

SUBJECT: Appraisals and Evaluations

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INTRODUCTION

This release applies to all credit unions, state or federal, when they engage in real estate lending, or sell, purchase, lease, or invest in real property.

EXECUTIVE SUMMARY

A major portion of the losses to the National Credit Union Share Insurance Fund has been associated with real estate lending. The NCUA has observed that for credit unions engaged in real estate lending, the greatest single risk protection they can obtain is a licensed or certified appraisal to support the loan-to-value ratio.

This release describes Part 722 of the NCUA Rules and Regulations requiring real estate appraisals, minimum standards for appraisals and qualifications of appraisers. It also reflects the *Interagency Appraisal and Evaluation Guidelines (Dec. 2010)*, NCUA Letter to Credit Unions No. 10-CU-23 (Dec. 2010), and other rules, regulations and guidance that apply to appraisals and evaluations of real estate.

A valuation is defined as either an appraisal or an evaluation. While the NCUA appraisal rule uses the term valuation to describe a written estimate of market value performed for a transaction exempted from the appraisal requirement, industry standards and the *Interagency Appraisal and Evaluation Guidelines (Dec. 2010)* use the term in a broader sense to include either an appraisal or an evaluation. The term valuation is used in the broader sense throughout this release. In addition, when there are references to the NCUA appraisal rule, the term evaluation has been substituted for valuation.

A valuation method that does not provide a property’s market value or sufficient information and analysis to support the value conclusion is not acceptable as an appraisal or evaluation. A credit union may not rely solely on data provided by local tax authorities to develop evaluations. The *Interagency Appraisal and Evaluation Guidelines (Dec. 2010)* specifically state that a credit union may use a tax assessment valuation in developing a real estate evaluation only when it can demonstrate that a valid correlation exists between the tax assessment data and the market value.

Under the NCUA regulations, if your credit union uses “Automated Valuation Models” in determining the value of collateral for a loan to be secured by the consumer’s principal dwelling in connection with making a credit decision on a mortgage, then the credit union must adopt policies, practices, procedures, and control systems to ensure that the Automated Valuations Models meet certain quality control standards.

The NCUA's Letter to Credit Unions No. 10-CU-23 (Dec. 2010) instructs the credit union's board of directors to review and adopt policies and procedures that establish and maintain an effective independent real estate appraisal and evaluation program for all of its lending functions and refers the credit union to the *Interagency Appraisal and Evaluation Guidelines* (Dec. 2010) to assist in that process. The NCUA's Letter to Credit Unions No. 05-CU-06 (Mar. 2005) provides questions and answers about appraisals and evaluations.

The Federal Truth in Lending regulation (Reg. Z) § 1026.42 establishes requirements for valuation independence, specifically for consumer credit transactions secured by consumers' principal dwellings (open- and closed-end), to ensure that persons who perform valuations are free to use their independent professional judgment in assigning home values without influence or pressure from those with interests in the transactions. The rule also requires creditors and their agents to pay customary and reasonable compensation to fee appraisers.

In 2024, the NCUA and other federal regulators issued guidance on "reconsiderations of value" in residential real estate lending. This refers to a credit union's request to an appraiser or other preparer of the valuation report to reassess their report, based upon potential deficiencies or other information that may affect the estimated value of the property. This ii Release summarizes that guidance.

Various state and federal regulations require credit unions to give mortgage loan applicants copies of appraisals or valuations (and in some cases, notify them that they have the right to obtain copies). For details on these requirements, see The League's ii Release No. B077.

SCOPE OF THE APPRAISAL RULE (§§ 722.102, 722.103)

The NCUA appraisal rule generally applies to any real estate-related financial transaction by federally insured or federally chartered credit unions.

A real estate-related financial transaction is virtually any transaction involving real estate in any way, not just real estate-secured loans and refinancings. It includes sales, purchases, or exchanges of real estate by the credit union, and investments in real estate or mortgage-backed securities. It also applies when the credit union sells property acquired through foreclosure.

All real estate-related financial transactions, of any dollar amount, must be supported by an appraisal meeting the NCUA requirements, unless they qualify for an exemption or an evaluation as described below.

MINIMUM APPRAISAL STANDARDS (§ 722.104)

Appraisals must meet detailed standards unless an evaluation is permitted. For federally-related transactions, all appraisals must, at a minimum:

- Conform to generally accepted appraisal standards – the Uniform Standards of Professional Appraisal Practice ("USPAP");
 - Appraisals must conform to USPAP unless principles of safe and sound banking require compliance with stricter standards. *Interagency Guidelines* (Dec. 2010).
- Be written and contain sufficient information and analysis to support the credit union's decision to grant the loan or engage in the transaction;
 - Report should contain sufficient disclosure of the nature and extent of inspection and research performed to verify the property's condition and support the opinion of market value. The appraiser must disclose whether the property was inspected and whether anyone provided significant assistance to the appraiser signing the report. Further, the appraiser must disclose whether he or she previously appraised the property. *Interagency Guidelines* (Dec. 2010).

The guidelines specifically state that the result of an Automated Valuation Model, by itself or signed by an appraiser, is not an appraisal, and that a broker price opinion may not be used as the primary basis to determine the value of a piece of property. *Interagency Guidelines* (Dec. 2010).

- Analyze and report appropriate deductions and discounts for proposed construction or renovation, etc.;
 - This standard is designed to avoid having appraisals prepared using unrealistic assumptions and inappropriate methods in arriving at the property's market value. Appendix C of the guidelines provides further discussion on deductions and discounts. *Interagency Guidelines* (Dec. 2010).

- Be based upon the definition of market value as set forth in § 722.102(f) (essentially meaning the most probable price which a property should bring in a competitive and open market with the buyer and seller each typically motivated, acting prudently and knowledgeably);
 - Value opinions such as “going concern value,” “value in use,” or a special value to a specific property user may not be used as market value. An appraisal may contain separate opinions of such values so long as they are clearly identified and disclosed. The market value should consider the real property’s actual physical condition, use, and zoning as of the appraisal date; and for construction or renovation financing, provide the property’s market value in its as is condition and its prospective value at completion. *Interagency Guidelines (Dec. 2010)*.

As required by USPAP, the appraisal must include any approach to value (i.e., cost, income, or sales comparison approach) that is applicable to the assignment and should disclose the rationale for omission if no valuation approach is used. The appraiser must reconcile the information from the various approaches and provide a discussion on market conditions, including property value trends, demand and supply factors, and exposure time. Other information might include prevalence of sales and financing concessions, the list-to-sale price ratio, and availability of financing. In addition, an appraisal should reflect an analysis of the property’s sales history and an opinion as to the highest and best use of the property. *Interagency Guidelines (Dec. 2010)*.

- Be performed by state-licensed or certified appraisers as described below under *Appraisals Required and Appraiser Qualifications*.

Be sure to inform the credit union's appraisers of the NCUA minimum appraisal standards, as they are in addition to the USPAP standards. Also, note that the NCUA rules do not prevent a federally insured credit union from requiring additional appraisal standards if deemed appropriate.

