

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 614

RIN 3052-AC94

Collateral Evaluation Requirements

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA, we, or our) proposes amendments updating our regulations on appraisal and evaluation requirements for property serving as collateral for loans made by the Farm Credit System (System). We propose reorganizing existing rules to remove redundancies and add clarity on the distinct valuation standards for each type of collateral. We also propose adding regulatory requirements for the use of automated valuation tools and releasing appraisal and evaluations to borrowers.

DATES: Comments on this proposed rule must be submitted on or before [INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION IN THE *Federal Register*].

ADDRESSES: We offer a variety of methods for you to submit comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by email or through the

FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we do not accept comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an email at reg-comm@fca.gov.
- FCA Web site: <http://www.fca.gov>. Click inside the "I want to..." field near the top of the page; select "comment on a pending regulation" from the dropdown menu; and click "Go." This takes you to an electronic public comment form.
- Mail: Kevin J. Kramp, Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of all comments we receive at our office in McLean, Virginia, or on our Web site at <http://www.fca.gov>. Once you are in the Web site, click inside the "I want to..." field near the top of the page; select "find comments on a pending regulation" from the dropdown menu; and click "Go." This will take you to the Comment Letters page where you can select the regulation for which you would like to read the public comments. We will show your comments as submitted, but for technical

reasons we may omit some items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

I. Objectives

The objectives of this proposed rule are to:

- Improve the organization and readability of FCA appraisal and evaluation regulations;
- Clarify expectations for internal controls in appraisal and evaluation practices;
- Expand authorities on using various sources of appraisers and evaluators as well as specifically authorizing use of automated valuation tools; and

- Update existing terminology and make other grammatical changes.

II. Background

The prevailing body of law for conducting collateral appraisals and evaluations in financial transactions is Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).¹ Title XI of FIRREA created the Appraisal Subcommittee within the Federal Financial Institutions Examination Council (FFIEC)² to provide federal oversight of state appraiser regulatory programs. Title XI of FIRREA also requires certain federally regulated lending institutions to use appraisers that are either state certified or state licensed under the Uniform Standards of Professional Appraisal Practice (USPAP).³ USPAP provides standards and qualifications for real estate appraisers and provides guidance on recognized

¹ Pub. L. 101--73, 103 Stat. 183, 12 U.S.C. 3331 et seq. (1989).

² The FFIEC was created in 1979 through Title X of Public Law 95-630 and is composed of representatives from the following federal financial regulators: Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, the Office of the Comptroller of the Currency, and Consumer Financial Protection Bureau. As the federal safety and soundness regulator of the System, the Farm Credit Administration is not a member of the FFIEC.

³ Title XI of FIRREA also requires appraisals used in connection with certain real estate-related financial transactions entered into by financial institutions to be written and conform to the appraisal standards promulgated by the Appraisal Standards Board of the Appraisal Foundation, as well as prescribes which categories of federally related transactions must have appraisals performed by a State certified appraiser and those where a State licensed appraiser may be used.

valuation methods and techniques for all evaluation professionals.

The Farm Credit Act of 1971, as amended (Act)⁴ charges FCA with issuing regulations establishing loan security requirements and the manner of conducting collateral security reviews.⁵ The Act requires System direct lenders to determine the value of loan security "by appraisal under standards prescribed by the [institution] in accordance with [FCA] regulations."⁶ FCA is further tasked with examining the quality and sufficiency of collateral used to secure System loans.⁷ Because these provisions within the Act existed before passage of FIRREA--and for other reasons--Congress exempted the System from Title XI of FIRREA, including following USPAP. However, FCA's present collateral evaluation rules are generally similar, although not identical, to FIRREA requirements.

In 1992, FCA issued subpart F of part 614, "Collateral Evaluation Requirements", which sets forth minimum regulatory standards for performing appraisals and evaluations of collateral securing extensions of credit

⁴ Pub. L. 92-181, 85 Stat. 583.

⁵ See, for example, sections 1.10(a)(3), 5.17(a)(6), and 5.17(a)(7) of the Act.

⁶ See, for example, section 1.10(a)(3) of the Act (12 U.S.C. 2018(a)(3)).

⁷ 12 U.S.C. 2252(a)(6) and (a)(7).

(lending and leasing) by Farm Credit banks and associations.⁸ The 1992 rulemaking applied many of the evaluation standards used by the banking industry under Title XI of FIRREA, including requiring the use of USPAP in certain loan transactions.⁹ In deciding to use these standards where appropriate, FCA determined the underlying policy behind Title XI of FIRREA was relevant to the System's operations, particularly for ensuring that reports on collateral values accurately reflect the current market value of collateral at the time of a credit decision and that those values be recognized as valid within the financial sector. However, our regulations differ from Title XI of FIRREA and USPAP where needed to address the unique cooperative structure of the System and to address specific provisions in the Act. For example, Title XI of FIRREA provides that no USPAP appraisal is required for a loan secured by real estate when that loan is made based on cashflow and not the value of real estate collateral (i.e., abundance of caution collateral). The System cannot use this exception for loans made under the authorities of

⁸ 57 FR 54683, Nov. 20, 1992.

⁹ FCA is not a FFIEC regulatory agency and therefore not required to follow FFIEC standards. However, we consider the policy positions of other regulators to decide if we should follow them or take a different approach if appropriate to implement the requirements and expectations of the Farm Credit Act of 1971, as amended.

Title I of the Act because those loans require a first lien on the real estate. Meaning those loans would never be made without consideration of the real estate collateral's value.

Collectively, subpart F of Part 614 has not been updated in over 25 years.¹⁰ As System institutions move toward increased use of fee appraisers and technology in loan making, we believe it is time to update our requirements for collateral appraisals and evaluations. We also believe our regulations should be updated to reflect the increased importance internal review and controls play in today's lending environment. Internal controls are an integral part of managing lending programs. Internal controls are also necessary to protect safety and soundness operations where institutions engage in credit programs using minimum information or where institutions move away from the use of staff appraisers and evaluators.

III. Section-by-Section Analysis

We discuss the specifics of our proposal below in the same order as they would appear in the regulation.

¹⁰ FCA regulation § 614.4265 on valuing real estate was modified in 2006 to increase the business loan exception allowing evaluations instead of USPAP-compliant appraisals for transactions under \$1 million. 71 FR 65387, Nov. 8, 2006.

A. Organization.

We propose general language changes to subpart F of Part 614 to enhance readability. We intend no change in the meaning of the affected regulatory provisions unless specifically stated in the discussions of those provisions. We also propose reorganizing existing provisions to consolidate like items, remove redundancy, and add clarity.

1. Section consolidations.

Among these proposed organizational changes are:

- Consolidating into § 614.4250 the existing basic appraisal and evaluation policies and standards of §§ 614.4245(a) and 614.4250(a) and proposing revisions to these policies and standards.
- Revising and consolidating into § 614.4255 the existing appraiser and evaluator independence requirements of §§ 614.4255, 614.4260(e), and 614.4267.
- Merging the existing contents of § 614.4266(a) and (b) into § 614.4260, to address in one section the evaluation requirements for all chattel, including personal and intangible property, while also revising the existing provisions of § 614.4266.
- Revising § 614.4250 to add a discussion of internal controls for valuing collateral.

- Consolidating the existing appraisal and evaluation requirements of §§ 614.4260, 614.4265, and 614.4266 into §§ 614.4260 and 614.4265, as appropriate for the type of collateral under discussion.
- Adding a new § 614.4270 discussing the use of appraisal and evaluation tools, including computer-based models.
- Moving to new § 614.4275 the existing contents of § 614.4260(d) regarding our authority to require appraisals and evaluations and proposing clarifications.

2. Section removals

We propose deleting as obsolete or redundant the existing requirements of:

- §§ 614.4250(b) and 614.4245(b), (c), and (d);
- § 614.4260(a); and
- §§ 614.4265(g) and 614.4266(d).

3. Section headings

In keeping with proposed reorganizational changes, we propose renaming the subpart and its section headings as follows:

Subpart F—Collateral Appraisal and Evaluation Requirements.

§ 614.4240 as "Definitions";

§ 614.4245 as "General";

§ 614.4250 as "Policies, standards, and internal controls for valuing collateral";

§ 614.4255 as "Appraiser and evaluator qualifications and independence";

§ 614.4260 as "Valuing business chattel, personal, and intangible property";

§ 614.4265 as "Valuing real property";

§ 614.4270 as "Appraisal and evaluation tools"; and

§ 614.4275 as "Reservation of authority".

B. Definitions [existing § 614.4240]

We propose general grammatical changes to certain terms in § 614.4240 to enhance readability. We intend no change in the meaning of the affected terms unless specifically stated. We also propose clarification, removal, or addition of certain terms as discussed below.

1. Clarifications

As a general matter, we propose adding introductory language explaining how certain terms (e.g., paper, record, provide) may be interpreted to permit the electronic equivalent if allowed under our e-commerce regulations in part 609. We add this clarification to reduce questions on

how technology adaptations in daily business activities are to be treated.

We propose clarifying changes to the following definitions:

a. "Abundance of caution".

We propose replacing the phrase "real estate" with "asset" when discussing an item taken out of an abundance of caution. We propose the change to recognize that not all collateral taken out of an abundance of caution is in the form of real estate. System lenders may hold collateral taken in an abundance of caution for real estate and non-real estate financial transactions. As a conforming change, we also propose replacing a reference to collateral required by regulations or the institution policies with a reference to assets legally required to secure the type of credit being extended. This change is intended to capture the variations in loan underwriting requirements, which allow for secured and unsecured lending in certain situations. However, the proposed clarification does not change legal requirements to take real estate as security for financing offered under Title I of the Act nor allow real estate taken as collateral for Title I lending to be considered an abundance of caution type of security.

b. "Appraisal".

