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SUPPLEMENTARY INFORMATION:

A. Background

Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) directed NCUA and the other financial institution regulatory agencies to publish appraisal rules for federally related real estate transactions within the jurisdiction of each agency. In accordance with statutory requirements, NCUA's final rule sets minimum standards for appraisals used in connection with federally related real estate transactions and identified those transactions that require a state certified appraiser and those that require either a state certified or licensed appraiser.

While in most cases an appraisal is an essential part of a sound underwriting decision, the Board believes that NCUA should not require Title XI appraisals where they impose costs without significantly promoting the safety and soundness of credit unions or furthering the purpose of Title XI of FIRREA. Furthermore, it has been the Board's experience that some requirements are no longer necessary. Accordingly, on March 1, 1995, the Board issued proposed amendments to part 722, the appraisal regulation. See 60 FR 13388 (March 13, 1995). The proposed amendments were intended to simplify compliance for credit unions by changing provisions in the appraisal regulation that govern: (i) The publication of the USPAP; (ii) minimum appraisal standards; (iii) appraisals to address safety and soundness concerns; (iv) unavailable information; (v) additional appraisal standards developed by credit unions; and (vi) appraiser independence.

B. Comments

Twenty-nine comments were received. Two commenters fully supported the amendments. The remaining twenty-seven comments were generally positive and consistently supported most of the proposed amendments. The issues that generated the most comments were the de minimus amount and appraiser independence.

Dollar Threshold for Obtaining an Appraisal (the De Minimus Amount)

The current appraisal regulation requires a credit union to obtain an appraisal by a certified and licensed appraiser if the transaction value is in excess of \$100,000 for residential real estate and \$50,000 for commercial property. See 12 CFR 722.3(a). The other federal financial institution regulatory

agencies 1 have increased the threshold to \$250,000. See 59 FR 29482, June 7, 1994. The Board considered whether the de minimus level should be increased for federally-insured credit unions. Although credit unions are well capitalized, they are generally much smaller than other financial institutions. As a result, the relative size of an average real estate loan in comparison to capital is generally much higher for a credit union, which translates to much greater relative risk. A major portion of the losses to the National Credit Union Share Insurance Fund in the past ten years were associated with real estate lending. Consequently, the Board did not propose to increase either threshold.

Twelve commenters supported the Board's position. One commenter specifically concurred with NCUA's rationale for not increasing the de minimus level. Two commenters believed that increasing the dollar threshold may cause safety and soundness problems. Eight commenters recommended increasing the de minimus level to \$250,000 for residential real estate. Most of these commenters believed that retaining the current threshold will make credit union loans more expensive and place credit unions at a competitive disadvantage. Two commenters recommended increasing the de minimus level to \$150,000. One commenter suggested increasing the de minimus level to \$250,000 for business loans. The Board does not believe the minimal effects on competition outweigh safety and soundness concerns. For credit unions that engage in real estate lending, their greatest single risk protection is to obtain a licensed or certified appraisal to support the loan-to-value ratio. The current thresholds of \$100,000 for residential real estate and \$50,000 for commercial property are sufficiently high to preclude most home equity or second trust lending from the appraisal requirement, but are low enough to ensure that appraisals are obtained for higher dollar value real estate lending.

Valuation Requirement

The Board did not propose any change to the requirement that any real estate transaction under the de minimus level, and not otherwise exempt, receive a valuation. Three commenters recommended eliminating the valuation requirement if the value of the loan was below a certain dollar threshold. Two

commenters would set the dollar threshold for a valuation at \$20,000 and one commenter would set the dollar threshold at \$50,000.

The Board continues to believe that there should be no de minimus level on the valuation requirement. Loans which are secured by real estate are often made at substantially lower interest rates than noncollateralized loans. The value of the real estate secured as collateral reduces the potential risk of the loan, thereby enabling the credit union to lend at a lower interest rate or smaller spread. Unless a valuation is performed that meets the requirements of part 722, the credit union has no assurance that the real estate offered as collateral is of sufficient value to provide the necessary risk protection to justify the reduced interest rate. However, the Board is exempting from the valuation requirement those real estate loans that are insured by a third party. In this case, there is virtually no risk to the credit union and the valuation requirement serves no practical purpose.

One commenter recommended that the agency define the term "valuation" in the preamble of the final regulation. The term was defined in the preamble to the original final rule. See 55 FR 30199 (July 25, 1990). The term was broadly defined to allow credit unions the flexibility to use various methods to measure market value. Any further refinement of the definition would reduce that flexibility. The Board does not believe that would be in the best interests of credit unions.

Some credit unions have established programs in which minimal valuation procedures are used for real estate loans which are below certain dollar thresholds and/or are below certain loan-to-value ratios. These minimal procedures do not involve a physical inspection of the property or "drive by", but instead may rely on other written evidence such as a recent tax assessment. The Board has no objection to such alternative valuation procedures, as long as the credit union has fully documented how the alternate procedures will work and demonstrated that the procedures do not impose an unacceptable risk by not performing a physical inspection. The credit union must also demonstrate how the other written evidence correlates to the value of the collateral. What constitutes an unacceptable level of risk will vary for each credit union and each loan based on such factors as the credit union's size, capital level and experience with real estate lending, and the borrower's debt level and credit history. For this reason, the Board believes that it would be inappropriate for it to attempt to set

¹ The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Office of Thrift Supervision.