HPML Appraisal Standards & Requirements

A “higher-priced mortgage loan” (HPML) is a closed-end consumer loan secured by the consumer's principal dwelling (including home purchase loans, refinancings, and home equity loans) if the APR is greater than the “Average Prime Offer Rate” for a comparable transaction (as of the date the interest rate is set) by certain margins.

If a loan is “higher-priced,” then Reg. Z §1026.35(c) imposes several restrictions on it, including two appraisal requirements, which apply to applications for certain types of HPMLs. Some types of loans may be exempt.

When the credit union originates a loan that is covered by the HPML appraisal rules, it must:

- Disclose to consumers within three business days after receiving the consumers’ applications that they are entitled to a free copy of any appraisal;
- Obtain a written appraisal of the property (including its interior) meeting certain standards; and
- Deliver copies of appraisals to applicants no later than three business days before closing (or within 30 business days after determining that the loan will not close).

A second appraisal is required from a different certified or licensed appraiser – at the credit union’s expense – if a covered HPML is being “flipped,” meaning that 1) it is being resold within 180 days after it was purchased by the seller and that 2) the price that the credit union’s applicant is paying is above certain thresholds. The HPML rules include several exemptions from this requirement.

The HPML appraisal rules are explained in detail (along with other HPML compliance issues) in The League’s *ii Release No. B068*.

APPRAISALS REQUIRED AND APPRAISER QUALIFICATIONS (§§ 722.103, 722.106)

The NCUA’s appraisal regulation mandates when an appraisal must be completed by a state certified or licensed appraiser. *The National Registry of State Certified or Licensed Appraisers* provides a listing, updated monthly, of state-certified and licensed real estate appraisers eligible to perform real estate appraisals for federally related transactions.

Transactions requiring a:

- State-certified appraiser:
 - All real estate transactions of \$1,000,000 or more.

- Nonresidential real estate transactions of more than \$250,000. (*Nonresidential* means not secured by a 1-4 family dwelling.). *This requirement is repealed as of Oct. 22, 2019.*
- Complex 1-4 family residential property transactions of \$400,000 or more.
- State-certified or -licensed appraiser:
 - Residential real estate transactions over \$400,000, but less than \$1,000,000.

Education and Experience

While a credit union must confirm that the appraiser holds a valid credential from the appropriate state regulatory authority, a state certification or license is a minimum credentialing requirement. In determining competency for a given appraisal assignment, a credit union must consider the appraiser's education and requisite experience and knowledge of the subject property's market.

- What courses has the appraiser completed beyond the minimum to qualify for state-licensing?
- Have continuing education courses been undertaken?
- Does the appraiser know your specific market?
- Get the appraiser's resume and review it critically!

Ask appraisers what other lenders are their clients. Call other local appraisers to verify your appraiser's professional reputation. Likewise, consult other clients. Require several samples of each type of appraisal that will be performed. Check to see that the appraiser carries errors and omissions insurance.

Also, what professional designations has the appraiser earned? *The Appraisal Institute Member Directory* lists real estate appraisers who are designated or associate members of the Appraisal Institute. This site does not indicate whether the appraiser is state-certified or licensed.

Keep in mind that credit unions are prohibited from discriminating against appraisers solely by virtue of membership, or lack thereof, in any particular appraisal organization. Membership may be a consideration, but not the sole consideration.

Credit unions are urged to maintain a relationship with more than one appraiser.

APPRAISER INDEPENDENCE (§ 722.105)

An appraiser may have no direct or indirect interest, financial or otherwise, in the property. Additional standards for independence depend on whether the appraiser is on staff or retained for a fee.

Staff Appraisers.

If an appraisal is prepared by a staff appraiser, that appraiser must be independent of the lending, investment, and collection functions of the credit union. The person may not be involved, except as an appraiser, in the real estate transaction. If the only qualified persons available to perform an appraisal are involved in the lending, investment, or collection functions of the credit union, the credit union must take appropriate steps to ensure that the appraisers exercise independent judgment.

Fee Appraisers

If an appraisal is prepared by a fee appraiser, the appraiser shall be engaged directly by the credit union or its agent. However, a credit union may accept an appraisal that was prepared by an appraiser engaged directly by another financial institution if:

- The appraiser has no direct or indirect interest, financial or otherwise, in the property or transaction; and
- The credit union determines that the appraisal complies with the NCUA appraisal rule and is otherwise acceptable.

Independence is compromised when a credit union uses an appraiser who is recommended by the borrower or allows the borrower to select the appraiser from the credit union's list of approved appraisers. Thus, NCUA says, credit unions may not use an appraisal prepared by an individual who was selected or engaged by a borrower.

Likewise, credit unions may not use readdressed appraisals - appraisal reports that are altered by the appraiser to replace any references to the original client with the credit union's name. Altering an appraisal report in a manner that conceals the original client or intended users of the appraisal is misleading and violates the NCUA appraisal regulation and USPAP.

Generally, NCUA rules provide that no official or employee of a credit union, or immediate family member, may receive, directly or indirectly, any commission fee or other compensation in connection with any loan made by the credit union, including for providing appraisal services. However, some exceptions may apply. See NCUA Rules at § 701.21(c)(8)(iii) for the exceptions.

Interagency Guidelines (Dec. 2010)

In its Letter to Credit Unions No. 10-CU-23, the NCUA states that the credit union'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 of its lending functions. Please see the *Interagency Appraisal and Evaluation Guidelines* section of this release for a comprehensive discussion on independence of the collateral valuation process.

EXEMPTIONS FROM THE APPRAISAL REQUIREMENT (§ 722.103(A))

The following types of transactions are exempt from the NCUA regulation, and thus do not require an appraisal:

1. Real estate transactions of \$400,000 or less;
 - Evaluation required unless another exception from 3 – 8 applies.
2. A transaction involving an existing extension of credit at the lending credit union provided that no new money is advanced (other than reasonable closing costs) or there is no obvious deterioration in the property or market conditions that threatens the credit union's protection, even with the advancement of new monies;
 - Evaluation required unless another exception from 3 – 8 applies.
3. Real estate collateral taken through an abundance of caution, with terms no more favorable than would be granted without the real estate lien (tack-on mortgage loans may qualify for this exemption);
4. A lien on real estate that has been taken for purposes other than the real estate's value, such as taking a lien against real estate upon which growing crops sit to ensure access to the agricultural product;
5. Any real estate lease, unless the lease is the economic equivalent of a purchase or sale of the leased real estate;
6. A loan or interest in a loan, pool of loans, or mortgage-backed securities if a proper appraisal was obtained for each loan at the time of origination;
7. Transactions which qualify for sale to a U.S. government agency or government sponsored agency; and
8. Residential real estate transactions in which an appraisal meeting appropriate FNMA or FHLMC standards is obtained.

Credit unions may well develop guidelines for use of appraisals that protect the safety and soundness of the credit union that are more rigorous than the rules. For example, a credit union may require a full USPAP appraisal for any new loan over \$50,000, with the view that this is the largest loan it is willing to grant with the risk of an inadequate estimate of fair market value.