We propose clarifying that the term "appraisal" means USPAP compliant valuations of real estate completed by either a state licensed or state certified appraiser. We propose this change as part of our objective to clarify our regulations by restricting the term "appraisal" to always mean a USPAP compliant real estate valuation. The proposed change would prevent using the term to identify non-USPAP valuations, including values assigned to non-real estate. We caution readers that our regulatory definition of "appraisal" is not meant to define the term as used in the Act. Instead, we believe both regulatory terms of "appraisal" and "evaluation" represent the appropriate interpretation of how the single term "appraisal" is used in the Act.

c. "Business loan".

We propose adding cooperatives to the list of borrowing entities in recognition of lending authorities contained within Title III of the Act. In doing so, we propose changing the order of the list to aid in readability.

d. "Evaluation".

We propose clarifying changes to the meaning of "evaluation" to explain an evaluation is in writing and presents an independent and impartial opinion of market value supported by relevant information. This clarification would remove the necessity of repeating throughout subpart F that evaluations need to be in writing and prepared by independent evaluators.

e. "Evaluator".

We propose changing the existing term "qualified evaluator" to "evaluator", using the same definition but with slight modifications. The term as proposed would explain an evaluator must always be qualified for the evaluation assignment by being trained and experienced in identifying values for the types of assets under review. For purposes of business chattel, personal and intangible property collateral evaluations, the term would continue to include eligible bank or association staff, certified public accountants, equipment dealers, grain buyers, livestock buyers, auctioneers, and other industry experts.

f. "Fee appraiser or fee evaluator".

We propose clarifying the term to mean either an appraiser or evaluator of assets who is not employed by the System lender but acts as a third-party contractor. We make

this change to further distinguish the term from appraisals or evaluations prepared by staff of the System lender. We also propose removing the last sentence of the existing definition that applies to personal and intangible evaluations. Instead, we propose moving that sentence to the term "evaluator." In this definition we also propose conforming changes to use new or revised terms being proposed, such as replacing "Farm Credit System institution" with "System lender."

g. "Highest and best use".

We propose clarifying changes to the term "highest and best use" to explain it means the legal use of the asset and to remove language that gives the impression the term only applies to real estate and not other collateral.

h. "Personal property".

We propose a clarifying change to the definition of "personal property" to exclude business chattel. As proposed, the term "personal property" would refer to moveable non-real estate property that is not in the form of equipment, livestock or crops. We propose the distinction to facilitate proper valuation of business chattel, which is commonly used as security for System financing, from other forms of chattel, such as household

goods, which require different valuation efforts and resources. As a conforming change, we also propose adding a new definition for "business chattel", which is discussed in section III.B.3 of this preamble.

i. "Real estate or real property".

We propose adding "or real property" to the existing term "real estate" to recognize the interchangeable use of the two terms. We also propose clarifying that the term includes fixtures, easements, rights of way, and other rights commonly attached to the land (e.g., mineral, water, gas, timber). We make this clarification to ensure appropriate identification and value adjustments for these items are part of the appraisals or evaluations of real estate. As a conforming change, we propose deleting the existing separate definition for the term "real property."

j. "State certified appraiser".

We propose clarifying and conforming language to the definition of "state certified appraiser" that explains no person will be accepted as meeting the FCA definition unless that person passed a state-administered examination equivalent to those exams conducted under the jurisdiction of the FFIEC appraisal subcommittee. Currently, the definition makes a definitive statement of who is or is not

a "state certified appraiser." Because FCA does not actually certify any appraisers, we believe the clarification is necessary.

2. Removals and relocations

First, we propose moving the terms "cost approach", "income capitalization approach", and "sales comparison approach" from the definitions contained in § 614.4240 and incorporating them into proposed § 614.4265, discussing real estate appraisals. This proposed movement should facilitate compliance with the requirements of real estate appraisals by keeping the definitions with the terms in the only place they are used within the rule.

Next, we propose deleting the term "Appraisal Foundation" because it is not used in the proposed rule text. We also propose removing the term "valuation" as the term has become a point of confusion. Currently, the term is defined as an evaluation that is not an appraisal. We propose removing this term and its definition, leaving only the terms "evaluation" and "appraisal". In conformance with this proposed change, we also propose revisions to the definitions of "evaluation" and "appraisal", drawing a distinction between the two types of reports. That proposed distinction would use the term "appraisal" only for USPAP

compliance reports valuing real estate. All other reports of value, including those for business chattel, other personal property and intangible property, would be "evaluations."

3. Additions

We propose adding six terms that would apply to all of subpart F, unless otherwise stated in the regulations. First, we propose adding a definition for "appraiser" to limit application of the term to only those persons state-certified or state-licensed under USPAP guidelines. The term as proposed would also specify that an appraiser has demonstrated experience in identifying values for real property under USPAP. We add this term as part of our efforts to differentiate USPAP required values from evaluations of non-real estate.

Second, we propose adding a definition of "automated valuation model" or AVM, explaining it means a computer-based program that estimates a property's market value based on certain factors. As proposed, the definition would also explain certain sub-set models used for particular assets. We propose adding the term to make clear what constitutes an automated model, selecting a description closely aligned with the definition used by the FIRREA

agencies. We chose to use a definition similar to FIRREA agencies in recognition that vendors of most AVMS design their models to comply with FIRREA standards.

Third, we propose adding a new definition for "business chattel" that would apply to property kept for the carrying on of any agricultural activity, such as production or use in the farming of land. We believe adding the definition will help eliminate confusion with other forms of chattel not in the form of equipment, livestock or crops (i.e., household goods, personal property). We propose the distinction to facilitate proper valuation of business chattel separate from other chattel that may not be subject to a lienhold by the System lender. The new definition of "business chattel" would explain it also applies to both livestock (any creature not in the wild but regarded as an asset) used to produce food, wool, skins, fur or similar purposes, and crops (growing, harvested, or in storage) kept for production or use in the farming of land or the carrying on of any agricultural activity.

Next, we propose adding a definition for "intangible property" to clarify the term refers to valuable items that are not physical in nature (i.e., copyrights, trademarks, goodwill, brand names, etc.). As discussed earlier, this

proposed change would include a conforming change to the existing definition of "personal property."

Fifth, we propose adding a definition of "Other Financing Institutions (OFI)", using a definition consistent with that used in other regulations.¹¹ We propose specifically including the OFI definition to recognize the requirements of 12 CFR part 614, subpart P that OFIs comply with System underwriting standards, including collateral evaluation requirements.

Lastly, we propose adding a definition of "System lender", using a definition consistent with the existing collateral evaluation regulations explaining subpart J of 12 CFR part 614 applies to any System institution engaged in lending or leasing activities secured by collateral. This proposal would add greater readability to the rule through the use of one term rather than the existing use of several terms (identifying various types of System institutions) explaining who is responsible for obtaining an appraisal or evaluation of collateral used to secure an extension of credit. We believe our proposed use of the

¹¹ "OFI" is defined elsewhere in our regulations to mean other financing institutions that have established an access relationship with a Farm Credit Bank or an agricultural credit bank under section 1.7(b)(1)(B) of the Act.

term "System lender" is in keeping with the appraisal requirements of the Act.

B. General [proposed § 614.4245]

We propose § 614.4245 be an all-purpose section identifying the minimum expectations applicable to every collateral appraisal or evaluation. As part of the restructure, we propose moving existing § 614.4245(a) to another section and deleting, due to redundancy, the exiting requirements of § 614.4245(b), (c), and (d), along with other proposed changes.

1. Required appraisals and evaluations [proposed § 614.4245(a)]

We propose adding as new § 614.4245(a) the general rule that all collateral must be valued via an evaluation or appraisal. This is not a new requirement, but rather a clarification of FCA's long-standing position that collateral securing a loan must be assigned a value. FCA issued an Informational Memorandum containing this clarification in 2016 after our examination staff identified some institutions held the belief no valuation was required in certain credit transactions for certain

types of collateral.¹² We recognize that non-real estate collateral may not always be a primary consideration or factor in determining creditworthiness. However, we believe that all security, including property taken out of an abundance of caution, should be properly valued. We also recognize failing to assign a market value to all collateral may negatively affect capital treatment, servicing decisions and loan classifications, as well as create borrower confusion if the property is later assigned the true market value because it has become essential to the credit. Therefore, FCA believes that whenever property is used to secure a loan, a market value must be assigned and supported by an appraisal or evaluation.

Also, we propose that, at a minimum, an appraisal or evaluation be obtained both when filing a lien against the property and when the lender expects to take liquidation actions. Ensuring an asset's value is the current market value at the identified times ensures credit decisions are using the best data available. As proposed, the rule would also require System lenders to act at other times to ensure

¹² FCA Informational Memorandum, "Guidance on Addressing Personal and Intangible Property within Collateral Evaluation Policies and Procedures (§ 614.4245)", dated August 29, 2016.

existing values are adjusted when there are market fluctuations.

2. Format and minimum content requirements. [proposed § 614.4245(b)]

We propose clarifying, reducing, and consolidating the existing minimum expectations for appraisals and evaluations into new § 614.4245(b). First, we propose adding a provision that explicitly requires appraisals to follow USPAP format requirements. Next, we propose adding language recognizing that an evaluation's format presentation will depend on the type of asset being valued and the tools and data sources used to set the value. For example, if equipment is being valued using an AVM, the evaluation format may be a computer screen shot of the recommended market value when that screen shows all the required information. Alternatively, the evaluation format may consist of several different documents with a cover synopsis. We propose this flexibility in recognition of the variety of data sources available and the different ways in which that data is obtained.

We are also proposing to establish minimum content requirements needed to support the final opinion of value. We propose using some existing content requirements and

removing others in the process. The existing content provisions come from §§ 614.4245(a) and 614.4250(a). As part of this consolidation, we propose grammatical changes as well as a few additional changes. As proposed, new § 614.4245(b) would require that all appraisals and evaluations:

- Have enough details to describe the asset, including relevant characteristics;
- Provide information to aid the reader in ascertaining the reasonableness of the value; and
- Identify the data sources used for setting the value, such as including the name and version of any AVM or other published source data used.

