

**VALUATION PRUDENTIAL STANDARDS
FOR LICENSED FINANCIAL INSTITUTIONS UNDER
THE BANKING ACT**



**EASTERN CARIBBEAN CENTRAL BANK
ST KITTS**

December 2017

TABLE OF CONTENTS

1. Commencement	2
2. Definitions	2
3. Objectives	5
4. Application	5
5. Regulatory reporting requirements	6
6. Real estate valuation program	6
7. Independence of the valuation program	7
8. Selection of appraisers	10
9. Approved list of appraisers	12
10. Engagement letters	12
11. Evaluation development	13
12. Evaluation content	14
13. Selection of evaluators	15
14. Transactions that require appraisals	16
15. Minimum appraisal standards	17
16. Appraisal development	20
17. Appraisal reports	22
18. Appraisal validation	24
19. Reviewing appraisals	25
20. Qualifications of appraisal reviewer	27
21. Depth of review	28
22. Resolution of deficiencies	28
23. Documentation of the review	29
24. Third party arrangements	29
25. Compliance process	31
26. Monitoring collateral values	32
27. Portfolio collateral risk	33
28. Payment for appraisal services	34
29. Referrals	35

**VALUATION PRUDENTIAL STANDARDS
FOR LICENSED FINANCIAL INSTITUTIONS**

These prudential standards are issued by the Eastern Caribbean Central Bank (ECCB), in exercise of the powers conferred on it by section 184 of the Banking Act, No....of 2015.

1. Commencement

These prudential standards shall come into effect on the **15 day of December 2017**.

2. Definitions

(1) In these prudential standards:

“**Act**” means the Banking Act 2015[No....of 2015];

“**appraiser**” means an independent and objective person who performs valuation services and reports an opinion of value and is Registered Member of the Royal Institute of Chartered Surveyors or any other internationally recognised professional designation approved by the Eastern Caribbean Central Bank, and in good standing;

“**appraisal report**” means a written statement prepared by an appraiser setting forth an opinion as to the market value of an adequately described property as of a specific date(s), supported by the presentation and analysis of the relevant market information;

“**appraisal reviewer**” means a person who reviews appraisals solicited by a licensed financial institution;

“**evaluator**” means a person who performs a valuation service for a licensed financial institution who is not an appraiser;

“**credit file**” means a hardcopy or electronic record that documents all information necessary to:

- (a) analyse the credit before it is granted; and
- (b) monitor the credit during its life.

“**engagement letter**” means a document outlining the expectations of each party to the appraisal assignment between a licensed financial institution and an appraiser;

“**going concern value**” means the value of a business entity rather than the value of the real property;

“**large exposures**” means an exposure to a person or a borrower group, which amounts to ten per cent or more of the capital base of a licensed financial institution;

“**loan administration staff**” means all personnel responsible for generating loan volume or approving loans, as well as their subordinates and supervisors;

“**Market Value**¹” means the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

*The following terms are included in the definition of **Market Value** and are included for transparency purposes:*

- (a) “**property**” is attributed to the asset under reference and includes movable as also immovable assets.
- (b) “**the estimated amount**” refers to the most reasonable price in the market place based on a hypothetical transaction, not a predetermined price.

¹ <https://www.ivsc.org/standards/glossary>

- (c) **“a property should exchange”** refers to the fact that the value of the property is an estimated amount rather than a predetermined amount or actual sale price. It is the price at which the market expects a transaction that meets all other elements of the market value definition should be completed on the date of valuation.
- (d) **“on the date of valuation”** makes the valuation estimate time specific as of a given day and date. The market conditions may change and therefore the value estimate may appear to be incorrect at another day and date and shall/may not hold good for the earlier or later day and date.
- (e) **“between a willing buyer”** refers to one who is motivated but not compelled to purchase the property. This buyer is neither over eager nor determined to buy at any price. This buyer is also one who purchases in accordance with the realities of the current market and with current market expectations, rather than in relation to a hypothetical market that cannot be demonstrated to exist.
- (f) **“a willing seller”** is neither an over eager nor a forced seller, prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market.
- (g) **“in an arm’s length transaction”** assumes unrelated parties, acting independent, not parent and subsidiary companies or tenant and landlord.
- (h) **“after proper marketing”** means that the property intended to be sold would be exposed to market in appropriate manner to effect disposed at best price reasonably obtainable and the intended sale is brought to the notice of adequate number of potential buyers prior to the valuation date.
- (i) **“wherein the parties had each acted knowledgeably and prudently”** means that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the property, its present use and potential uses. The parties were also made aware of the pulse of the market on the date of valuation. Both are expected to protect their individual interests.