Interagency Guidelines (Dec. 2010)

Although NCUA regulations allow a credit union to use an evaluation for certain transactions, a credit union should establish policies and procedures for determining when to obtain an appraisal for such transactions. For example, a credit union should consider obtaining an appraisal as its portfolio risk increases or for higher risk real estate-related transactions, such as those involving loans with: combined loan-to-value ratios in excess of the supervisory limits; atypical properties; properties outside the credit union's traditional lending market; or existing extensions of credit with significant risk to the credit union.

EVALUATION REQUIREMENT (§ 722.103(D))

An evaluation must provide a written reliable estimate of market value as defined in the regulation.

Under the NCUA appraisal rule, a real estate transaction of \$400,000 or less may be supported by a written evaluation instead of a full appraisal. In addition, a transaction may be supported by an evaluation if it involves an existing extension of credit at the lending credit union, provided that no new money is advanced (other than reasonable closing costs) or

there is no obvious deterioration in the property or market conditions that threatens the credit union's protection, even with the advancement of new monies.

The NCUA reserves the right to require an appraisal whenever the agency believes it is necessary to address safety and soundness concerns.

The person performing the evaluation must be qualified and experienced to perform such estimates of value for the type and amount of credit being considered, and may have no direct or indirect interest in the property, as described earlier for appraisals.

Keep in mind, § 701.2(c)(8) of NCUA's Rules and Regulations prohibits directors, loan officers, and certain others from receiving payment other than salary for performing valuations.

Interagency Guidelines (Dec. 2010)

The Guidelines outline regulatory expectations for evaluations to ensure they support the credit union's decisions to engage in the transactions, consistent with safe and sound banking practices.

Evaluation development

A credit union should establish criteria for determining the level and extent of research or inspection necessary to ascertain the actual physical condition of the property and the economic and market factors that affect its market value. Policies and procedures should address the process for selecting the appropriate valuation method for a transaction considering associated risk, rather than the using the method that renders the highest value, lowest cost, or fastest turnaround time. A credit union should consider performing an inspection to ascertain the actual physical condition of the property and market factors that affect its market value.

A valuation method that does not provide a property's market value or sufficient information and analysis to support the value conclusion is not acceptable. For example, a valuation method that provides a sales or list price, such as a broker price opinion, cannot be used as an evaluation because, among other things, it does not provide a property's market value. Likewise, information on local housing conditions and trends, such as a competitive market analysis does not contain sufficient information on a specific property and therefore would not be acceptable as an evaluation. The information obtained from such sources, while insufficient as an evaluation, may be useful to develop an evaluation or appraisal.

- **Analytical Methods and Technological Tools.**

Appendix B provides guidance on the appropriate use of analytical methods and technological tools for developing an evaluation.

A credit union should establish policies and procedures for using various methods/tools that:

- Address the selection, use, and validation of the valuation method/tool.
- Establish criteria for determining whether a particular valuation method/tool is appropriate for a given transaction or lending activity, considering associated risks. These risks include, but are not limited to transaction size and purpose, credit quality, and leverage tolerance (loan-to-value).
- Specify criteria when a market event or risk factor would preclude the use of a particular method/tool.
- Address standards for the use of multiple methods/tools, if applicable, for valuing the same property to support a particular lending activity.
- Provide criteria for ensuring that the credit union uses a method/tool that produces a reliable estimate of market value that supports the credit union's decision to engage in a transaction.
- Address the extent to which:
 - o An inspection or research is necessary to ascertain the property's actual physical condition, and
 - o Supplemental information is needed to assess the effect of market conditions or other factors on the estimate of market value.

- **Tax Assessment Valuations.**

Appendix B provides further clarification on the use of Tax Assessment Valuations (TAVs). A credit union may not rely solely on the data provided by local tax authorities to develop an evaluation unless the resulting evaluation is consistent with safe and sound banking practices and these Guidelines. Since analytical methods such as TAVs

generally need additional support to meet these Guidelines, credit unions should develop policies and procedures that specify the level and extent of supplemental information that should be obtained to develop an evaluation. A credit union may use a TAV in developing an evaluation when it can demonstrate that a valid correlation exists between the tax assessment data and the market value.

When using a TAV to develop an evaluation, a credit union should:

- Determine and document how the tax jurisdiction calculates the TAV and how frequently property revaluations occur.
- Perform an analysis to determine the relationship between the TAV and the property market values for properties within a tax jurisdiction.
- Test and document how closely TAVs correlate to market value based on contemporaneous sales at the time of assessment and reevaluate whether the correlation remains stable as of the effective date of the evaluation.

Evaluation content.

An evaluation should contain sufficient information detailing the analysis, assumptions, and conclusions to support the credit decision. An evaluation's content should be documented in the credit file or be reproducible.

The evaluations should, at a minimum:

- Identify the location of the property.
- Provide a description of the property and its current and projected use.
- Provide an estimate of the property's market value in its actual physical condition, use and zoning designation as of the effective date of the evaluation, with any limiting conditions.
- Describe the method(s) the credit union used to confirm the property's actual physical condition and the extent to which an inspection was performed.
- Describe the analysis that was performed and the supporting information that was used in valuing the property.
- Describe the supplemental information considered when using an analytical method or technological tool.
- Indicate all sources of information used in the analysis, as applicable, to value the property.
- Include information on the preparer such as the name, contact information and signature.

AUTOMATED VALUATION MODELS (§722.201-.203)

Subpart B of Chap. 722 in the NCUA regulations governs "Quality Control Standards for Automated Valuation Models" also known as AVMs.

These rules apply to mortgage originators that use AVMs in determining the value of collateral for a loan to be secured by the consumer's principal dwelling in connection with making a credit decision determination regarding a mortgage. (The rules also cover covered securitization determinations regarding a mortgage-backed security, which this ii Release does not address). The rules require credit unions that use covered AVMs in their credit decisions to adopt policies, practices, procedures, and control systems to ensure that the AVMs meet certain quality control standards.

This includes decisions about originating, modifying, or terminating mortgages but excludes AVMs used solely for portfolio monitoring.

The rules also cover AVMs used by servicers working on behalf of mortgage originators in loan modifications.

The rules apply regardless of whether the loan is primarily for consumer purposes or business purposes, and whether the credit is closed-end or open-end.

Definitions (§722.202)

"Automated valuation model" means any computerized model used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer's principal dwelling.

“Mortgage originator” means any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain (i) takes a mortgage application, (ii) assists a consumer in obtaining or applying to obtain a mortgage, or (iii) offers or negotiates terms of a mortgage.

“Credit decision” means a decision about whether and under what terms to originate, modify, terminate, or make other changes to a mortgage, including a decision whether to extend new or additional credit or change the credit limit on a line of credit.

Other uses of AVMs, such as for portfolio monitoring, are outside the scope of the rules.

Additionally, the rules do not cover AVMs used to develop an appraisal by a certified or licensed appraiser, nor in the review of the quality of already completed determinations of collateral value.

“Control systems” means “the functions (such as internal and external audits, risk review, quality control, and quality assurance) and information systems that are used to measure performance, make decisions about risk, and assess the effectiveness of processes and personnel, including with respect to compliance with statutes and regulations.”