When applicable, we also propose that the appraisal or evaluation include a statement that different appraisal or evaluation standards were used but use of those standards was not a result of any prohibited discriminatory factors.

We propose these requirements to provide the reader of the report with sufficient information as to how the appraiser or evaluator chose the final market value and to provide some assurance on the validity of the process used to reach a final value so that it is recognized by other lenders as a fair market value.

3. Age of appraisal or evaluation reports [proposed
§ 614.4245(c)]

We propose a new provision addressing when to obtain a new appraisal or evaluation (outside the two events proposed under § 614.4245(a)). We are not proposing specific evaluation or appraisal age requirements at this time. Instead, proposed § 614.4245(c) would respect the existing practice of allowing appraisals and evaluations to be updated pursuant to the System lender's policies. This would include updating benchmarking methodologies used to track and identify market conditions for a specific type of asset. However, we propose adding a requirement that an appraisal or evaluation may only be used if the reported value reflects market conditions at the time the value is used by the lender.

We had considered regulating the age of appraisals and evaluations but decided a fixed age may not capture market changes in an appropriate timeframe. Instead, we believe each System lender is in a better position to identify upward and downward movement in market conditions within its territory. For that reason, we maintain high expectations that each System lender will incorporate

within its appraisal and evaluation policies and procedures timely reviews of collateral value.

4. Using the appraisal of another lender. [proposed § 614.4245(d)]

We propose moving the existing provision regarding sharing fee appraisals among System institutions from § 614.4255(d) to § 614.4245(d). We also propose expanding this authority to cover all types of real estate appraisals when the applicant or borrower consents. The ability to share collateral appraisals and/or evaluations for the sale and purchase of loans under subpart H of part 614 is unaffected by this proposal as System lenders are expected to address the sharing of collateral appraisals and/or evaluations in those transactions through their purchase of interests in loan agreements under § 614.4325(c)(3), as appropriate and necessary to satisfy underwriting criteria.

As proposed, a System lender may use the real estate appraisals of other lenders when the lender obtaining the appraisal will not be extending the requested credit and agrees to transfer the appraisal. FCA believes that it would be beneficial to System institutions and serve as a cost-savings measure for applicant to allow sharing appraisals among System lenders when one or more are

involved in a credit transaction. To preserve the quality of the transferred appraisal, we propose retaining the existing requirement that such transfers may only occur with other System lenders or lenders subject to Title XI of FIRREA. Additionally, we propose that the System lender receiving the transferred appraisal assume responsibility for verifying the accuracy of the appraisal.

5. Releasing appraisal or evaluations [proposed

§ 614.4245(e)]

We propose adding a provision on the release of appraisals and evaluations to applicants and borrowers. We are proposing this provision to further implement the requirements of section 4.13A of the Act, which provides that borrowers have the right to obtain reports valuing their assets anytime during the life of the loan. Specifically, borrowers must be given, when requested, "copies of each appraisal of the borrower's assets made or used by the qualified lender."¹³ Additionally, we propose language specifying that a System lender is to release a copy of the collateral appraisal or evaluation to the applicant or borrower when issuing an adverse credit decision that relies in whole or part upon collateral

¹³ 12 U.S.C. 2200.

values. This provision would align with provisions in Part 617 and our guidance regarding the contents of adverse credit decisions.

As proposed, appropriate duplication fees may be charged when more than one copy is given, excepting those copies included with notice of an adverse credit decision. We also propose that System lenders provide a copy of a collateral appraisal or evaluation within 7 days of the request. We are proposing a fixed time to ensure that applicants and borrowers receive the report within a reasonable time. We propose 7 calendar days in consideration of other regulatory timeframes where the asset's value may affect an applicant's or borrower's decision making or review rights.

In coordination with our proposed language on evaluation presentation format (§ 614.4245(b)), we propose that the appraisal or evaluation copies provided to applicants and borrowers contain all the information required by regulation or USPAP. These copies serve an essential role in an applicant's or borrower's decision on whether to challenge the value assigned an asset before the Credit Review Committee (CRC). Ensuring the applicant or borrower receives the relevant information forming the

appraisal or evaluation will also fulfill Congressional intent behind section 4.13A. Additionally, we believe that the information provided in the documentation should be presented in a manner that is easily understood by the applicant or borrower.

6. Recordkeeping. [proposed § 614.4245(f)]

We propose adding a requirement on the amount of time System lenders are required to maintain appraisal and evaluation reports. As proposed, a lender's general recordkeeping policies would apply to appraisals and evaluations, except the lender would be required, at a minimum, to maintain them for the same duration as the related credit file. We also specifically propose that the lender preserve the data set used in establishing the value in effect as of the date of the appraisal or evaluation. Our proposal is intended to ensure that the appraisals and evaluations used in the credit process are preserved in case questions arise about the credit decision that may lead back to asset values and to inform whether any updated value is required. Additionally, the proposed requirement to retain the data source(s) used for an appraisal or evaluation reconciles this provision with proposed § 614.4245(e). Under new § 614.4245(e) we propose

requirements addressing the statutory authority of a borrower to request, at any time during the borrowing relationship, copies of all appraisals and/or evaluations used by the System lender.

C. Policies, standards, and internal controls. [proposed § 614.4250]

We propose consolidating into § 614.4250 the existing requirement that System lenders develop policies and standards for conducting appraisals and evaluations. The current requirements are located in §§ 614.4245(a) and 614.4250(a). As part of this consolidation, we propose additional requirements and conforming changes.

1. Policies [proposed § 614.4250(a)]

As proposed, § 614.4250(a) would contain the existing requirement that System lenders adopt and maintain written policies on when and how to issue collateral appraisals or evaluations. The rule further proposes required minimum contents for the policies, including:

- Addressing when an evaluation instead of an appraisal will be used (where the regulations allow a choice);
- Establishing the frequency and timing of when to complete either an appraisal or evaluation;

- Monitoring market conditions;
- Authorizing or prohibiting the use of shared appraisals or using out-of-territory fee appraisers and evaluators;
- Setting parameters for using AVMs and other tools;
- Verifying the independence of those performing the valuation functions;
- Prohibiting any practice that would base an appraisal or evaluation on a requested minimum value or loan amount; and
- Outlining internal controls needed to ensure compliance with relevant laws and regulations.

We believe these minimum requirements provide the basic foundation for a good appraisal and evaluation policy.

Further, we propose requiring Farm Credit banks to address within their collateral appraisal and evaluation policies OFI compliance with those policies. Elsewhere in our regulations, OFI lending activities that are discounted with a Farm Credit bank are required to follow relevant policies and procedures contained in subpart P of 12 CFR 614. We believe specifically addressing OFIs in the

collateral regulations and related institution policies will facilitate compliance with those regulations.

2. Standards [proposed § 614.4250(b)]

We propose § 614.4250(b) contain the existing requirement of § 614.4250(a) that System lenders adopt and maintain written standards for appraisals and evaluations. In addition, we propose requiring those standards be designed to represent current market values to protect the lender's interest in maintaining adequate loan collateral. The rule would continue to identify minimum items the standards must address, including support for the identified market value, the selection process for appraisers and evaluators, continuous monitoring of market conditions, and addressing inspections of the subject property. The level of information each System lender requires within these standards is expected to be specific to the type and nature of the collateral securing the loan. A System lender might also include addressing what it considers appropriate evaluation techniques for complex and specialized assets or high-risk transactions. When valuing complex and specialized assets, additional information addressing the unique characteristics and conditions affecting the market value of such assets demands providing

more than the minimums proposed to ensure a reader of the evaluation receives sufficient information on how the value was established. We believe the System lender is in the best position to determine the level of this additional information given territorial considerations.

When considering how and in what manner to conduct property inspections, we expect the lender to include controls addressing the accuracy and integrity of the inspections. We are aware industry practices continue to place increased reliance on various types of technology to enhance or replace the physical inspection process. When other methods such as these are used, additional controls may be necessary to validate the data's accuracy. While we have not proposed prohibiting the use of such technology, we continue to believe physical inspections are the most appropriate method to verify assets in most cases.

3. Internal controls [proposed § 614.4250(c)]

We are proposing § 614.4250(c) address internal controls in managing the collateral appraisal and evaluation process. We propose that each lender have written internal control policies and procedures specifically designed for the collateral appraisal and evaluation process. We believe the internal controls

process for collateral valuations should be designed to protect the integrity of those values and the process by which they are determined. We propose requiring the controls include safeguarding the independence of those setting values from the credit process, verifying the condition of the asset being valued, and recognizing and reacting to changes in market conditions.

We recognize that existing § 618.8430 contains general requirements for internal controls in collateral valuations and other processes, but we believe there is a need for greater clarity on what the internal controls for collateral valuations should contain. We are not proposing any changes to § 618.8430 and do not intend for the proposed § 614.4250(c) to replace or supersede it. Instead, we intend proposed § 614.4250(c) as an elaboration on the requirements of § 618.8430. As such, we encourage commenters to advise us if they read any conflict between the two provisions.