(j) **“without compulsion”** means that both parties to the transaction are willingly motivated by their own appetite to sell on the one hand and to buy on the other hand without any shadow of compulsion to influence them anywhere.

(k) **“real estate-related financial transaction”** means any transaction involving:

- (a) the sale, lease, purchase, investment in or exchange of real property, including interests in real property, or the financing of real property;
- (b) the refinancing of real property or interests in real property; or
- (c) the use of real property or interests in real property as security for a loan or investment, including mortgage-backed securities.

“valuation” includes both appraisals and evaluations conducted on behalf of a licensed financial institution.

(2) For the purposes of these prudential standards any reference to an appraiser may be construed as including a reference to a valuator.

3. Objectives

(1) These prudential standards aim to:

- (a) provide guidance to licensed financial institutions under the Act on several key principles for real estate valuation;
- (b) highlight the minimum content of a real estate valuation program.

4. Application

(1) These prudential standards apply to all licensed financial institutions under the Act.

(2) These prudential standards address supervisory matters relating to real estate appraisals and evaluations used to support real estate-related financial transactions.

5. Regulatory reporting requirements

- (1) Each licensed financial institution shall submit a copy of its real estate valuation policy to the Central Bank within thirty days of approval by the board of directors.
- (2) This policy shall be submitted to the Central Bank on an annual basis at a minimum.
- (3) Each licensed financial institution shall submit changes to these policies and procedures to the Central Bank within thirty days of approval by the board of directors.
- (4) Every licensed financial institution shall forward minutes of credit committee meetings and management reports to the Central Bank within fourteen days after the end of the month in which the minutes were confirmed.
- (5) Each licensed financial institution shall:
 - (a) submit on an annual basis a spreadsheet summarizing all real estate lending activity, including both funded loans and declined loans; and
 - (b) ensure that the spreadsheet contains all the pertinent data related to each transaction.

6. Real estate valuation program

- (1) The board of directors of a licensed financial institution is responsible for adopting and reviewing policies and procedures that establish an effective real estate valuation policy. The board should review periodically, but at least once a year, the real estate valuation policies and procedures to ensure that they are sound and prudent and adequately support the institution's real estate credit activities and that they are adequately applied.
- (2) The management of a licensed financial institution is responsible for implementing real estate policies and ensuring that they are prudently and appropriately applied.
- (3) All licensed financial institutions shall:
 - (a) provide for the independence of the persons ordering, performing, and

- reviewing appraisals and evaluations;
- (b) establish the selection criteria and procedures to evaluate and monitor the ongoing performance of appraisers and evaluators;
- (c) ensure that appraisals and evaluations comply with these prudential standards and are consistent with any further directives from the Central Bank;
- (d) ensure that appraisals and evaluations contain sufficient information to support the credit decision;
- (e) maintain the criteria for the content and appropriate use of valuations consistent with safe and sound banking practices;
- (f) provide for the receipt and review of the appraisal report and evaluation report in a timely manner to facilitate the credit decision;
- (g) develop criteria to assess whether an existing appraisal or evaluation may be used to support a subsequent transaction;
- (h) establish the criteria for monitoring the value of real estate; and
- (i) establish a method for documenting and monitoring appraisal and evaluation activity in the form of a spreadsheet or similar medium.

7. Independence of the valuation program

- (1) A licensed financial institution should maintain prudential standards of independence as part of an effective valuation program for all of its real estate lending activity.
- (2) The valuation program shall be clearly defined and independent of loan administration.
- (4) A licensed financial institution shall establish reporting lines independent of loan administration for staff who administers the licensed financial institution's valuation program, including the ordering, reviewing, and acceptance of appraisals and evaluations.
- (5) All appraisers within a licensed financial institution shall be independent of the loan administration and collection processes and have no direct, indirect or prospective interest, financial or otherwise, in the property or transaction.

