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Raising appraisal De minimis: good or bad for the industry? - by Steve Hurlburt

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Just recently, the federal regulatory agencies, Office of the Comptroller of the Currency, Treasury (OCC); board of governors of the Federal Reserve System (Board); and Federal Deposit Insurance Corporation (FDIC), agreed to raise the appraisal threshold level from $250,000 to $500,000 for commercial real estate appraisals. They left it untouched at $250,000 for residential. Going forward for loans up to $500,000 on commercial real estate, an evaluation can be used without an appraisal being prepared. The final rule makes a conforming change to the section requiring state certified appraisers to be used for federally related transactions that are commercial real estate transactions above the increased threshold. The final rule also reflects a change to the proposed definition of commercial real estate transaction, which no longer includes construction loans secured by a single 1 to 4 family residential property, regardless of whether the loan is for initial construction only or includes permanent financing. Thus, under the final rule, a loan that is secured by a single 1 to 4 family residential property, including a loan for construction, will remain subject to the $250,000 threshold.

On the surface, this looks like great news for lenders and not so good news for appraisers. Upon a deeper look, this may not necessarily be the case.

There is a lot of concern on the part of appraisers assuming there will be less work now available while lenders are happy to be able to streamline costs to the consumer.

While there is a good amount of concern, a case can be made for an appropriate De minimis level, even at the current $500,000 level. On low risk transactions, evaluations (as opposed to full appraisals) can be appropriate and even beneficial for risk management of the overall lending system.

Lending volumes tend to increase and decrease faster than the supply of qualified appraisers. As a result, boom cycles can place extreme pressure on appraisers. This scenario makes quality control extremely challenging. The option to leverage efficient evaluations on low risk transactions can improve the risk management of the entire system by devoting limited appraisal resources to these transactions. Raising the De minimis threshold will enable lenders to focus scarce resources on the riskier transactions.

Reviewing individual appraisals is an important source of market trend analysis for investors during overheated markets. Although the typical single-family appraisal may contain a microanalysis of neighborhoods that lenders may find informative, most investors already access market and economic trend data via other sources.

There is a place for evaluations in prudent lending practices. Relying on additional risk measurements, rather than just focusing on a one size fits all De minimis level can provide a formula for better risk management. Ultimately, it is up to the lender to decide the appropriateness for using an evaluation. The lenders can still decide if they would prefer to have a full appraisal. Some factors that could determine this:

The overall risk. Certain situations in Connecticut, i.e., crumbling foundations may persuade the lender to go with full appraisals where the foundation is fully inspected and photographed, for more overall documentation and confidence with the collateral.

Complexity. Many times the Originator may ask for an evaluation because the loan is less than $500,000. But a review of the collateral indicates there are multiple buildings with tenants and different types of uses. This is virtually impossible to value using only principals of an evaluation. More confidence is afforded the lender by going with a full appraisal.

Evaluation/Accuracy. If prepared by a qualified appraiser, accuracy of the data provided in an evaluation shouldn't be a major concern. Appraisers tend to follow basic procedures as outlined by USPAP no matter what product they are providing. Since Connecticut is considered a mandatory appraisal state the evaluations need to be prepared by qualified appraisers. This eliminates some of the concern about accuracy.

Business Decision-Cost. The constant battle between cost and providing adequate documentation in order to be comfortable with the value estimate of the collateral being appraised. Small Business Units at banks are typically dealing with clients on a tighter budget and don't have the funds to spend on full narrative appraisal reports. This may necessitate the need for a lesser detailed report.

An example of when an evaluation could be used may be a $300,000 refinance, with an estimated loan to value of 25%, on an owner occupied 30,000 s/f industrial building of newer construction and located within a complex of similar properties in a market with many transfers. Probably enough market data available to get a good handle on a minimum value using an evaluation product.

A good rule of thumb to follow on the residential side of the ledger is complete a full appraisal on all purchases regardless if loan amount is less than $250k. HELOC/Home Equity and especially loans with a low loan to value ratio would require an evaluation product only.

Raising the De minimis may not be as bad for the appraisal industry as some might think. It comes down to solid quality control, banks identifying the need for sufficient reporting and appraisers adjusting to a world where performing evaluations is okay and a necessary part of the lending process.

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