D. Appraiser and evaluator qualifications and independence
[proposed § 614.4255]

We propose consolidating into new § 614.4255 the existing appraiser and evaluator independence standards from §§ 614.4255 and 614.4267. We also propose that System

lenders verify an appraiser's or evaluator's competency to value the type of collateral under review. In addition, we propose several clarifying changes to existing conflict of interest prohibitions for a lender's staff. As proposed, § 614.4255(b) would require lenders to establish written standards setting forth how independence from the credit decision will be determined. We had considered removing the ability of a single person to both establish the collateral value and make the related credit decision. However, we are mindful there are smaller associations or service offices where complete separation may not be possible. Also, we took into consideration the use of automated credit approval processes. As a result, we are not proposing to remove the current regulatory authority allowing one person to perform the valuation and credit function. However, we propose that those System lenders choosing to embrace such a practice implement a secondary review. We are proposing in § 614.4255 (b) that a secondary review occur either before credit approval or soon after loan closing. We believe System institutions already have the policies and procedures in place to address this requirement. Additionally, we propose in § 614.4255(b)(3) and (4) that a review of that person's work be conducted by someone

separate from the credit transaction and the CRC. We also propose clarifying language that the CRC may not be treated as a secondary review source. Notwithstanding this proposed provision, all aspects of the proposed § 614.4255(b) would remain applicable to System lenders allowing a single person to both establish the collateral value and make the related credit decision.

Finally, we propose moving existing prohibitions on who may perform collateral appraisals and evaluations to new § 614.4255(c). We also propose clarifying that the existing prohibition against a fee appraiser or fee evaluator having a financial interest in the loan or subject property does not include fees earned for valuation services. In addition, we propose expanding the existing prohibition against directors, officers and employees of the System lender performing real estate appraisals and/or evaluations to include all assets where that person has a direct financial interest in the asset being valued. We do not propose extending this prohibition to those appraisals or evaluations prepared by the lender's staff where the staff is engaged in marketing, lending, collection, or credit decision process, but holds no financial interest in

the asset and the appraisal or evaluation is subject to the aforementioned secondary review.

We propose new language in paragraph(c)(6) to prohibit directors, officers and employees of the System lender from serving on the CRC when that same director, officer or employee performed an appraisal or evaluation that is under review by the CRC. To ensure continued independence in the valuation process, we believe it is important to restrict those performing the appraisal or evaluation from serving on the CRC when a credit decision involving the appraisal or evaluation prepared by that person is under review by the CRC.

E. Valuing business chattel, personal, and intangible property. [proposed § 614.4260]

We propose renumbering existing § 614.4266 as new § 614.4260 and keeping the existing requirements of § 614.4266 that chattels are valued using market-values and contain detailed descriptions of the chattel as well as identify the source(s) used to set the value. We also propose providing a nonexclusive list of acceptable sources. Additionally, we propose adding language to make clear that evaluations of business chattel, personal and intangible properties must use recognized techniques and

sources when deriving the final value. We believe limiting the manner of identifying values to recognized techniques and sources helps ensure the accuracy of assigned values, which in turn strengthens the soundness of the related credit decision. It also furthers the likelihood of those evaluations being recognized as valid market values within the financial sector. As a conforming change, we propose adding language to reference the proposed regulatory sections on minimum content, borrower access, and record-keeping for chattel evaluations. However, for intangible property, we propose keeping, with slight modification, the existing requirements from §§ 614.4250(a)(6) and 614.4266(c) that evaluations of intangible property include discussion of the asset's marketability.

In developing this proposed rule, we considered proposing a "score card" exemption or, in the alternative, a reduced analysis for chattel taken out of an abundance of caution. Ultimately, we concluded that Congress expected all forms of chattel to be valued when making a loan. Within the Act, Congress established certain loan making actions to ensure safe and sound credit decisions and provided legal rights for borrowers regarding collateral. To satisfy these congressional requirements and

expectations, all collateral needs a substantiated value. This is true particularly when an applicant seeks to challenge the value through the CRC process.¹⁴ Even though we have not proposed any exemptions or offered special provisions for chattel taken out of an abundance of caution, we believe our proposal to allow the expanded use of AVM and other source data procedures and our proposed changes in documentation required for chattel evaluations serve to address the majority of concerns expressed on the interaction of chattel evaluations and automated loan processes.

F. Valuing real property. [proposed § 614.4265]

We propose revising the current requirements of § 614.4265 by consolidating like provisions currently located in § 614.4260, reorganizing and clarifying content, and adding some additional requirements.

1. General. [§ 614.4265(a) and (b)].

We propose clarifying in § 614.4265(a) that all real estate collateral must be appraised unless an evaluation is specifically permitted by new § 614.4265(c). We propose

¹⁴ Section 4.14 of the Act provides that applicants and borrowers may obtain a review of appraisals and evaluations used in the loan making or loan servicing decision by obtaining an independent evaluation and presenting it to the CRC.

moving to new § 614.4265(b) the existing requirement of § 614.4260(b)(2) that if a real estate-related financial transaction is over \$1 million dollars, then only a state certified appraiser may issue the appraisal report for the real estate security. We also propose removing the existing § 614.4260(b)(1) requirement that appraisals for transactions over \$250,000 be completed by state-licensed or state-certified appraiser. Our other proposed changes, such as to the definition of "appraisal," remove the need for this provision.

2. Permitted use of real estate evaluations. [existing § 614.4260(c); proposed § 614.4265(c)].

We propose moving to new § 614.4265(c) the existing exceptions in § 614.4260(c) for when an evaluation of real estate may be used instead of an appraisal. We also propose adding clarifications to their use because over the years we have had to issue guidance and address questions on the meaning and applicability of the regulatory exceptions. We intend no change to the original scope of the exceptions unless otherwise provided for in the regulation and as explained in this preamble. Specifically, we are proposing to keep the existing authorization to issue an evaluation, not an appraisal, for real estate collateral in the

following loan transactions when use of an exception is justified.

a. Transactions valued at or below \$250,000

We propose moving the existing exception in § 614.4260(c)(1) for transactions that do not include a business loan and which are valued at or below \$250,000 to new § 614.4265(c)(1) and naming it "non-business loan transactions".

b. Business loan transactions

We propose moving the existing exception in § 614.4260(c)(2) for transactions that are business loans valued at or below \$1 million to new § 614.4265(c)(2) and naming it "business loan transactions". Those persons eligible for the business loan exception include individuals, corporations, sole proprietorships, et al. that meet the eligibility requirements of FCA regulations §§ 613.3000(b), 613.3010, and 613.3020.

Additionally, we clarify that we propose no change to this exemption being used for first-lien real estate taken under 12 U.S.C. 2018(a). The value of this first-lien security is used to establish the Loan-to-Value lending ratio (LTV) and so the Act requires it to be "appraised" because Congress intended values used in the LTV be strong

and supportable. When developing the existing rule in 1992, we set in § 614.4265 the minimum requirement that all real estate evaluations determine market value after analyzing the property's value under three approaches: Income capitalization, sales comparison, and cost. This was to afford System lenders use of the FIRREA business loan transaction exemption for first-lien real estate taken under 12 U.S.C. 2018(a) while also satisfying the requirements of the Act. For that reason, in this rulemaking we propose no changes to allowing use of the business loan transaction exemption for first lien real estate taken under 12 U.S.C. 2018(a). In coordination with this, we propose no change in the requirement to use three approaches when either appraising or evaluating real estate, as discussed in the following preamble section III.F.3., "Determining value."

We are proposing changes to one of the conditions for using the business loan exception. Currently, our regulations state that the repayment of the business loan cannot be dependent on income derived from the sale or cash rental of real estate as the primary source of repayment if using the exception. We are proposing to relax this limitation by restricting it to repayment coming from cash

rental from nonagricultural operations. That is, we propose allowing business loan transactions at or below \$1 million to use evaluations when repayment of the loan is from rental income derived from agricultural sources. We believe renting land for agricultural purposes should not prevent use of this exception. Farmers or ranchers who receive cash rents from production on agricultural land should not have to bear the cost of an appraisal solely because the repayment of their loan is from cash rents off that land. This includes those farmers or ranchers who have set aside land and receive conservation payments from a federal or state program.

c. Subsequent loan transactions

We propose moving the existing exception in § 614.4260(c)(5) for subsequent transactions that do not involve new collateral or new monies to new § 614.4265(c)(3) and naming it "subsequent loan transactions". We propose clarifying changes to the existing language, but propose no material change to this exception.

d. Pooled loan transactions

We propose moving the existing exception in § 614.4260(c)(6) for loan transactions where a System

lender purchases an interest in a loan or pool of loans to new § 614.4265(c)(4) and naming it "purchased loans". We propose clarifying changes to existing language, but propose no material change to this exception.

e. Guaranteed loan transactions

We propose moving the existing exception in § 614.4260(c)(7) for loan transactions involving a U.S. Government guarantee to new § 614.4265(c)(5) and naming it "U.S. Government guarantee". We propose clarifying changes to existing language, but propose no material change to this exception. Specifically, we propose clarifying the exception's applicability by converting the existing single sentence into two separate sentences: one for purchased loans already having a guarantee and one for when the lender is making the loan with a guarantee. We believe this clarification will facilitate use of the exception.

f. Additional security in a loan transaction

We propose moving and consolidating the existing exceptions in § 614.4260(c)(3) and (c)(4) for loan transactions involving real property that is either not required by law or is taken for a purpose other than the land's value to new § 614.4265(c)(6), "Additional security". As proposed, an evaluation process would be

available for real estate taken under an abundance of caution. We believe this proposed change captures the intent of the existing exceptions but presents them in a simpler manner.