- (6) These standards of independence should also apply to the evaluators.
- (7) Where a licensed financial institution does not have a separate unit for valuations, the licensed financial institution is to demonstrate that it has prudent safeguards to isolate its valuation program from influence or interference from the loan administration process.
- (8) Pursuant to subsection (6), an independent loan officer, other officer, or director of the licensed financial institution may analyse the value of real estate.
- (9) The directors or loan administration staff shall abstain from the approval process involving loans on which they ordered, performed, or reviewed the appraisal or evaluations to ensure their independence.
- (10) Communication between the licensed financial institution's valuation staff and an appraiser or evaluator is essential for the exchange of appropriate information relative to the valuation assignment.
- (11) The licensed financial institution's real estate valuation policies and procedures should specify the methods of communication to ensure independence in the valuation.
- (12) These policies and procedures should foster timely and appropriate communications regarding the assignment and establishment of a process for responding to queries or comments from the appraiser or evaluator.
- (13) The licensed financial institution may exchange information with appraisers and evaluators, which may include providing a copy of the sales contract for a purchase transaction, copies of lease or rental agreements, and past appraisals.
- (14) A licensed financial institution shall not directly or indirectly influence, or otherwise encourage an appraiser or an evaluator to misstate or misrepresent the value of the

property or any other information relevant to the property and valuation.

- (15) Consistent with its policies and procedures, a licensed financial institution may request the appraiser or an evaluator to:
- (a) consider additional information about the subject property or about comparable properties;
 - (b) provide additional supporting information about the basis for a valuation; or
 - (c) correct factual errors in a valuation.
- (16) A licensed financial institution shall ensure that its policies and procedures avoid inappropriate actions that would compromise the independence of the valuation, including:
- (a) communicating a predetermined, expected, or qualifying estimate of value, or a loan amount or target loan-to-value ratio to an appraiser or an evaluator;
 - (b) specifying a minimum value requirement for the property that is needed to approve the loan or as a condition of ordering the valuation;
 - (c) conditioning a person's compensation on loan consummation; and or compensation related to the valuation estimate or the sales price;
 - (d) failing to compensate a person because a property is not valued at a certain amount;
 - (e) implying that current or future retention of a person's services depends on the amount at which the appraiser or an evaluator values a property;
 - (f) excluding an appraiser or evaluator from consideration for future engagement because a property's reported market value does not meet a specified threshold.
- (17) A licensed financial institution should not use the threat of reporting a false allegation in order to influence or coerce an appraiser or an evaluator.

Explanatory note: After obtaining an appraisal or evaluation, as part of its business practice, a licensed financial institution may find it necessary to obtain another appraisal or review of a property and would be expected to adhere to a policy of selecting the most credible appraisal or

evaluation, rather than the appraisal or evaluation that states the highest value.

8. Selection of appraisers

- (1) A licensed financial institution shall establish the criteria for the selection, evaluation, and monitoring of the performance of appraisers who shall:
 - (a) be a Registered Member of the Royal Institute of Chartered Surveyors or any other internationally recognised professional designation approved by the Eastern Caribbean Central Bank, and in good standing;
 - (b) be capable of rendering an unbiased opinion;
 - (c) be independent and have no direct, indirect, or prospective interest, financial or otherwise, in the property or the transaction or with the party to the real estate-related transaction with whom the licensed financial institution is dealing;
 - (d) hold the appropriate registration at the time of the assignment;
 - (e) possess the appropriate appraisal or collateral valuation education, expertise, and experience relevant to the type of property being valued;
 - (f) continually update knowledge through a process of continuing education.
- (2) The work performed by appraisers and evaluators shall be reviewed by the licensed financial institution at a minimum on an annual basis.
- (3) A licensed financial institution or its representatives (such as appraisal management companies) shall directly select and engage appraisers and evaluators.

Explanatory note: Independence is compromised when a borrower recommends an appraiser or an evaluator. Independence is also compromised when loan administration staff selects a person to perform a valuation for a specific transaction outside the licensed financial institution's formal selection process.

- (4) A licensed financial institution's selection process shall ensure that a qualified, competent and independent person is selected to perform a valuation assignment.

- (5) A licensed financial institution shall maintain documentation to demonstrate that the appraiser or evaluator is competent, independent, and has the relevant experience and knowledge for the market, location, and type of real property being valued.
- (6) The person who selects or oversees the selection of appraisers or evaluators shall be independent from the loan administration unit.
- (7) No licensed financial institution shall use a borrower-ordered or borrower-provided appraisal as part of its valuation program.
- (8) A licensed financial institution shall maintain documentation to ensure that criteria exist for the duration of selected appraisers/evaluators, Appraiser/Evaluator rotation, removal of appraiser/evaluator and re-appointment of appraiser/evaluators.

