



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 95-16 (SUP)
March 28, 1995

TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK

SUBJECT: Real Estate Appraisal Requirements for Other Real Estate Owned (OREO)

The June 1994 amendments to the Board's real estate appraisal regulation[See footnote 1] revised the appraisal exemption for real estate related transactions involving an existing extension of credit. As a result of this revision, questions have arisen regarding the treatment of other real estate owned (OREO) transactions under this appraisal exemption. In general, transactions involving most loan renewals, modifications, workouts, and refinancings are considered to be transactions arising from an existing extension of credit and do not require an appraisal, but do require an evaluation.

Real estate posted as collateral that has been acquired by an institution through foreclosure, or a deed in lieu of, (collectively referred to as OREO) now qualifies for the appraisal exemption for existing extensions of credit. Therefore, when acquiring OREO, an institution is not required to obtain an appraisal, but is required to obtain an evaluation. In general, it is expected that an appraisal or evaluation will be obtained prior to entering into a transaction. When the transaction involves a foreclosure or deed in lieu of, an institution may first act to prudently protect its collateral interest by initiating the foreclosure proceeding and may obtain the evaluation in a reasonable amount of time after title to the property is taken.

Because the sale or disposal of OREO does not arise from an existing extension of credit, it does not qualify for the appraisal exemption. Thus, an institution is required to have a valid appraisal to support the transaction. However, if the sale price of the OREO is to be below the \$250,000 appraisal threshold, the institution would only be required to obtain an evaluation. If an institution finances the sale of the OREO, this extension of credit would be considered a new transaction and would require a valid appraisal, unless the transaction qualifies for the threshold exemption or another exemption in the regulation.

In any OREO transaction, if an institution already has an appraisal (or an evaluation) of the real estate collateral and it is determined to be valid, the institution need not obtain a new appraisal. The determination that an appraisal remains valid (i.e., no material change in the market value reported in the appraisal) should be made by an individual who has appropriate real estate expertise and market knowledge. The individual should provide written documentation for the loan file to support the determination that the appraisal is still valid or that a new appraisal is necessary. The basis for determining whether an appraisal continues to be valid will vary depending upon the circumstances of the property and marketplace. Some of the factors that need to be taken into account include: the passage of time; the volatility of the local market; the availability of financing; the inventory of competing properties; new improvements to, or lack of maintenance of, the subject property or competing, surrounding properties; change in zoning; or environmental contamination.

In the course of monitoring OREO assets, financial institutions should have appropriate policies and procedures in place to help determine when a new appraisal or evaluation should be obtained. An institution may be required to substantiate the valuation of the OREO asset for financial reporting purposes.[See footnote 2] If an institution determines that an appraisal or evaluation should be obtained, the appraisal or evaluation must conform to the requirements of the agencies' appraisal regulations or guidelines.

The above represents the Board's position on appraisals and evaluations for OREO for state member banks and bank holding companies. In addition, state licensed branches and agencies of foreign banks should consider these requirements in relation to their policies and procedures for OREO. Banks subject to another primary regulator should seek guidance from their regulator.

Reserve Banks should communicate immediately this clarification to regulated institutions. Any questions on the Board's appraisal regulation should be directed to Stanley Rediger 202/452-2629 or Virginia Gibbs at 202/452-2521.

Richard Spillenkothen
Director

Footnote: 1 These amendments were issued on June 7, 1994, in the Federal Register (59 FR 29482).

Footnote: 2 The Accounting Standards Division of the American Institute of Certified Public Accountants issued a Statement of Position No. 92-3, "Accounting for Foreclosed Assets." This statement provides guidance on the balance sheet treatment of foreclosed assets after foreclosure.