We considered adding a commercial real estate transaction exception in response to an exception of this nature being added by those regulators subject to FIRREA. The commercial real estate transaction exception recently authorized by other regulators, such as the Federal Deposit Insurance Corporation, provides that a commercial loan using real estate security, but not involving a single 1-to-4 family residence,¹⁵ may use an evaluation instead of an appraisal for the real estate when the loan transaction is at or below \$500,000. The unique nature of the System would have made the exception of little value. Farm Credit direct lenders are non-depository institutions who primarily make commercial business loans to the agricultural sector. These System lenders have authority to make owner-occupied home loans in rural areas populated by 2,500 persons or less, but these home loans may not make up more than 15 percent

¹⁵A single 1 to 4 family residence is generally considered to be a single-family home, a duplex, a tri-plex or a four-plex. It generally does not include farm or ranch properties that have a residence on the farm or ranch-site unless the entire property is primarily residential.

of the institution's loan portfolio. Further, a loan made to finance one of these homes would not be a business loan or a commercial transaction, so would be ineligible for a commercial real estate transaction exception. Additionally, System institutions may make the occasional consumer loan as part of an agricultural operation's 'other credit needs' and these loans would also not qualify for a commercial real estate transaction exception because they too would be consumer transactions. However, System institutions may finance certain commercial transactions under the same 'other credit needs' authority and, if no residence were involved, these loans might qualify for a commercial real estate transaction exception. In evaluating the volume of loan transactions such an exception would cover and considering the fact that these loans would mainly be commercial transactions so most would already be eligible under the "business loan" exception (if the loan transaction is \$1 million or less), we did not see the value in adding an additional exemption.

3. Determining value. [proposed § 614.4265(d)]

We propose consolidating in new § 614.4265(d) the existing requirements of §§ 614.4250(a)(6) and 614.4265. We also propose moving from the existing definitions those

explanations for the "cost approach", "income capitalization approach", and "sales comparison approach", incorporating them into new § 614.4265(d).

As proposed, new § 614.4265(d) would continue to require real estate be valued on the basis of market value but would add clarification of how to arrive at a market value. We propose clarifying that market value is identified only after considering the three valuation methods: income capitalization, sales comparison, and cost approach. We propose this clarification in part through relocating the existing definitions for "cost approach", "income capitalization approach", and "sales comparison approach" to new paragraph (d)(1) through (3). We further propose clarifying that arriving at a market value includes identification of nonagricultural influences, as is currently required in existing § 614.4265(f). Also, we propose requiring in all cases that real estate appraisals and evaluations contain detailed documentation of the best approach to value as part of the written report. We propose that details of the other approaches only be required when primarily used to identify the market value. We propose these modifications to provide better clarity as to why an appraiser or evaluator may not have chosen to use a

specific valuation approach. It also increases transparency and allows the user to better understand the logic behind the final market value.

In proposed new paragraph (d)(1), the income capitalization approach would be explained using the current definition of such. Similarly, proposed new paragraph (d)(2) would contain expectations for the sales comparison approach, using the current definition and adding new requirements for using at least three comparable sales, unless the appraiser or evaluator provides documentation that such comparable sales are not available. FCA believes that requiring appraisals and evaluations to contain at least three comparable properties provides adequate information to form an opinion on the market value of the property in question. Additionally, three comparable sales would provide the end user with an adequate range of values for the subject property for comparison purposes.

Lastly, proposed new paragraph (d)(3) would contain expectations for the cost approach by using the current definition and adding a documentation requirement when the property has unique improvements. FCA believes adding the documentation requirement would allow end users to better understand the methodology chosen to derive the final

recommended market value of the subject property.

Additionally, we believe the documentation would provide greater transparency to the end user regarding the improvements on the property.

4. Valuation of fixtures. [proposed § 614.4265(e)]

Proposed § 614.4265(e) would retain the existing requirement that real estate fixtures be included in the value of real estate. As proposed, greater specificity would be added to clarify that buildings capable of being used for income-producing purposes related to agriculture must have an assigned value. However, we propose language preserving the discretion of the appraiser or evaluator to assign certain obsolete buildings no value. In the past, questions have arisen on whether such buildings should be assigned even a salvage value. Since appraisers and evaluators are trained in assessing market demands, we believe they need to retain the final authority on what value is given obsolete fixtures. To ensure the fixtures are not prematurely determined obsolete, we also propose that the value assigned be premised upon the average buyer. We believe this will alleviate potential disputes among the owner, the lender, the examiner, and the appraiser/evaluator on whether the building is obsolete or

retains some contributory value in each individual's opinion.

5. Additional content requirements. [proposed
§ 614.4265(f)]

We propose keeping, with slight modification, the existing requirements from §§ 614.4250(a)(6) that real property appraisals and evaluations include discussion of the land's marketability. We also propose requiring that appraisals and evaluations of real property include certain information in addition to the general contents proposed in new § 614.4245(b). Specifically, we propose that the appraisal or evaluation include a description of any permanent fixtures, known water or mineral rights, and recorded access rights associated with the land being valued. In recent years, we have had several situations arise where these items were not properly noted, resulting in disputes when the lender later went to act on its lien or there was a land transfer matter. We believe having an appraisal or evaluation notate known permanent fixtures, water or mineral rights, and recorded access rights will further aid lenders in verifying the information against title reports. We also propose keeping the existing requirement that an appraisal or evaluation name the

purpose(s) for which the property will be used by the applicant or borrower when that purpose will be different from the land's highest and best use.

Next, we propose that an appraisal or evaluation of real property name readily observable conditions on the subject property that may pose an environmental hazard. As proposed, System lenders would have to inform the appraiser or evaluator of any reported or known potential hazards. FCA believes the identification of known hazards on the subject property provides valuable information in formalizing the valuation of the property.

Finally, we propose requiring System lenders provide appraisers and evaluators Federal Emergency Management Agency (FEMA) forms prepared on the subject property. Specifically, when the property includes items listed in a Special Flood Hazard Area, the lender would have to supply to the appraiser or evaluator the FEMA form showing the location of the buildings. We propose this provision to align our appraisal and evaluation rules with our existing flood insurance rule of § 614.4940.

G. Computer-based models and other tools [proposed
§ 614.4270]

We propose adding a new § 614.4270 discussing the use of certain appraisal and evaluation tools. FCA previously issued Informational Memoranda addressing the use of automated analytical tools in assigning values to collateral¹⁶ and we propose incorporating most of that guidance into this new regulatory section. Specifically, we propose allowing System institutions to establish computer-based analytical methods and technological tools for collateral appraisal and evaluations, provided the lender can demonstrate that the method(s) used to establish a value is consistent with safe and sound lending practices and contains sufficient information and analysis to provide a market value conclusion. As proposed, analysis tools may not be used as a standalone appraisal or evaluation because these tools are intended for use in assisting appraisers and evaluators in the collateral evaluation process, not replacing them. For example, computer-based models may be used if there is sufficient data available for the type of property being evaluated and if the lender has the necessary expertise to interpret the data.

¹⁶ Referring to ORP-IM, "Collateral Evaluation Requirements and Frequently Asked Questions", dated April 21, 2008 and OE-IM, "Computer-Based Model Validation Expectations", dated June 17, 2002.

We propose that use of automated valuation models (AVM) be limited to situations where the AVM uses information specific to the subject property, including the actual physical condition of the subject property, rather than generalized 'assumptions.' As proposed, assumptions used by the evaluator will require sufficient support and the evaluator will have to demonstrate that the 'assumption' is appropriate for the subject property. Appropriate due diligence is also essential when using these models, including conducting independent reviews to ensure institutions' boards of directors and senior managers are receiving clear and informative descriptions of the model's assumptions and limitations. As such, we propose that System lenders perform due diligence through an independent validation process. We also propose that System lenders retain staff or contract with persons who have experience in using the AVM chosen by the System lender. FCA believes that lenders who maintain staff with AVM expertise would be better positioned to respond to questions or concerns from the output of the AVM or in the event the AVM does not perform as anticipated.

We further propose allowing the use of tax assessment values (TAV) when there is additional support to show a

valid correlation between the TAV and market value but would limit TAV use to valuing real estate. As proposed, the lender would be required to document how the TAV is developed and updated by the tax authorities. We also propose using the TAV only in a manner consistent with safe and sound lending practices, which would involve using additional support for final recommended values rather than sole reliance upon the TAV. We are not proposing to allow use of TAVs for chattel and personal property. We are aware some states assess and tax chattel and personal property, but we do not believe those valuations processes are refined enough to use in credit decisions. As we understand them, chattel valuation processes vary widely by state, not all states provide such valuations, and the values do not consider any additional features or the actual condition of the chattel.

Additionally, we propose requiring System lenders using these tools have policies and procedures in place that, among other things, include appropriate internal controls. In new § 614.4270(c) we propose minimum control requirements that the policies and procedures must address. These requirements include ensuring staff training and expertise, validating model results and setting criteria

when the models will be used and to what extent. We believe the proposed minimum internal control requirements are common industry practice and provide a sound basis for System institutions to develop additional institution-specific requirements.

H. Reservation of authority [proposed § 614.4275]

We propose moving to new § 614.4275 the existing contents of § 614.4260(d) regarding our authority to require appraisals and evaluations. We also propose clarifying that our collateral evaluation regulations do not prevent exercising this authority when safety and soundness issues or enforcement actions require it.

V. Regulatory Flexibility Act and Congressional Review Act
Conclusions

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), FCA hereby certifies that the proposed rule will not have a significant impact on a substantial number of small entities. Each of the banks in the Farm Credit System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, Farm

Credit System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

List of Subjects in 12 CFR Part 614

Agriculture, Banks, banking, Foreign trade, Reporting and recordkeeping requirements, Rural areas.

PART 614--DISCLOSURE TO SHAREHOLDERS

1. The authority citation for part 614 continues to read as follows:

Authority: 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128; secs. 1.3, 1.5, 1.6, 1.7, 1.9, 1.10, 1.11, 2.0, 2.2, 2.3, 2.4, 2.10, 2.12, 2.13, 2.15, 3.0, 3.1, 3.3, 3.7, 3.8, 3.10, 3.20, 3.28, 4.12, 4.12A, 4.13B, 4.14, 4.14A, 4.14C, 4.14D, 4.14E, 4.18, 4.18A, 4.19, 4.25, 4.26, 4.27, 4.28, 4.36, 4.37, 5.9, 5.10, 5.17, 7.0, 7.2, 7.6, 7.8, 7.12, 7.13, 8.0, 8.5 of the Farm Credit Act (12 U.S.C. 2011, 2013, 2014, 2015, 2017, 2018, 2019, 2071, 2073, 2074, 2075, 2091, 2093, 2094, 2097, 2121, 2122, 2124, 2128, 2129, 2131, 2141, 2149, 2183, 2184, 2201, 2202, 2202a, 2202c, 2202d, 2202e, 2206, 2206a, 2207, 2211, 2212, 2213, 2214, 2219a, 2219b, 2243, 2244, 2252, 2279a, 2279a-2, 2279b, 2279c-1, 2279f, 2279f-1, 2279aa, 2279aa-5); sec. 413 of Pub. L. 100-233, 101 Stat. 1568, 1639.