Explanatory note:

- (a) Duration of the selected appraisers/evaluators. In general, the duration of the appointment should be for a fixed period of years, and the performance of the appraiser/evaluator should be reviewed periodically and at minimum annually by the financial institution. If performance is not satisfactory, the appraiser/evaluator can be depanelled at the discretion of the financial institution.*
- (b) Appraiser/evaluator rotation. Rotating the appraiser/evaluator gives more independence to a particular assignment, providing a new look on the property valuation. In addition, appraisers/evaluators should be rotated periodically over a number of years.*
- (c) Removal of the appraiser/evaluator. A person can be removed from the list of selected appraisers/evaluators, when she/he has been found to be indulging in unfair practices or professional misconduct, violating the code of ethics and professional practice. The removal can be for a fixed number of years, if charges are found serious.*

(d) Re-appointment of appraisers/evaluators. In the case of appraisers, they can be re- empaneled again for a specific period, based on the recommendations of the Royal Institute of Chartered Surveyors.

9. Approved list of appraisers

- (1) Where a licensed financial institution establishes a list of approved appraisers, the licensed financial institution shall put in place the appropriate procedures for the development and administration of the list not limited to duration, rotation, removal and re-appointment of selected appraisers and evaluators.
- (2) These procedures should include a process for qualifying an appraiser for initial placement on the list, as well as periodic monitoring of the appraiser's performance and credentials to assess whether to retain the appraiser on the list.
- (3) The licensed financial institution shall conduct, at a minimum, an annual internal review of the use of the list of approved appraisers to confirm that appropriate procedures and controls exist to ensure independence in the development, administration, and maintenance of the list.

10. Engagement letters

- (1) A licensed financial institution shall use written engagement letters when ordering appraisals for all real estate valuations.
- (2) Each engagement letter issued by a licensed financial institution shall at a minimum:
 - (a) identify the intended use and user(s);
 - (b) reflect the extent to which the property needs to be identified and inspected; and
 - (c) specify whether there are any legal or contractual restrictions on the sharing of the appraisal with other parties.

- (3) A licensed financial institution shall include the engagement letter in its credit file.
- (4) To avoid the appearance of any conflict of interest, a licensed financial institution shall not commence valuation development work until the licensed financial institution has selected and engaged an appraiser for the assignment.

Explanatory note: An engagement letter facilitates communication with the appraiser and documents the expectations of each party to the appraisal assignment.

11. Evaluation development

- (1) Licensed financial institutions shall ensure that every evaluation conducted is consistent with safe and sound banking practices and supports the licensed financial institution's decision to engage in a transaction.
- (2) A licensed financial institution should be able to demonstrate that an evaluation, whether prepared by an individual or supported by an analytical method or a technological tool, provides a reliable estimate of the collateral's market value as of a stated effective date prior to the decision to enter into a transaction.
- (3) A licensed financial institution shall not accept a valuation method that does not provide a property's market value and sufficient information and analysis to support the value conclusion.
- (4) A licensed financial institution shall establish policies and procedures for determining an appropriate collateral valuation method for a given transaction considering associated risks.
- (5) The policies and procedures established under subsection (4) shall address the process for selecting the appropriate valuation method for a transaction rather than using the method that renders the highest value, lowest cost, or fastest turnaround time.

- (6) Licensed financial institutions shall ensure that a valuation method addresses the property's actual physical condition and characteristics as well as the economic and market conditions that affect the estimate of the collateral's market value.
- (7) Each licensed financial institution shall establish the criteria for determining the level and extent of research or inspection necessary to ascertain the property's actual physical condition and the economic and market factors that should be considered in developing an evaluation.
- (8) Each licensed financial institutions shall perform an inspection to ascertain the actual physical condition of the property and market factors that affect its market value.
- (9) Each licensed financial institution shall ensure that an evaluation is not based on unsupported assumptions such as an assumption that the property is not affected by adverse market conditions.