Five quality control standards (§722.203)

Credit unions that use covered AVMs in their credit decisions must adopt policies, practices, procedures, and control systems to ensure that the AVMs meet five quality control standards:

1. Ensure a high level of confidence in estimates: Credit unions must ensure that AVMs produce reliable and accurate property valuations.
2. Protect against data manipulation: Safeguards must be in place to prevent any tampering with the data used by AVMs.
3. Avoid conflicts of interest: Credit unions must implement measures to prevent conflicts of interest in the valuation process.
4. Require random sample testing and reviews: Regular testing and reviews of AVMs are required to ensure ongoing accuracy and reliability.
5. Comply with applicable nondiscrimination laws: Credit unions must ensure that AVMs comply with all relevant nondiscrimination laws, such as the Equal Credit Opportunity Act and Fair Housing Act.

The rules give credit unions flexibility to adopt approaches that reflect their individual business models and risk profiles. In releasing these AVM rules in 2024, the NCUA and other regulators wrote:

Different policies, practices, procedures, and control systems may be appropriate for institutions of different sizes with different business models and risk profiles, and a more prescriptive rule could unduly restrict institutions’ efforts to set their risk management practices accordingly.

Existing guidance

When regulators released the AVM rules in 2024, they recommended that credit unions and other institutions review and apply existing guidance to help meet their AVM quality control obligations.

- Since 2010, the FDIC, OCC, Fed, and NCUA have provided supervisory guidance on the use of AVMs by their regulated institutions in *Appendix B to the Interagency Appraisal and Evaluation Guidelines*. Those Guidelines recommend that institutions establish policies, practices, and procedures governing the selection, use, and validation of AVMs, including steps to ensure the accuracy, reliability, and independence of an AVM.

The next section of this ii Release summarizes the 2010 Guidelines, which are also mentioned elsewhere in the Release.

- In addition, the FDIC, OCC, and Fed have issued *guidance on model risk management practices* that provides supervisory guidance on validation and testing of computer-based financial models. While the NCUA is not a party to that Model Risk Management Guidance, it monitors the model risk management efforts of federally insured credit unions through by confirming that the governance and controls over AVMs are appropriate based on the size and complexity of the transactions, the risk the transactions pose to the credit union, and the capabilities and resources of the credit union.

2010 INTERAGENCY GUIDANCE - INTERAGENCY APPRAISAL AND EVALUATION GUIDELINES (DEC. 2010) AND REG. Z REQUIREMENTS

Information from the *Interagency Guidelines (Dec. 2010)* is interspersed throughout this release.

In its Letter to Credit Unions No. 10-CU-23, the NCUA states that the credit union'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 of its lending functions and directs the credit union to refer to the *Interagency Guidelines (Dec. 2010)* to assist in that process, highlighting:

- Independence of collateral valuation process from other parts of the lending process;
- Quality controls that include a periodic review of the work completed by appraisers and for individuals selected to hold appropriate state certification or licenses;
- Expanded *Minimum Appraisal Standards* to clarify appraisals:
 - Must contain an opinion of market value;
 - Must disclose the nature and extent of research performed to verify a property's condition and support of market value (an Automated Valuation Model, by itself, is not an appraisal); and
 - Should have appropriate adjustments to market value for factors such as prospective improvements, lease terms, and market conditions and should not incorporate factors such as favorable financing or special value to a specific property user;
- Management of relationships with third parties as they pertain to real estate lending; and
- Need to develop policies for determining an appropriate collateral valuation methodology for various transactions conducted by the credit union.

Independence of the Collateral Valuation Process

The independence requirements in the *Interagency Guidelines*, as well as the special rules in Reg. Z § 1026.42, apply to all persons involved in the collateral valuation process: appraisers and persons performing evaluations; and staff that administer the collateral valuation program, including persons ordering, performing and reviewing valuations.

Independence requirements for real estate-related financial transactions.

- The staff who administer the collateral valuation program must have reporting lines independent of loan production.
 Loan production is defined to include all personnel responsible for generating loan volume or approving loans, as well as their subordinates and supervisors. These individuals include any employee whose compensation is based on loan volume. (Exclusions: Employees are not considered loan production staff just because part of their compensation includes a general bonus or profit sharing plan that benefits all employees. Employees responsible solely for credit administration or credit risk management are not considered loan production staff.)
- Appraisers and persons that perform evaluations must be independent of the loan production and collection processes and have no direct, indirect or prospective interest, financial or otherwise, in the property or transaction.
- Guidance provided for when absolute lines of independence may not be possible:
 - *Interagency Guidelines* for all real estate-related financial transactions.

For a small or rural institution or branch, it may not always be possible or practical to separate the collateral valuation program from the loan production process. If absolute lines of independence cannot be achieved, a credit union should be able to demonstrate clearly that it has prudent safeguards to isolate its collateral valuation program from influence or interference from the loan production process.

- In such cases, another loan officer, officer, or director of the credit union may be the only person qualified to analyze the real estate collateral. To ensure their independence, such lending officials, officers, or directors must abstain from any vote or approval involving a loan on which they ordered, performed or reviewed the appraisal or evaluation.

- Reg. Z rules for credit transactions security by a consumer's primary residence.

For employees and affiliates of creditors with assets of \$250 million or less for either of the past two calendar years, a person who is employed by or affiliated with a creditor does not have a conflict of interest based on the person's employment or affiliate relationship with the creditor if:

- o The person's compensation is not based on the value arrived at in the valuation; and
- o The creditor requires that any employee, officer or director of the creditor who orders, performs, or reviews a valuation for a covered transaction abstain from participating in any decision to approve, not approve, or set the terms of that transaction.

A credit union that relies on one of these provisions should have clear policies and procedures that are designed to show independence, provide appropriate training to its personnel, and monitor for compliance.

- Communication between the credit union's collateral valuation staff and an appraiser or person performing an evaluation is essential for the exchange of appropriate information relative to the valuation assignment. A credit union's policies and procedures should specify methods for communication that ensure independence in the collateral valuation function.
- Appropriate actions (generally described as permitted actions in Reg. Z § 1026.42):
 - o Exchange information with appraisers and persons who perform evaluations, which may include providing a copy of the sales contract for a purchase transaction. However, a credit union should not directly or indirectly coerce, influence or otherwise encourage an appraiser or person who performs an evaluation to misstate or misrepresent the value of the property.
 - o Consistent with its policies and procedures, a credit union may also ask the appraiser or person who performs an evaluation to:
 - Consider additional information about the subject property or about comparable properties.
 - Provide additional supporting information about the basis for a valuation.
 - Correct factual errors in an appraisal.
 - o After obtaining an appraisal or evaluation, a credit union may find it necessary to obtain another valuation, and should take care to select the most credible/reliable valuation.
- Inappropriate actions (described as prohibited actions in Reg. Z § 1026.42):
 - o Communicating a predetermined, expected, or qualifying estimate of value, or a loan amount or target loan-to-value ratio.
 - o Specifying a minimum value requirement for the property that is needed to approve the loan or as a condition of ordering the valuation.
 - o Conditioning a person's compensation on loan consummation.
 - o Failing to compensate a person because a property is not valued at a certain amount. (This provision does not preclude a credit union from withholding compensation based on a breach of contract or substantial non-performance of services under a contract provision.)
 - o Implying that current or future retention of a person's services depends on the amount at which the appraiser or person performing an evaluation values a property.
 - o Excluding a person from consideration for future engagement because a property's reported market value does not meet a specified threshold.