2. Revise the heading of subpart F to read as follows:

Subpart F—Appraisal and Evaluation Requirements

3. Subpart F, consisting of §§ 614.4240 through 614.4275, is revised to read as follows:

Subpart F—Appraisal and Evaluation Requirements

Contents

§614.4240 Definitions.

§614.4245 General.

§614.4250 Policies, standards, and internal controls for valuing collateral.

§614.4255 Appraiser and evaluator qualifications and independence.

§614.4260 Valuing business chattel, personal, and intangible property.

§614.4265 Valuing real property.

§614.4270 Appraisal and evaluation tools.

§614.4275 Reservation of authority.

§ 614.4240 Definitions.

For the purposes of this subpart, the following definitions apply excepting that terms such as copy, document, file, record, provide, written, and similar words generally should be interpreted to permit electronic transmissions and communications as allowable under 12 CFR part 609:

Abundance of caution means a decision to require an asset as security for a loan when the asset is not used as a basis for extending credit, a prudent lender would extend

credit without the asset, and the asset is not legally required as security for the type of credit being extended.

Appraisal means a USPAP compliant written evaluation prepared and issued by a state licensed or state certified appraiser setting forth an independent and impartial opinion as to the market value of real estate as of a specific date(s), which value is supported by the presentation and analysis of relevant market information.

Appraisal Subcommittee means the Appraisal Subcommittee of the Federal Financial Institutions Examination Council.

Appraiser means a state-certified or state-licensed appraiser who is competent, reputable, impartial, and has demonstrated sufficient training and experience in identifying values for real property through issuance of USPAP compliant reports.

Automated Valuation Model or AVM means a computer program that estimates a property's market value based on market, economic, and demographic factors using a quantitative method, system, or approach applying statistical, economic, financial, or mathematical theories, techniques, and assumptions. Hedonic models generally use property characteristics (such as square footage and room

count) and methodologies to process information, often based on statistical regression. Index models generally use geographic repeat sales data over time rather than property characteristic data. Blended or hybrid models use elements of both hedonic and index models.

Business chattel means livestock (e.g. any creature not in the wild which is regarded as an asset such as those to produce food, wool, skins, fur or similar purposes) and crops (growing, harvested, or in storage) kept for production or use in the farming of land or the carrying on of any agricultural activity. The term also encompasses equipment used in business operations, including agricultural equipment.

Business loan means a loan or other extension of credit to finance the business activities of an individual, sole proprietorship, general or limited partnership, joint venture, cooperative, corporation, business trust, or other legal business entity (including those engaged in farming enterprises).

Evaluation means an independent and impartial written opinion of market value for an identified interest in, or aspects of, an asset, which value is supported by the presentation and analysis of relevant market information.

Evaluator means an individual who is competent, reputable, impartial, and has demonstrated sufficient training and experience in identifying values for assets. For purposes of business chattel, personal, and intangible collateral evaluations, the term may include, but is not limited to, System lender staff, certified public accountants, equipment dealers, grain buyers, livestock buyers, and auctioneers.

Fee appraiser or fee evaluator means a qualified appraiser or evaluator of assets who is not an employee of the party contracting for the completion of the appraisal or evaluation and who performs an appraisal or evaluation on a fee basis. For purposes of this subpart, a fee appraiser or fee evaluator may include staff from another System lender only if the employing lender is not operating under joint management with the contracting System lender.

FIRREA means the Financial Institutions Recovery, Reform, and Enforcement Act of 1989.

Highest and best use means the reasonable and most probable legal use of the asset as of the date of valuation that is physically possible, appropriately supported, financially feasible, and results in the highest value.

Intangible property means an item of worth that is not physical in nature, including, but not limited to, a copyright, trademark, goodwill, easement, lease, corporate logo or brand name.

Market value means the most probable price that a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently, knowledgeably, and assuming neither is under duress. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- (1) Buyer and seller are typically motivated;
- (2) Both parties are well informed or well advised, and acting in what they consider their best interests;
- (3) A reasonable time is allowed for exposure in the open market;
- (4) Payment is made in terms of cash in United States dollars or in terms of financial arrangements comparable thereto; and
- (5) The price represents the normal consideration for the property sold unaffected by special or creative

financing or sales concessions granted by anyone associated with the sale.

Other Financing Institutions or OFI means the entities described in 12 U.S.C. 2015(b)(1)(B), but only with respect to loans discounted or pledged under 12 U.S.C. 2015.

Personal property means all tangible and movable property not considered real property and its fixtures or business chattel.

Real estate or real property means an identified parcel or tract of land, including fixtures, easements, rights of way, improvements, if any, and associated mineral, oil, gas, timber, or water rights attached to the parcel or tract of land.

Real estate-related financial transaction means any transaction involving:

(1) The sale, lease, purchase, investment in, or exchange of real property, including interests in property or the financing thereof; or

(2) The refinancing of real property or interests in real property; or

(3) The use of real property or interests in real property as security for a loan or investment, including mortgage-backed securities.

State certified appraiser means any individual who has satisfied the requirements for and has been certified as an appraiser by a State or territory whose requirements for certification currently meet or exceed the minimum criteria for certification issued by the Appraiser Qualification Board of the Appraisal Foundation. No individual will be accepted under these regulations as a State certified appraiser who has not achieved a passing grade on a state-administered examination that is consistent with, and equivalent to, the Uniform State Certification Examination issued or endorsed by the Appraiser Qualification Board of the Appraisal Foundation. In addition, the Appraisal Subcommittee must not have issued a finding that the policies, practices, or procedures of the State or territory are inconsistent with title XI of FIRREA.

State licensed appraiser means any individual who has satisfied the requirements for licensing and has been licensed as an appraiser by a State or territory in which the licensing procedures comply with title XI of FIRREA and in which the Appraisal Subcommittee has not issued a finding that the policies, practices, or procedures of the State or territory are inconsistent with title XI of FIRREA.

System lender means a chartered Farm Credit System institution that engages in lending or leasing secured by collateral.

Transaction value means:

(1) For loans or other extensions of credit, the amount of the loan, loan commitment, or other extensions of credit;

(2) For sales, leases, purchases, investments in, or exchanges of real property, the market value of the property interest involved; and

(3) For the pools of loans or interests in real property, the transaction value of the individual loans or the market value of the real property interests comprising the pool.

USPAP means the Uniform Standards of Professional Appraisal Practice adopted by the Appraisal Foundation.
§ 614.4245 General.

(a) Required appraisals and evaluations. System lenders must obtain appraisals or evaluations of all collateral used to secure an extension of credit (including leasing activities) or the purchased interest in credit extended by another lender. System lenders must maintain appraisals or evaluations reflecting current market

conditions. At a minimum, every item of collateral must be appraised or evaluated both at the time a lien is obtained and when the System lender expects to liquidate its lienhold interest.

(b) Format and minimum content requirements. An appraisal or evaluation is a written impartial opinion of an asset's market value, independently developed and supported by analysis of relevant market information. The market analysis supporting the final opinion of value may be conducted using a variety of appraisal and evaluation tools and data sources.

(1) All appraisals must follow the format requirements of USPAP, or its successor. For evaluations, the presentation format may be in the form of a report, a synopsis, a computer-generated printout, or equivalent records, depending upon the asset and as permitted under the evaluation standards of 12 CFR 614.4250. The reporting format used for evaluations must be appropriate for both the type of asset being valued and the tools and data sources used in setting the value.

(2) To support an opinion of value, each appraisal or evaluation must, at a minimum, include:

(i) A description of the asset in sufficient detail to reflect the relevant characteristics and complexity of the subject asset;

(ii) Information that will enable the reader to ascertain the reasonableness of the estimated market value;

(iii) Identification of the data source(s) used for determining the final market value (e.g., real estate comparable properties, the name and model version of an AVM used, the name and date of reputable publications used, validated information specific to the System lenders' territory); and, if applicable,

(iv) In those situations when different appraisal or evaluation standards are used than those normally employed for the type of asset being valued, the appraiser or evaluator must attest that use of the different standards was not due to any prohibited discriminatory factors like the age, race, or gender of the asset owner or buyer.

(c) Age of appraisal or evaluation reports. It is the responsibility of the System lender to monitor market conditions and trends, loan risk, and collateral conditions to appropriately determine the frequency for performing new or updated collateral appraisals or evaluations in keeping with regulatory requirements. When making credit decisions

or approving new or additional funds, the System lender may use existing collateral appraisals or evaluations reports only if the appraisals or evaluations reflect current market conditions at the time of use.

(d) Using the appraisals of another lender. An appraisal ordered by another financial institution on assets of a loan applicant may be transferred to a System lender when:

(1) The System lender will complete the credit transaction instead of the other financial institution;

(2) The other financial institution and the applicant agree in writing to transfer the report;

(3) The other financial institution is either subject to Title XI of FIRREA or a System lender; and

(4) The System lender receiving and using the appraisal assumes full responsibility for the integrity, accuracy and thoroughness of the appraisal, including the methods used by the other financial institution to establish collateral values.

(e) Releasing appraisals or evaluations to applicants and borrowers.