12. Evaluation content

A licensed financial institution shall ensure that each evaluation contains sufficient information detailing the analysis, assumptions, and conclusions to support the credit decision which is to be documented in the credit file and, at a minimum shall:

- (a) identify the location of the property;
- (b) provide a description of the property and its current and projected use;
- (c) provide an estimate of the property's market value in its actual physical condition, use and zoning designation as of the effective date of the evaluation (that is, the date that the analysis was completed), with any limiting conditions;
- (d) describe the method(s) the licensed financial institution used to confirm the property's actual physical condition and the extent to which an inspection was performed;
- (e) describe the analysis that was performed and the supporting information that was

- used in valuing the property;
- (f) describe the supplemental information that was considered when using an analytical method or technological tool;
- (g) indicate all source(s) of information used in the analysis, as applicable, to value the property, including:
 - (i) external data sources (such as market sales databases and public tax and land records);
 - (ii) property-specific data (such as previous sales data for the subject property, tax assessment data, and comparable sales information);
 - (iii) evidence of a property inspection;
 - (iv) photos of the property;
 - (v) description of the neighborhood;
 - (vi) local market conditions;
 - (vii) copy of land registry and survey map.
- (h) include information on the evaluator when an evaluation is performed by a person, such as the name and contact information, and signature (electronic or other legally permissible signature) of the evaluator.

13. Selection of evaluators

A licensed financial institution as part of its valuation program shall establish the criteria to select, evaluate, and monitor the performance of evaluators in accordance with the following:

- (a) the person selected possesses the requisite education, expertise, and experience to competently complete the assignment;
- (b) the person selected should continually update their knowledge through a process of continuing education;
- (c) the work performed by persons providing evaluation services is periodically reviewed by the licensed financial institution;
- (d) the person selected is capable of rendering an unbiased opinion;

- (e) the person selected is independent and has no direct, indirect, or prospective interest, financial or otherwise, in the property or the transaction;
- (f) persons who perform evaluations should possess the appropriate appraisal or collateral valuation education, expertise, and experience relevant to the type of property being valued;
- (g) International best practices.

14. Transactions that require appraisals

- (1) An appraisal is required for all real estate-related financial transactions except those in which:
 - (a) the transaction includes all of the following:
 - (i) loan amount is two hundred and seventy thousand Eastern Caribbean Currency dollars (270,000 EC)] or less,
 - (ii) is a single family residence, completed, not under construction or in need of major deferred maintenance or repairs,
 - (iii) is used as a primary residence,
 - (iv) is not complex, and
 - (v) has a maximum loan to value ratio of seventy-five per cent.
 - (b) a lien on real estate has been taken as collateral in an abundance of caution;
 - (c) the transaction is not secured by real estate;
 - (d) a lien on real estate has been taken for purposes other than the real estate's value;
 - (e) the transaction is a business loan only with no real estate;
 - (f) the transaction involves an existing extension of credit at the licensed financial institution and:
 - (i) there has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the licensed financial institution's real estate collateral protection;
 - (ii) there is no advancement of new monies, other than funds necessary to cover reasonable closing costs.

The Central Bank may request an appraisal where it considers it necessary to address safety and soundness concerns in a real estate transaction.

- (2) For a transaction that does not require the services of an appraiser under this section, the licensed financial institution shall obtain an appropriate evaluation of the real property collateral that is consistent with safe and sound banking practices.

15. Minimum appraisal standards

- (1) Where a licensed financial institution requires an appraisal the following minimum standards in subsection (2) for the preparation of an appraisal shall apply.
- (2) Every appraisal by an appraiser shall:
 - (a) conform to the generally accepted appraisal standards as dictated by the Royal Institute of Chartered Surveyors or any other internationally recognised professional designation approved by the Eastern Caribbean Central Bank, unless principles of safe and sound banking practices require compliance with stricter standards;
 - (b) contain an opinion of market value;
 - (c) be written and contain sufficient information and analysis to support the licensed financial institution's decision to engage in the transaction;
 - (d) contain sufficient information to enable the intended user of the appraisal to understand the report properly;
 - (e) analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units;
 - (f) be performed by a registered member in accordance with requirements set out by the Royal Institute of Chartered Surveyors or any other internationally recognised professional designation approved by the Eastern Caribbean Central Bank;
 - (g) be signed by the appraiser with their registration number, date of registration expiration, and have a certification and limiting conditions.

Explanatory note: These standards do not permit an appraiser to appraise any property in which the appraiser has an interest, direct or indirect, financial or otherwise in the property or transaction.