Additional valuation independence requirements of Reg. Z § 1026.42.

Reg. Z § 1026.42 establishes requirements for valuation independence for consumer open- and closed-end credit transactions secured by consumers' principal dwellings. (Substantially similar requirements, which had been in place for closed-end credit only under § 1026.36(b) have been removed.)

A consumer's principal dwelling does not necessarily need to be real property. The Federal Reserve's Official Staff Commentary to Reg. Z says that mobile homes, boats and trailers are dwellings if they are in fact used as residences – whether or not the residence is real property under state law. See The League's *ii Release No. B042* for the basic requirements of Reg. Z.

- Coercion.

Reg. Z prohibits coercion and other similar actions designed to cause a person that prepares a valuation to base the value of the property on factors other than their independent judgment. The regulation provides examples of permitted and prohibited actions that are substantially similar to the communication guidance provided in the *Interagency Guidelines* described earlier in this section.

- Conflict of Interest.

Reg. Z prohibits persons preparing a valuation or performing a valuation management function from having interests (direct, indirect, financial or otherwise) in the properties or the credit transactions:

- For employees and affiliates of creditors with assets of more than \$250 million for both of the past two calendar years, a person who is employed by or affiliated with a creditor does not have a conflict of interest based on the person's employment or affiliate relationship with the creditor if:
 - o The person's compensation is not based on the value arrived at in the valuation;
 - o The person reports to a person who is not part of the creditor's loan production function and compensation is not based on the closing of the transaction to which the valuation relates; and
 - o No person in the creditor's loan production function is directly or indirectly involved in selecting, retaining, recommending or influencing the selection of the person to prepare a valuation or perform a valuation function, or in determining who will be included in or excluded from a list of approved persons who prepare valuations or perform valuation management functions.
- For employees and affiliates of creditors with assets of \$250 million or less for either of the past two calendar years, a person who is employed by or affiliated with a creditor does not have a conflict of interest based on the person's employment or affiliate relationship with the creditor if:
 - o The person's compensation is not based on the value arrived at in the valuation; and
 - o The creditor requires that any employee, officer or director of the creditor who orders, performs, or reviews a valuation for a covered transaction abstain from participating in any decision to approve, not approve, or set the terms of that transaction.

- Customary and Reasonable Compensation.

Reg. Z requires the payment of reasonable and customary compensation to appraisers who aren't employees of the creditors or of appraisal management companies hired by the creditors. A creditor and its agents shall be presumed to comply with this requirement if:

- The creditor or its agents compensate the appraiser in an amount that is reasonably related to recent rates paid for comparable appraisal services performed in the geographic market of the property being appraised; and
- The creditor or its agents do not engage in any anticompetitive acts in violation of state or federal law that affect the compensation paid to appraisers.

- Prohibited extension of credit.

Reg. Z prohibits a creditor from making a loan if it knows (at or before closing) that the loan is based on a valuation made in violation of these rules, unless the creditor documents that it has acted with reasonable diligence to determine that the value of the dwelling isn't materially misstated. A credit union is deemed to have acted with reasonable diligence if it makes a loan based on another qualified valuation that did not violate these rules.

- Mandatory reporting.

Reg. Z requires creditors and other providers of settlement services that have information about appraiser misconduct file reports with the appropriate state agency.

Quality Controls

A credit union's collateral valuation program should establish criteria to select, evaluate, and monitor the performance of appraisers and persons who perform evaluations.

Selection of appraisers or persons who perform evaluations.

- Qualifications.

A credit union's selection process should ensure that a qualified, competent and independent person is selected to perform a valuation assignment. A credit union should maintain documentation to demonstrate that the appraiser or person performing an evaluation is competent, independent, and has the relevant experience and knowledge for the market, location, and type of property being valued.

- Independence.

The person who selects or oversees the selection of appraisers or persons providing evaluation services should be independent of the loan production areas. A credit union or its agent must directly select and engage appraisers. The only exception to this requirement is that a credit union can use an appraisal prepared for another financial services institution provided the credit union requests it directly from the institution and other conditions are met.

- Approved Appraiser List.

For residential transactions, loan production staff can use a revolving, pre-approved appraiser list, provided the development and maintenance of the list is not under their control. Credit unions must have appropriate procedures for the development and administration of the list, including a process for qualifying an appraiser for initial placement on the list, as well as periodic monitoring of the appraiser's performance and credentials to assess whether to retain the appraiser on the list. There should also be a periodic internal review of the list to confirm that appropriate procedures and controls exist to ensure independence.

- Engagement Letters.

A credit union should use written engagement letters when ordering appraisals, particularly for large, complex, or out-of-area commercial real estate properties. An engagement letter facilitates communication with the appraiser and documents the expectations of each party. In addition to other information, the engagement letter will identify the intended use and user(s), as defined in USPAP. An engagement letter may also specify whether there are any legal or contractual restrictions on the sharing of the appraisal with other parties. A copy of the engagement letter should be placed in the credit file.

- Scope of Work.

A credit union should consider the risk, size and complexity of the transactions when discussing its needs and expectations with the appraiser to assist in establishing the scope of work and determining the appraisal report format. These communications should adhere to the credit union's policies and procedures on independence of the appraiser and not unduly influence the appraiser. An institution should not allow lower cost or speed of delivery time to inappropriately influence its appraisal ordering procedures or the appraiser's determination of the scope of work.

Validity of existing appraisal or evaluation.

The NCUA appraisal regulation allows credit unions to use an existing appraisal or evaluation to support a subsequent transaction in certain circumstances. A credit union's collateral valuation program should establish criteria for assessing whether an existing appraisal or evaluation continues to reflect the market value of the property. The documentation in the file should provide the facts and analysis to support the credit union's conclusion that the existing appraisal or evaluation may be used in the subsequent transaction.

A new appraisal or evaluation is necessary if the original reported market value has changed due to factors such as: passage of time, volatility of the local market, changes in terms and availability of financing, natural disasters, limited or over supply of competing properties, changes in underlying economic and market assumptions (such as capitalization rates and lease terms), changes in zoning, building materials, or technology, or environmental contamination.

Reviewing evaluations and appraisals.

As part of the credit approval process and prior to a final credit decision, a credit union should review appraisals and evaluations to ensure they comply with the NCUA appraisal regulation and are consistent with supervisory guidance and

its own internal policies. The credit union may also use the review findings to monitor and evaluate the competency and ongoing performance of appraisers/persons performing evaluations.

A credit union's policies and procedures for reviewing appraisals/evaluations should address the following issues:

- Reviewer Qualifications.

Address the independence, educational and training qualifications of the reviewer.

- For a discussion on independence, refer to the *Independence of the Collateral Valuation Process* part of this section of the release.
- Assess the level of in-house expertise available to review appraisals for complex projects, high-risk transactions and out-of market properties. A credit union may find it appropriate to engage a third party to perform the reviews. When using a third party, the credit union remains responsible for the quality and adequacy of the review process, including the qualification standards for reviewers. For a discussion on third parties, refer to the *Management of Relationships with Third Parties* part of this section of the release.

