRE	19.57%	18.25%	23.61%	61.43%
Impact on Number of Transactions	**26.98%**	**18.59%**	**20.89%**	**66.46%**

Commercial Real Estate Market Dollars				
Property Type	Percent of Market Dollars Exempted at the $250K Threshold	Additional Market Dollars Exempted at the $500K Threshold	Additional Market Dollars Exempted at the $1MM Threshold	Total Market Dollars Exempted at the $1MM Threshold
Land for Development	2.95%	5.68%	10.34%	18.97%
Non-Owner Occupied CRE	1.20%	2.60%	6.48%	10.28%
Owner Occupied CRE	0.93%	2.24%	5.84%	9.01%
Impact on Market Dollars	**1.77%**	**3.63%**	**7.74%**	**13.14%**

*includes all U.S. commercial real estate transactions from the Costar Group, Inc. 2016 database

Increased Threshold Only Adds Marginal Risk

Commercial Real Estate ≈ 4% of CU Assets

Minus: 75-90% of CRE not exempt from appraisal

= less than 1% of CU Assets not subject to appraisal

Minus: All CRE < $250K

Minus: Exempted transactions that would still obtain appraisal

= Net Transaction Exposure of less than 1% of CU Assets

Residual Risk is a function of net transaction exposure, difference in degree of precision between valuation types, and time lapse from point of valuation.

Next Steps

- **Board Approval of the Final Rule 722 – Appraisals**

- **Effective Date is 90 days after published in the Federal Register**

- **Update:**
  - ❑ **Exam procedures and guidance**
  - ❑ **National Supervision Policy Manual**
  - ❑ **Examiner training**