- (3) A licensed financial institution shall obtain an appraisal that is appropriate for the particular transaction, considering the risk and complexity of the transaction.

Explanatory note: The level of detail should be sufficient for the licensed financial institution to understand the appraiser's analysis and opinion of the property's market value. As provided by the scope of work, appraisers are responsible for establishing the scope of work to be performed in rendering an opinion of the property's market value.

- (4) A licensed financial institution shall ensure that the scope of work is appropriate for the assignment.

Explanatory note: The appraiser's scope of work should be consistent with the extent of the research and analyses employed for similar property types, market conditions, and transactions. Therefore, a licensed financial institution should be cautious in limiting the scope of the appraiser's inspection, research, or other information used to determine the property's condition and relevant market factors, which could affect the credibility of the appraisal.

- (5) A licensed financial institution shall specify the level of detail required for any appraisal report whenever it engages an appraiser that is commensurate with the risk and complexity of the transaction.

Explanatory note: The appraisal report should contain sufficient disclosure of the nature and extent of inspection and research performed by the appraiser to verify the property's condition and support the appraiser's opinion of market value. However, the appraiser is not to be held responsible for the adequacy of the appraisal to meet the requirement of the loan risk analysis, this is the responsibility of the licensed financial institution.

Explanatory note: Appraisers must analyze, apply, and report appropriate deductions and discounts when providing an estimate of market value based on demand for real estate in the future. This standard is designed to avoid having appraisals prepared using unrealistic assumptions and inappropriate methods in arriving at the property's market value.

Each appraisal must contain an estimate of market value, as defined. The definition of market value assumes that the price is not affected by undue stimulus, which would allow the value of the real property to be increased by favorable financing or seller concessions. Value opinions such as "going concern value," "value in use," or a special value to a specific property user may not be used as market value for bank transactions. An appraisal may contain separate opinions of such values so long as they are clearly identified and disclosed. The going concern valuation is based on the existing operations of the business and its current operating record, with the assumption that the business will continue to operate.

The estimate of market value should consider the real property's actual physical condition, use, and zoning as of the effective date of the appraiser's opinion of value. For a transaction financing construction or renovation of a building, a licensed financial institution would generally request an appraiser to provide the property's current market value in its "as is" condition, and, as applicable, its prospective market value upon completion and/or prospective market value upon stabilization. Prospective market value opinions should be based upon current and reasonably expected market conditions. When an appraisal includes prospective market value opinions, there should be a point of reference to the market conditions and time frame on which the appraiser based the analysis. A licensed financial institution should understand the real property's "as is" market value and should consider the prospective market value that corresponds to the credit decision and the phase of the project being funded, if applicable.

In determining competency for a given appraisal assignment, a licensed financial institution must consider an appraiser's education and experience. While a licensed financial institution must confirm that the appraiser holds a valid registration and has the minimum credential requirement,

appraisers are expected to be selected for individual assignments based on their competency to perform the appraisal, including knowledge of the property type and specific property market. A registered appraiser may not be considered competent solely by virtue of having a registration.

- (6) No borrower or any party directly associated with the borrower shall recommend or select an appraiser, request an appraisal or provide an appraisal.

16. Appraisal development

- (1) Every licensed financial institution shall use an engagement letter to communicate with an appraiser.
- (2) Where a licensed financial institution engages an appraiser, the licensed financial institution shall ensure that the appraiser submits an appraiser certification disclosing whether he has provided any services related to the property in the past three years.
- (3) A licensed financial institution is responsible for obtaining an appraisal, which contains information that meets the minimum standards and analysis to support its decision to engage in the transaction.
- (4) To ensure that an appraisal is appropriate for the intended use, a licensed financial institution should discuss its needs and expectations for the appraisal with the appraiser.

Explanatory note: Such discussions should assist the appraiser in establishing the scope of work and form the basis of the licensed financial institution's engagement letter, as appropriate. These communications should adhere to the licensed financial institution's policies and procedures on the independence of the appraiser and should not unduly influence the appraiser.

- (5) A licensed financial institution should not allow lower cost or the speed of delivery time to inappropriately influence its appraisal ordering procedures or the appraiser's determination of the engagement letter for an appraisal supporting a licensed financial institution's

transaction.