- Depth of Review.

Reflect a risk-focused approach for determining the depth of the review. The review should be sufficient to ensure the methods, assumptions, data sources, and conclusions are reasonable, well-supported, and appropriate for the transaction, property, and market. The review should be tailored to the various types of transactions.

- *Commercial Real Estate*. Transactions involving complex properties or high-risk commercial loans should be reviewed more comprehensively to assess the technical quality of the appraiser's analysis. Persons performing such reviews should have the appropriate expertise and knowledge relative to the type of property and its market. For lower risk transactions, establish criteria for when to expand the depth of the review.
- *1 to 4- Family Residential Real Estate*. Consider risk factors including debt-to-income ratios, loan-to-value ratios, level of documentation, transaction dollar amount, or other relevant factors when determining depth of review. With prior regulatory approval, a credit union may employ various techniques, such as automated tools or sampling methods, for performing prefunding reviews of appraisals/evaluations supporting lower risk mortgages.
- *Appraisals from other Financial Services Institutions*. Subject appraisal to standard review process. Confirm the appraiser was engaged directly by the other institution (not the borrower) and appraiser had no direct, indirect, or prospective interest in the property. Do not accept an appraisal that has been readdressed or altered with the intent to conceal the original client.

- Resolution of Deficiencies.

Establish a process for resolving any deficiencies in an appraisal or evaluation.

- Implement adequate internal controls to ensure that communications between the credit union and the appraiser/person who prepared the evaluation do not result in any coercion or undue influence.
- Address significant deficiencies in the appraisal that could not be resolved with the original appraiser by obtaining a second appraisal or relying on a review that complies with USPAP and is performed by a qualified state certified or licensed appraiser prior to the final credit decision.
- Replace deficient evaluations that do not provide credible results or lack sufficient information prior to credit decisions.

- Documentation of Review.

Set forth documentation standards for the review and the resolution of noted deficiencies. Address the level of documentation needed for the review, given the type, risk and complexity of the transaction. The documentation should describe the resolution of any appraisal/evaluation discrepancy, including reasons for obtaining and relying on a second appraisal or evaluation.

- Additional guiding principles for analyzing an appraisal not addressed above.

When the credit union receives an appraisal it has ordered, there is more to look at than just the final estimated market value at the end of the form. A wealth of information is provided on the Uniform Residential Appraisal Report. Reviewing the report tells the credit union how much confidence to place in the value shown on the appraisal and even the appraiser. In the end, the review of the appraisal may lead the credit union to deny the loan, request clarification or additional information from the appraiser, or the credit union may decide not to use that appraiser on future loans. The bottom line is how desirable (or undesirable) the property is as collateral. Will the credit union have difficulty selling it for the price relied on in the event of foreclosure?

Follow the guidelines provided by your secondary market or private mortgage insurer, but a sampling of some items to review is provided below.

- *Marketing Time.* The marketing time should be less than six months. A slower marketing time means it will be harder for the credit union to sell in the event of foreclosure. The appraiser should provide comments explaining longer marketing times.
- *Predominant Value.* The appraiser must list the common price range and predominant value of single-family housing in the neighborhood. Properties that exceed the upper price range of typical sales in the neighborhood are considered over-improved. These may call for more conservative loan terms.
- *Effective Age.* Good maintenance of a home will result in an effective age lower than the actual age.
- *Comparables.* A recently sold house with the greatest possible similarity to the subject property makes a good comparable. Lenders typically require at least three comparables.
 - o At least two of the three comparables should be located within a one mile from the subject property (except for rural areas). Use of more distant comparables must be justified.
 - o Comparables should be based on closed sales, not mere listings or accepted offers. The sales should generally be from the previous 12 months, ideally the previous six months. Be sure the appraiser has actually viewed the exterior of the comparables.
 - o If all adjustments to comparables are in one direction, either up or down, the comparables may be invalid and thus the valuation questionable.

Be on the alert for appraisers that always come back with a market value that supports the loan. The credit union relies on an appraisal to determine the fair market value and not to back into the purchase price.

Monitoring collateral values.

A credit union's policies and procedures should address the need for obtaining current collateral valuation information to understand its collateral position over the life of a loan and effectively manage the risk in its real estate portfolios. Policies and procedures should address the need to obtain current valuation information for collateral supporting or considered for a loan workout. Under the appraisal regulation, the NCUA reserves the right to require a credit union to obtain an appraisal or evaluation when there are safety and soundness concerns on an existing real estate credit, thus, a credit union should be able to support the current market value of the collateral and the classification of a problem real estate credit.

• Portfolio collateral risk.

A credit union can use a variety of techniques for monitoring the effect of collateral valuation trends on portfolio risk. Sources of relevant information may include external market data, internal data, or reviews of recently obtained appraisals and evaluations. A credit union should be able to demonstrate that it has sufficient, reliable and timely information on market trends to understand the risk associated with its lending activity. Prudent portfolio monitoring practices include criteria for determining when to obtain a new appraisal or evaluation. The criteria should address deterioration in the credit since origination or changes in market conditions. In assessing whether changes in market conditions are material, a credit union should consider the individual and aggregate effect of these changes on its collateral protection and the risk in its real estate lending programs or credit portfolios.

As a credit union's reliance on collateral becomes more important, its policies and procedures should:

- Ensure that timely information is available to management for assessing collateral and associate risk.
- Specify when new or updated collateral valuations are appropriate or desirable to understand collateral risk in the transactions(s).

- Delineate the valuation method to be employed after considering the property type, current market conditions, current use of the property, and the relevance of the most recent appraisal or evaluation in the credit file.
- Modifications and workouts of existing credit.

A credit union's policies should address the need for obtaining current collateral valuation information for a loan modification or workout. The policies should specify the valuation method to be used and address the need to monitor collateral risk on an ongoing basis taking into consideration changing market conditions and the borrower's repayment performance. An institution also should be able to demonstrate that the collateral valuation method used is reliable for a given credit or loan type. Also, for loan workouts, a credit union's policies should address the need to obtain an appraisal or evaluation for safety and soundness reasons even though one is not otherwise required by the appraisal regulations.

- *Loan modifications.* A loan modification that involves a limited change in the terms of the note or loan agreement and that does not adversely affect the institution's real estate collateral protection after the modification does not rise to the level of a new real estate-related financial transaction for purposes of the appraisal regulations, but a credit union should still have an understanding of its collateral risk. For example, a credit union can use automated valuation models or other valuation techniques when considering a modification to a residential mortgage loan. A credit union should have procedures for ensuring an alternative collateral valuation method provides reliable information. In addition, a credit union should be able to demonstrate that a modification reflects prudent underwriting standards and is consistent with safe and sound lending practices.
- *Loan workouts.* A loan workout can take many forms, including a modification that adversely affects the credit union's real estate collateral protection after the modification, a renewal or extension of loan terms, the advancement of new monies, or a restructuring with or without concessions. These types of loan workouts are new real estate related financial transactions and require an appraisal or evaluation as appropriate. If the loan workout does not include the advancement of new monies other than reasonable closing costs **and** there have been no obvious and material changes in market or property conditions, the NCUA appraisal regulation allows a credit union to obtain an evaluation in lieu of an appraisal.