(1) At any time during the life of the loan, an applicant or borrower may request a copy of each appraisal

and evaluation made or used by the System lender in the credit relationship. The System lender must provide the copies within 7 calendar days of receiving the request. The copy of an appraisal or evaluation provided to an applicant or borrower must, at a minimum, contain the final opinion of value, the information required under 12 CFR 614.4245(b), and, as appropriate to the type of asset being valued, the information required under 12 CFR 614.4260 or 12 CFR 614.4265(d), (e), and (f). The first copy of each appraisal or evaluation given to the applicant or borrower must be provided free of charge, but the System lender may assess reasonable copying charges for any additional copies supplied during the life of the loan, excluding copies provided as part of an adverse credit decision.

(2) When issuing an adverse credit decision, a System lender must include as an attachment to the decision letter copies of those collateral evaluations and appraisals used in the decision-making process. The applicant or borrower is not required to first request such copies and the copies must be provided at no cost to the applicant or borrower. The copy of an appraisal or evaluation provided to an applicant or borrower must, at a minimum, contain the final opinion of value, the information required under 12 CFR

614.4255(b), and, as appropriate to the type of asset being valued, the information required under 12 CFR 614.4260 or 12 CFR 614.4265(d), (e), and (f).

(3) To the extent that an appraisal or evaluation may contain confidential third-party information, the lender may protect such confidential information as provided under 12 CFR 618.8325(b).

(f) Records. The System lender must maintain collateral appraisals or evaluations for the duration required by the lender's recordkeeping policies. The records must capture source data used as of the date of the evaluation. At a minimum, collateral appraisals or evaluations made or used by a System lender for making or servicing a loan must be maintained in the related credit file for the life of the loan. Appraisals and evaluations used to deny a credit request from a new applicant must be maintained in the related credit file for the same amount of time as the lender's recordkeeping policies and procedures require the credit request to be maintained.

§ 614.4250 Policies, standards, and internal controls for valuing collateral.

(a) Policies. The board of directors of each System lender must adopt and maintain written policies on when and

how to issue collateral appraisals and evaluations for all of the System lender's credit functions. in keeping with regulatory requirements. Farm Credit banks must include OFIs in their policies and procedures for those lending and leasing activities conducted under 12 U.S.C. 2015(b)(1)(B). At a minimum, the policies must:

(1) Identify when an evaluation will be used instead of an appraisal (when the regulations allow either to be used);

(2) Establish parameters identifying the frequency and timing of appraisals and evaluations, including monitoring portfolio collateral values on an ongoing basis;

(3) Authorize or prohibit the use of out-of-territory appraisers or sharing appraisals;

(4) Establish parameters for using AVMs and other tools in identifying market values of real estate and/or chattel;

(5) Ensure the independence of the persons ordering, performing, and reviewing appraisals and evaluations;

(6) Prohibit basing an appraisal or evaluation on a requested minimum valuation, specific value, or loan amount;

(7) Implement internal controls that promote compliance with applicable laws, rules and policies; and, as applicable,

(8) Require OFIs to follow collateral appraisal and evaluation requirements.

(b) Standards. Each System lender must adopt and maintain written standards for appraisals and evaluations that implement regulatory requirements, and which are designed both to protect the lender's interest and adequately represent real-time collateral values. At a minimum, the standards must address:

(1) The level of information required to support the value assigned beyond regulatory minimum content requirements, including considerations for complex and specialized assets or high-risk transactions;

(2) Using collateral appraisals and evaluations in a manner consistent with safe and sound practices;

(3) The qualifications of individuals selected to perform an appraisal or evaluation;

(4) Development and maintenance of a list of approved fee appraisers and fee evaluators, including the criteria to follow when selecting and engaging a fee appraiser or fee evaluator;

(5) Providing fee appraisers and fee evaluators with a copy of the collateral appraisal and evaluation regulations contained in this subpart and instructing the fee appraiser or fee evaluator to apply the regulatory requirements in formation of the contracted appraisal or evaluation;

(6) On-going reviews of market conditions, including how recognition of special events affecting values, such as natural disasters, will be handled;

(7) The frequency and form of property inspections;
and

(8) How existing appraisals and evaluations will be handled in renewals, refinancings, and other subsequent credit transactions.

(c) Internal Controls. Each System lender must have written internal control policies and procedures for managing its collateral appraisal and evaluation activities. The internal controls policies and procedures must be kept up-to-date and, at a minimum, include the following elements:

(1) Protecting the integrity of the overall collateral appraisal and evaluation function;

(2) Verifying the condition of pledged collateral is as listed in the appraisal or evaluation report;

(3) Safeguarding the independence of appraisers and evaluators in activities conducted under this subpart;

(4) Ensuring appraisals and evaluations are used to verify collateral market values contained within credit analysis and financial statements; and

(5) Reviewing appraisals and evaluations periodically for compliance with applicable laws, regulations, policy and industry standards.

§ 614.4255 Appraiser and evaluator qualifications and independence.

System lenders are responsible for verifying that persons performing appraisals and evaluations for use by the lender meet the requirements of this section.

(a) Competency. An appraiser or evaluator must have the requisite knowledge and experience for both the specific asset being valued and the relevant market area.

(1) An appraiser or evaluator may not be considered competent solely by virtue of being certified, licensed, or accredited. Any determination of competency must be based on the individual's experience and educational background as it relates to the specific appraisal or evaluation assignment for which such individual is being considered.

(2) A State certified appraiser or a State licensed appraiser may not be excluded from consideration for an assignment solely by virtue of membership or lack of membership in any particular appraisal organization. System lenders may use State certified or State licensed appraisers from any State provided that:

(i) The appraiser is competent to perform such appraisals;

(ii) The applicable System lender has established policies providing for use of interstate appraisals; and

(iii) The State appraiser licensing and certification agency where the subject property is located recognizes the certification or license of the appraiser's State of permanent certification or licensure.

(b) Staff appraisers and evaluators. Each System lender must maintain written standards implementing regulatory requirements on appraiser and evaluator independence from lending activities, as well as real or perceived conflicts of interest, for collateral appraisal and evaluation functions performed by staff of the System lender. The standards must address how a separate secondary review of the assigned value(s) by a person not connected to the credit decision will be used and determine if the

secondary review will happen before the final credit decision is made or soon after loan closing. The written standards on appraiser and evaluator independence from lending activities, at a minimum, must also:

(1) Facilitate the exercise of independent judgment by staff appraisers and evaluators when developing collateral values by providing protections from undue influence by the loan production and collection processes;

(2) Require staff appraisers and evaluators to have no direct, indirect, or prospective interest, financial or otherwise, in the asset being valued;

(3) Require staff appraisers and evaluators to have no direct, indirect, or prospective interest, financial or otherwise, in the transaction for which the appraisal or evaluation will be used when there is no separate secondary review of the assigned value(s) by another person who is not connected to the credit decision nor a member of the Credit Review Committee (CRC) reviewing the credit decision; and

(4) Restrict staff appraisers and evaluators from subsequent participation in any decision related to a loan connected to the collateral that the staff member is valuing, including the sale, purchase, or servicing of that

loan, when there is no separate secondary review of the assigned value(s) by another person who is not connected to the credit decision (including through service on the CRC) or subsequent credit activities.

(c) Prohibitions. In addition to required internal controls for managing a System lender's collateral appraisal and evaluation activities, the following prohibitions apply:

(1) No person may be a fee appraiser or fee evaluator for the System lender when such person has a direct or indirect interest, financial or otherwise, in the loan or subject property being valued (excluding fees generated from performing an appraisal or evaluation).

(2) No director of the System lender may vote on or approve a loan decision when that same person performed the collateral appraisal or evaluation for the loan under review.

(3) No director of the System lender may perform a collateral appraisal or evaluation in connection with any transaction on which such person made, or will be required to make, a credit decision.

(4) No director, officer, or employee of the System lender may perform an appraisal or evaluation of an asset

serving as security for a credit request when that person has a direct or indirect interest, financial or otherwise, in the asset.

(5) Absent a secondary review process, no person may perform an appraisal or evaluation of an asset serving as security for a credit request or loan when that person is engaged in the marketing, lending, collection, or credit decision processes of any of the following:

(i) A System lender making or originating the loan;

(ii) A System lender operating under common management with the System lender making or originating the loan; or

(iii) A System lender purchasing an interest in the loan.

(6) A director, officer, or employee of the System lender performing a collateral appraisal or evaluation for assets connected to a credit or servicing request may not also serve as a Credit Review Committee member at a committee meeting where that appraisal or evaluation report, whether alone or as part of a credit decision, is under review. This prohibition extends to any person performing the secondary review process for an appraisal or evaluation that was prepared by a staff appraiser or evaluator.

§ 614.4260 Valuing business chattel, personal, and intangible property.

(a) General. A market value-based evaluation for business chattel, personal, or intangible property taken as collateral must employ the industry-recognized methods and techniques used to value similar property. Each System lender is responsible for identifying appropriate collateral evaluation data sources and applying proper criteria in evaluating business chattel, personal, and intangible property. When a request is made under 12 CFR 614.4245(e), the System lender must provide to the requestor the supporting information and criteria used in the evaluation of the subject asset(s).

(b) Data source(s). Data sources used to establish the market value of business chattel, personal, or intangible property may include, but are not limited to, AVMs, reputable industry publications, validated information specific to the System lender's territory, equipment dealers, grain buyers, livestock buyers, auctioneers, commodities market, and market sales reports. Identification of data sources made pursuant to the requirements of 12 CFR 614.4245(b)(2)(iii) must include the

name of the source and the date of the publication/contact or version of AVM used, as applicable.

(c) Business chattel and personal property. When providing details of a subject asset under the requirements of 12 CFR 614.4245(b)(2), an evaluation for business chattel and personal property must explain the quality, condition, quantity, species, weight, value per unit, etc. of the asset, as applicable to the type of asset being valued. The evaluation must also describe the location of the chattel at time of valuation.