- (6) A licensed financial institution shall ensure that all appraisals are done using the sales comparison approach and shall include at least one of the following approaches to value:
 - (a) cost, or
 - (b) income, that is applicable and necessary to the assignment.
- (7) The appraiser shall disclose to the licensed financial institution the rationale for the omission of a valuation approach.
- (8) The appraiser must analyse and reconcile the information from the approaches to arrive at the opinion of market value.
- (9) The appraisal shall include a discussion on market conditions, including:
 - (a) relevant information on property value trends,
 - (b) demand and supply factors,
 - (c) exposure time,
 - (d) the prevalence and effect of sales and financing concessions,
 - (e) the list-to-sale price ratio, and availability of financing.
- (10) An appraisal must reflect an analysis of the property's sales and listing history for a minimum of three years and an opinion as to the highest and best use of the property.

Explanatory note:

The three years sales and listing history is only a minimum. If the credibility of the appraisal is affected by data older than three years then the appraiser is obligated to report and analyze that information.

- (11) Every appraiser must disclose whether or not the subject property was inspected and to what extent, and whether anyone provided significant assistance to the appraiser signing the appraisal report.

17. Appraisal reports

- (1) Subject to subsection (4) a licensed financial institution is responsible for identifying the appropriate level of detail in the appraisal report to support its credit decisions.
- (2) A licensed financial institution should consider the risk, size, and complexity of the transaction and the value of the real estate when determining the level of detail in the appraisal report format to be specified in the engagement letter to an appraiser.

Explanatory note: A report level that merely states, rather than summarizes or describes the content and information required in an appraisal report, may lack sufficient supporting information and analysis to explain the appraiser's opinions and conclusions.

Regardless of the report level, the appraisal report shall contain sufficient detail to allow the licensed financial institution to understand the scope of work performed.

Sufficient information includes the disclosure of research and analysis performed, as well as disclosure of the research and analysis typically warranted for the type of appraisal, but omitted, along with the rationale for its omission.

- (3) The appraisal report shall:
 - (a) describe the supplemental information that was considered when using an analytical method or technological tool;
 - (b) indicate all source(s) of information used in the analysis, as applicable, to value the property, including:
 - (i) external data sources (such as market sales databases and public tax and land records);
 - (ii) property-specific data (such as previous sales data for the subject property, tax assessment data, and comparable sales information).

- (4) Every appraisal report shall at a minimum contain the following:
- (a) property, neighborhood and improvement description and analysis;
 - (b) local market conditions and analysis;
 - (c) subject property site description including inspection;
 - (d) subject property sales and listing history as described in Section 16.10
 - (e) highest and best use analysis with supporting data;
 - (f) client (intended user);
 - (g) intended use should be clearly highlighted according to the purpose for example for financing, for taxation, for insurance, for bankruptcy etcetera;
 - (h) identification of real estate:
 - (i) supportable analysis for depreciation including effective age and total economic life;
 - (j) two approaches to value with supporting documentation (see Section 16.6);
 - (k) effective date of value opinion:
 - (l) real property interest valued:
 - (m) estimated exposure time for value to be obtained;
 - (n) the income approach when applicable with a well-supported capitalization rate and net operating income for income producing properties;
 - (o) values of comparable properties;
 - (p) discounted cash flow where appropriate, especially for partially leased or partially constructed properties;
 - (q) supported reconciliation and conclusions;
 - (r) photos that support condition and report neighboring property uses including interior and exterior photos of the subject and exterior photos of the comparables;
 - (s) addendums to support valuation conclusions;
 - (t) a certification and any limiting conditions;
 - (u) date of the report;
 - (v) scope of work:
 - (i) describe level of inspection;
 - (ii) describe process of gathering information;
 - (iii) describe how comparable sales or rental information was confirmed;

- (iv) describe the valuation approaches used and address the exclusion of any of the typical approaches (sales comparison, cost, income).
- (5) A licensed financial institution shall include information on the appraiser, such as the name and contact information, and signature (electronic or other legally permissible signature) of the appraiser.
- (6) The conclusions of the valuation report should be clear and accurate in order to avoid unambiguous interpretation.