Program compliance

Deficiencies in a credit union's appraisal and evaluation program that result in violations of appraisal regulations or contraventions of supervisory guidance reflect negatively on management. The compliance process should:

- Maintain a system of adequate controls, verification, and testing to ensure that appraisals and evaluations provide credible market values.
- Insulate the persons responsible for ascertaining the compliance of the credit union's appraisal and evaluation functions from any influence by loan production staff.
- Ensure the credit unions' practices result in the selection of appraisers and persons who perform evaluations with the appropriate qualifications and demonstrated competency for the assignment.
- Establish procedures to test the quality of the appraisal and evaluation review process.
- Use, as appropriate, the results of the credit union's review process and other relevant information as a basis for considering a person for a future appraisal or evaluation assignment.
- Report appraisal and evaluation deficiencies to appropriate internal parties and, if applicable, to external authorities in a timely manner.

Referrals

A credit union should file a complaint with the appropriate state appraiser regulatory officials when it suspects that a state certified or licensed appraiser failed to comply with USPAP, applicable state laws, or engaged in other unethical or unprofessional conduct. In addition, Reg. Z § 1026.42(g) sets forth mandatory reporting requirements for transactions involving principal dwellings. A credit union also must file a suspicious activity report when suspecting fraud or identifying other transactions meeting the SAR filing criteria. For more information, see The League's *ii Release No. 0109*.

Management of Relationships with Third Parties

A credit union that engages a third party to perform certain collateral valuation functions (including the ordering or reviewing of appraisals and evaluations, selecting an appraiser or person to perform an evaluation, or providing access to analytical methods or tools) on the credit union's behalf is responsible for understanding and managing the risks associated with the arrangement. A credit union is accountable for ensuring that any services performed by a third party comply with applicable laws and regulations and is consistent with supervisory guidance.

Selection of third party

A credit union should exercise appropriate due diligence in the selection of a third party. This process should include sufficient analysis by the credit union to assess whether the provider can perform the services consistent with the credit union's performance standards and regulatory requirements. The decision to outsource any part of the collateral valuation functions should not be unduly influenced by any short-term cost savings. A credit union should take into account all aspects of the long-term effect of the relationship, including the managerial expertise and associated costs for effectively monitoring the arrangement on an ongoing basis.

Contract with third party

A credit union should have a written contract that clearly defines the expectations and obligations of both the credit union and the third party, including that the third party will perform its services in compliance with applicable laws and regulations and consistent with supervisory guidance.

Oversight of third party.

The reduced operational control over outsourced activities poses additional risk. A credit union should be able to demonstrate that its policies and procedures establish effective internal controls to monitor and periodically assess the collateral valuation functions performed by a third party. A credit union should document the results of ongoing monitoring efforts and periodic assessments for compliance with applicable regulations and consistency with supervisory guidance and its performance standards and take remedial action in a timely manner if deficiencies are discovered.

2024 GUIDANCE ON “RECONSIDERATIONS OF VALUE”

In 2024, the NCUA and other federal regulators *issued guidance* on “reconsiderations of value” (ROVs) in residential real estate lending. An ROV “is a request from the financial institution to the appraiser or other preparer of the valuation report to reassess the report based upon potential deficiencies or other information that may affect the value conclusion.”

The 2024 ROV guidance highlights risks associated with deficient residential real estate valuations and describes how credit unions and other financial institutions may incorporate ROV processes and controls into established risk management functions. The guidance also provides examples of policies and procedures that a financial institution may choose to implement to help identify, address, and mitigate the risk of discrimination impacting residential real estate valuations.

Potential risks & deficiencies

The regulators begin their 2024 ROV guidance by stressing that “credible collateral valuations, including appraisals, are essential to the integrity” of real estate lending. They go on to explain that collateral valuations may be “deficient” due to:

- Prohibited discrimination,
- Errors or omissions, or
- “Valuation methods, assumptions, data sources, or conclusions that are otherwise unreasonable, unsupported, unrealistic, or inappropriate.”

Deficient valuations can harm consumers, but they also pose risks to credit unions' financial conditions and operations, including loan losses, violations of law, fines, civil money penalties, payment of damages, and civil litigation.

Use of third parties

Whether credit unions internally review valuations and resolve deficiencies, or whether that is handled by a third party, the credit unions still bear responsibility for operating in a safe and sound way and for complying with applicable laws and regulations. Credit unions must oversee their business relationships with service providers in a way that ensures compliance with federal consumer protection laws.

ROV requests

A credit union can request an ROV because of its own valuation review or after considering information received from a consumer through a complaint or a request to the loan officer or other credit union representative. Regardless how the ROV request is started, a consumer inquiry or complaint could be resolved through a credit union's independent valuation review or other process to ensure credible appraisals and evaluations.

An ROV request may include consideration of comparable properties not previously identified, property characteristics, or other information about the property that may have been incorrectly reported or not previously considered, which may affect the value conclusion. To resolve deficiencies, including those related to potential discrimination, credit unions can communicate relevant information to the original preparer of the valuation and, when appropriate, request an ROV.

Complaint resolution process

A credit union can capture consumer feedback about potential valuation deficiencies through an existing complaint resolution process. That process may capture complaints and inquiries about the credit union's products and services offered across all lines of business, including those offered by third parties, as well as complaints from various channels (such as letters, phone calls, in person, transmittal from regulators, third-party valuation service providers, emails, and social media).

Depending on the nature and volume, appraisal and other valuation-based complaints and inquiries can be an important indicator of potential risks and risk management weaknesses.

Appropriate policies, procedures, and control systems can adequately address the monitoring, escalating, and resolving of complaints including a determination of the merits of the complaint and whether a credit union should ask for an ROV.

Examples of policies, procedures, and control systems

The 2024 ROV guidance says that “[f]inancial institutions may consider developing risk-based ROV-related policies, procedures, control systems, and complaint resolution processes that identify, address, and mitigate the risk of deficient valuations, including valuations that involve prohibited discrimination” Those policies, procedures, control systems, and complaint processes may necessarily vary according to the credit union's size and complexity. Smaller credit unions that choose to implement the 2024 ROV guidance may have policies and procedures that differ from those at larger credit unions.

The 2024 ROV guidance gives these examples for the development of policies, procedures and control systems:

- Consider ROVs as a possible resolution for consumer complaints or inquiries related to residential property valuations. If a complaint or inquiry includes allegations of discrimination, the credit union may consider, in addition to processing the ROV, separately starting the process that the credit union may have to respond to allegations of discrimination.
- Consider whether any information or other process requirements related to a consumer's request for an ROV creates unreasonable barriers or discourages consumers from requesting an ROV.
- Establish a process that provides for the identification, management, analysis, escalation, and resolution of valuation-related complaints or inquiries across all relevant lines of business, from various channels and sources (such as letters, phone calls, in person, regulators, third-party service providers, emails, and social media).
- Establish a process to inform consumers how to raise concerns about the valuation early enough in the underwriting process for any errors or issues to be resolved before a final credit decision is made. This may include educating consumers on the type of information they may provide when communicating with the credit union about potential valuation deficiencies.