(d) Intangible items. For intangibles only, the evaluation must include a review and description of the documents supporting the interest(s) in the asset and marketability of the intangible property, including applicable terms, conditions, and restrictions contained in the document that would affect the value of the property.

§ 614.4265 Valuing real property.

(a) General. An appraisal is required for all real estate collateral unless an evaluation is specifically permitted by this section.

(b) Appraiser limitations. Only a State certified real estate appraiser may issue an appraisal report for real estate-related financial transactions over \$1,000,000.

(c) Permitted use of evaluations. System lenders may establish the value of real estate collateral through an evaluation in any of the following loan transactions (if documentation justifies use of such exceptions):

(1) Non-business loan transactions. An evaluation of real estate may be used instead of an appraisal for a non-business loan with a transaction value at or below \$250,000.

(2) Business loan transactions. An evaluation of real estate may be used instead of an appraisal for a business loan with a transaction value at or below \$1,000,000 provided repayment of the loan is not primarily dependent upon either:

(i) Income derived from the sale of real estate, or

(ii) Income from the cash rental of real property being rented for nonagricultural purposes.

(3) Subsequent loan transactions. An evaluation of real estate may be used instead of an appraisal for subsequent loan transactions that do not involve new collateral or the advancement of new loan funds, other than funds necessary to cover reasonable closing costs. Additionally, there must be no obvious or material change

in the physical aspects of the existing real estate collateral or market conditions affecting the property.

(4) Purchased loans. An evaluation of real estate may be used instead of an appraisal when a System lender purchases a loan or an interest in a loan, pool of loans, or interests in real property, including mortgage-backed securities, provided that:

(i) The originating lender's real estate appraisal prepared for each loan, pooled loan, or real property interest, when originated, met the standards of this subpart, other Federal regulations adopted pursuant to FIRREA, or the requirements of the government-sponsored secondary market intermediaries under whose auspices the interest is sold; and

(ii) There has been no obvious or material change in market conditions or the physical aspects of the property that would threaten the System lender's secured position.

(5) U.S. Government guarantee. An evaluation of real estate may be used instead of an appraisal when a System lender makes a loan secured by real estate and such loan is guaranteed by an agency of the United States Government and use of an evaluation conforms to the requirements of the guaranteeing agency. An evaluation of real estate may be

used instead of an appraisal when a System lender purchases a loan secured by real estate and such loan is both guaranteed by an agency of the United States Government and otherwise supported by an appraisal that conforms to the requirements of the guaranteeing agency.

(6) Additional security. When a System lender makes a loan secured, in part or in whole, by real estate and some or all of the real estate is taken out of an abundance of caution, an evaluation, in lieu of an appraisal, of the real estate taken out of an abundance of caution is permitted. All other real estate security must be appraised, absent another permitted use of evaluations being applicable.

(d) Determining value. Real estate is valued on its market value, which must be developed from considering three approaches: the income capitalization approach, the sales comparison approach, and the cost approach. Consideration of all three approaches includes identifying all relevant influences, including, but not limited to, urban development, mineral deposits, and commercial activity in the area. All real estate appraisals and evaluations must include detailed documentation of the main approach used to identify the market value of the subject

property, including an explanation of why that approach was the primary method relied upon by the appraiser or evaluator. The appraisal or evaluation must include a general discussion of the other approaches considered but not relied upon to reach the final market value. In situations where one or more of the three approaches must be excluded from consideration due to a lack of data, the appraisal or evaluation must include an explanation justifying the exclusion.

(1) Income capitalization approach. The income capitalization approach measures the present value of the expected future benefits of property ownership. This value is derived from either:

(i) Capitalizing a single year's income expectancy or an annual average of several years' income expectancies at a market-derived capitalization rate that reflects a specific income pattern, return on investment, and change in the value of the investment; or

(ii) Discounting the annual cashflows for the holding period and the reversion at a specified yield rate or specified yield rates which reflect market behavior.

(2) Sales comparison approach. The sales comparison approach compares the subject property to similar

properties located in relatively close proximity, having similar size and utility, and which have been recently sold in arm's-length transactions (comparable sales). Not less than three comparable sales will be used unless the appraiser or evaluator provides documentation that such comparable sales are not available. Under this approach, the appraiser or evaluator must estimate the degree of similarity and difference between the subject property and comparable sales. Such comparison must be based on conditions of sale, financing terms, market conditions, location, physical characteristics, and income characteristics. Appropriate adjustments to the sales prices of comparable properties are allowed when there are identified deficiencies or superiorities of the subject property. The appraiser or evaluator must use his or her knowledge of the area and apply good judgment in the selection of comparable sales that are the best indicators of value for the subject property.

(3) Cost approach. The cost approach establishes an indicated value by measuring the current market cost to construct a reproduction of, or replacement for, the improvements, minus the amount of depreciation (physical deterioration, or functional obsolescence) evident in the

structure from all causes, plus the market value of the land. If the appraiser or evaluator considers the property to be unique or have specialized improvements, the appraiser or evaluator will identify the source of the cost estimates and will comment on the methodology used to estimate depreciation, effective age and remaining economic life.

(e) Valuation of fixtures. Real estate fixtures closely aligned with, an integral part of, and normally sold with real estate are included in the value of the real estate and must be identified in the appraisal or evaluation. Structures principally used, or capable of being used, for income-producing agricultural or farming commercial enterprise purposes, such as barns, silos, commercial greenhouses, or livestock facilities, must be assigned a value. At the discretion of the appraiser or evaluator, non-dwelling structures no longer used for a commercial purpose and which the average buyer would consider as adding no contributory role to the real estate do not require assignment of a value.

(f) Additional report content requirements. In addition to the minimum content requirements of 12 CFR 614.4245(b) and the requirements of paragraphs (d) and (e)

of this section, an appraisal or evaluation for real estate must include all of the following:

(1) A description of any permanent fixtures, known water and mineral rights, and recorded access rights associated with the real estate being valued.

(2) The purpose for which the property is or will be used by the loan applicant or borrower, if different from the highest and best use.

(3) A list of readily observable conditions that may pose a present environmental hazard. If the System lender knows, or is informed by another party, of a potential hazard, that information must be disclosed to the appraiser or evaluator before the appraisal or evaluation is completed.

(4) Identification of any structures located in known flood hazard areas. When the real property being valued includes buildings or dwellings in a Special Flood Hazard Area, the appropriate Federal Emergency Management Agency form identifying the structure and its location on the property, as required by § 614.4940 of this part, must be made available to the appraiser or evaluator before the appraisal or evaluation report is completed.

(5) The reasonable sales exposure time, the current market conditions or trends affecting, or likely to affect, the value of the land, and the most probable marketplace for the land.

§ 614.4270 Appraisal and evaluation tools.

A System lender may use a variety of analytical methods and technological tools in developing an appraisal or evaluation, provided the lender can demonstrate that the method(s) used is consistent with safe and sound lending practices and contains sufficient information and analysis to support the resulting market value conclusion. The tools by themselves do not constitute either an appraisal or evaluation.

(a) Automated models (AVM). Values for real estate, business chattel, personal, and intangible property may be determined using computer-based models only when there is sufficient data enabling the model's statistical determination of accurate market values.

(1) Scope of use. Use of an AVM must be commensurate with the System lender's credit risk exposure and due diligence in setting minimum performance criteria for the model. Any assumption used must be fully supported and appropriate for the subject property. A System lender must

have or engage persons with expertise relative to a particular method or tool before using that analysis tool.

(2) Validation. System lenders must establish an independent validation process to determine the appropriate application of AVMs. Persons overseeing the model validation must be independent of the loan underwriting and portfolio management process. If the System lender adopts a third-party vendor model, the lender must periodically document the integrity and applicability of the model and the vendor's maintenance of the model.

(b) Tax assessment values (TAV). System lenders may use TAV only in the appraisal or evaluation of real estate. When using TAVs, the System lender must determine and document how the tax jurisdiction calculates the TAV and how frequently TAVs are updated. A System lender may rely on the data provided by local tax authorities to develop the resulting market value unless inconsistent with safe and sound lending practices or, when applicable, USPAP. The use of a TAV requires additional support to demonstrate a valid correlation between the TAV and market value.

(c) Internal controls when using appraisal and evaluation tools. A System lender must establish and maintain written policies and procedures providing a sound

process for using various methods or tools and for verifying that a valuation method or tool is employed in a consistent manner. At a minimum, the policies and procedures must:

(1) Define the requisite expertise and training of staff in managing the selection, use, and validation of an analytical method or technological tool;

(2) Address the selection, use, and validation of the analysis method or tool;

(3) Establish criteria for determining whether a particular method or tool is appropriate for a given transaction or lending activity, considering associated risks for transaction size and purpose, credit quality, and leverage tolerance (loan-to-value);

(4) Specify criteria identifying when a market event or risk factor would preclude the use of a particular method or tool;

(5) Address standards for the use of multiple methods or tools, if applicable, for valuing the same property or to support a particular lending activity;

(6) Provide criteria for ensuring that the method or tool used produces a reliable estimate of market value; and

(7) Address the extent to which an inspection or research is necessary to ascertain the property's actual physical condition and what supplemental information is needed to assess the effect of market conditions or other factors on the AVM estimate of market value.

§ 614.4275 Reservation of authority.

(a) Nothing in this subpart shall be read to limit the authority of the Farm Credit Administration to take supervisory or enforcement action, including action to address unsafe and unsound practices or conditions, or violations of law and regulation.

(b) FCA reserves the right to require an appraisal or evaluation under this subpart whenever it believes it is necessary to address safety and soundness issues.

(c) Nothing in this subpart prevents the FCA from accessing appraisals and evaluations during an examination, enforcement action, or other exercise of its regulatory authority.

Date: _____

Dale L. Aultman,
Secretary,
Farm Credit Administration Board.