- Identify stakeholders and clearly outline each business unit's roles and responsibilities for processing an ROV request (e.g., loan origination, processing, underwriting, collateral valuation, compliance, etc.)
- Establish risk-based ROV systems that route the request to the appropriate business unit. For example, requests that include concerns or inquiries that allege discrimination could be routed to compliance, legal, and appraisal review staff who have the skills and authority to research and resolve the requests.
- Establish standardized processes to increase consistency for considering ROV requests:
 - Use clear, plain language in notices to consumers of how they may request the ROV;
 - Use clear, plain language in ROV policies that provide a consistent process for the consumer, appraiser, and internal stakeholders;
 - Establish guidelines for the information the credit union may need to start the ROV process;
 - Set timelines in the complaint or ROV processes for when milestones need to be achieved;
 - Set guidelines for when a second appraisal could be ordered and who assumes the cost; and
 - Establish protocols for communicating the status of the complaint or ROV and the lender's determination to consumers.
- Ensure relevant lending and valuation-related staff, including third parties (e.g., appraisal management companies, fee-appraisers, mortgage brokers, and mortgage servicers) are trained to identify deficiencies (including practices that may result in discrimination) through the valuation review process.

APPLICANT'S RIGHT TO COPY OF APPRAISAL

Various state and federal regulations require credit unions to give mortgage loan applicants copies of appraisals or valuations (and in some cases, notify them that they have the right to obtain copies).

The following material briefly summarizes the requirements. For details, see The League's *ii Release No. B077*.

Wisconsin Consumer Act

For loans subject to the Wisconsin Consumer Act, credit unions must provide the customer, before any payment is due, with a copy of any appraisal for which he/she is assessed an additional charge. (Wis. Admin. Code DFI-WCA §1.263.)

NCUA regulations

The NCUA requires federal credit unions (FCUs) to make copies of any appraisal used in connection with a member's subordinate-lien, dwelling-secured loan application available to that member upon request. (NCUA Regulations §701.31(c)(5).) The right to request the copy continues for 25 months from notification of action taken on the application. The NCUA rules do not apply to state-chartered credit unions, only FCUs, and they do not apply to applications for first-lien loans, which are covered by Reg. B (described next).

Equal Credit Opportunity Act / Reg. B

A credit union must share copies of all written valuations (not just appraisals) that it develops in connection with an application for a closed-end loan or open-end line of credit (i.e., HELOC) secured by a first lien on a dwelling. (Reg. B §1002.14.)

A credit union has three days after it gets an application for a first-lien dwelling-secured loan to notify the applicant of the right to copies of appraisals and other written valuations developed in connection with the application.

The credit union must share copies of appraisals and other written valuations with the applicant promptly upon completion, or at least three business days before loan closing (for closed-end credit) or account opening (for open-end credit), whichever is earlier. This requirement applies whether credit is extended or denied or the application is incomplete or withdrawn.

Appraisals for higher-priced mortgage loans

If a loan is “higher-priced,” then Reg. Z §1026.35(c) imposes several restrictions on it, including two appraisal requirements, which apply to applications for certain types of HPMLs. Both of the HPML appraisal rules are explained in detail (along with other HPML compliance issues) in The League’s *ii Release No. B068*.

- The credit union must:
 - Disclose to consumers within three business days after receiving the consumers’ applications that they are entitled to a free copy of any appraisal;
 - Obtain a written appraisal of the property (including its interior) meeting certain standards; and
 - Deliver copies of appraisals to applicants no later than three business days before closing (or within 30 business days after determining that the loan will not close).
- A second appraisal is required from a different certified or licensed appraiser – at the credit union’s expense – if a covered HPML is being “flipped,” meaning that it is being resold within 180 days after it was purchased by the seller, and the price that the credit union’s applicant is paying is above certain thresholds. The HPML rules include several exemptions from this requirement.

Complying with multiple rules

If a loan is subject to more than one set of rules, credit unions must look at the requirements that apply and comply with the stricter requirement on any point where they differ. The League’s *ii Release No. B077* includes a chart to help clarify when and how the various regulations apply.

PROHIBITED DISCRIMINATION IN APPRAISALS

The Fair Housing Act, Equal Credit Opportunity Act and other laws prohibit discrimination by lenders on such bases as sex, race, color, religion, national origin, marital status, receipt of public assistance, familial status, and handicap. The Fair Housing Act in particular prohibits such discrimination in conducting and using appraisals.

It is very important that the credit union be aware of the risk of liability should an appraiser or person conducting an evaluation be influenced by prohibited factors in determining values.

The following are just a few examples of discriminatory practices that examiners may screen for:

- Assigning a lower value to a neighborhood because of a mix of races and national origins.
- Equating a racially mixed neighborhood with a deteriorating neighborhood.
- Incorporating the idea that deterioration of a neighborhood is inevitable.
- Equating age of the property with the value of the property.

References to the desirability of a neighborhood, or the pride of ownership exhibited by residents should be either excluded from appraisal reports, or fully supported and demonstrated to have an impact on market value. In contrast to appraisal practices during the 1950s and 1960s, professional appraisal organizations now state as a matter of policy that racial, religious, and ethnic factors are unreliable predictors of value trends or price variance, and that the notion of racial or ethnic factors are unreliable predictors of value trends or price variance, and that the notion of racial or ethnic homogeneity, as a requirement for maximum value, is without empirical support.

Credit unions should determine that their appraisers have recently received effective fair housing training. Similarly, lenders should be certain that their appraisers are aware of, and ascribe to, the current fair housing standards of the Appraisal Foundation, or other appraisal organizations.

Credit unions should be alert to two appraisal practices most likely to cause equal opportunity problems:

- In the cost approach to value, racial bias may be reflected in unsupported adjustments for functional and economic obsolescence. Credit unions should not assume that, because a home or neighborhood is over a certain age, large adjustments are appropriate.
- In the comparable sales approach, racial bias may cause the appraiser to either select comparables or make adjustments that are inappropriate.

If appraised values appear to play a substantial role in rejections or reductions of loan amounts for properties in minority areas, credit unions should review their appraisals with careful attention to the *Valuation by Cost* and *Valuation by Comparable Sales* sections. In doing so, credit unions could compare the work of different appraisers, and look for consistency among different appraisers and between minority and nonminority neighborhoods. Rather than performing a review specifically for nondiscrimination in appraisals, many financial institutions have incorporated nondiscrimination considerations into their regular appraisal quality control process.

RELATED TOPICS

Details on the following related topics are addressed in other ii releases or laws as indicated.

- 1099-MISC Reporting.

If the credit union makes payment of more than \$600 in a year to an appraiser who is unincorporated, an IRS Form 1099-MISC must be filed.

- Finance Charge.

If the credit union charges appraisal fees which are not bona fide and reasonable in amount, Reg. Z § 1026.4(c)(7) requires them to be disclosed as finance charges, increasing the APR that is to be used when quoting, disclosing or advertising loan rates.

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Legal Affairs Department

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