18. Appraisal validation

- (1) A licensed financial institution is allowed to use an existing appraisal to support a subsequent transaction in certain circumstances.
- (2) A licensed financial institution should establish criteria for assessing whether an existing appraisal continues to reflect the market value of the property (that is, remains valid).
- (3) The criteria will vary depending upon the condition of the property and the marketplace, and the nature of the transaction.
- (4) The documentation in the credit file should provide the facts and analysis to support the licensed financial institution's conclusion that the existing appraisal may be used in the subsequent transaction.
- (5) A licensed financial institution shall request a new appraisal where the originally reported market value has changed due to factors such as:
 - (a) passage of time;
 - (b) volatility of the local market;
 - (c) changes in terms and availability of financing;
 - (d) natural disasters;
 - (e) limited or over supply of competing properties;

- (f) improvements to the subject property or competing properties;
 - (g) lack of maintenance of the subject or competing properties;
 - (h) changes in underlying economic and market assumptions, such as capitalization rates and lease terms;
 - (i) changes in zoning, building materials, or technology;
 - (j) environmental contamination;
 - (k) changes in the subject property's use.
- (6) A licensed financial institution shall specify in its appraisal policy the following minimum requirements:
- (a) the validation of the appraisal may be prepared by an evaluator within the licensed financial institution whose experience has been fully documented by the licensed financial institution;
 - (b) the validation of the appraisal shall comprise of the following:
 - (i) current inspection of the property with photos confirming the condition of the property and neighboring properties;
 - (ii) current market data to support analysis and conclusions on the subject's current value compared to the most recent appraisal;
 - (iii) current use of the property compared to most recent appraisal;
 - (iv) changes to surrounding properties, zoning or use changes;
 - (v) analysis of any changes compared to the most recent appraisal;
 - (vi) be signed by person completing the validation report with date and title.

19. Reviewing appraisals

- (1) A licensed financial institution shall ensure that appraisals contain sufficient information and analysis to support a licensed financial institution's decision to engage in the credit transaction.
- (2) For certain transactions that do not require an appraisal, the licensed financial institution

shall obtain an appropriate evaluation of real property that is consistent with safe and sound banking practices.

- (3) As part of the credit approval process and prior to a final credit decision, a licensed financial institution shall review appraisals to ensure that they comply with these prudential standards and are consistent with further directives from the Central Bank and its own internal policies.
- (4) This review should also ensure that valuations contain sufficient information and analysis to support the decision to engage in the transaction.
- (5) During the review process, a licensed financial institution should be able to assess the reasonableness of the appraisal, that is, whether the valuation methods, assumptions and data sources are appropriate and well supported.
- (6) The licensed financial institution shall use the review findings to monitor and evaluate the competency and ongoing performance of appraisers.
- (7) When a licensed financial institution identifies an appraisal that is inconsistent with the appraisal standards in section (12) and the deficiencies cannot be resolved with the appraiser, the licensed financial institution must obtain an appraisal that meets the requirements prior to making a credit decision.

Explanatory note: Though an appraisal reviewer cannot change the value conclusion in the original appraisal, an appraisal review performed by an appropriately qualified and competent appraiser may result in a second opinion of market value.

- (8) A licensed financial institution may rely on the second opinion of market value obtained through an acceptable appraisal review to support its credit decision.
- (9) A licensed financial institution shall rely on an appraisal and a second opinion of market

value for large exposures.

- (10) All licensed financial institutions shall ensure at the minimum that their policies and procedures:
 - (a) address the independence, educational and training qualifications, and role of the appraisal reviewer;
 - (b) reflect a risk-focused approach for determining the depth of the review;
 - (c) establish a process for resolving any deficiencies in appraisals;
 - (d) set forth documentation standards for the review and the resolution of noted deficiencies.

20. Qualifications of appraisal reviewer

- (1) Each licensed financial institution shall establish the qualification criteria for persons who are eligible to act as an appraisal reviewer.
- (2) An appraisal reviewer should be independent of the transaction and have no direct or indirect interest, financial or otherwise, in the property or transaction, and be independent of and insulated from any influence by the loan administration staff.
- (3) An appraisal reviewer should also possess the requisite education, expertise, and competence to perform the review commensurate with the complexity of the transaction, type of real property and market.
- (4) An appraisal reviewer should be capable of assessing whether the appraisal or evaluation contains sufficient information and analysis to support the licensed financial institution's decision to engage in the transaction.
- (5) Where a licensed financial institution has limited staff then prudent safeguards should be implemented for reviewing appraisals when absolute lines of independence cannot be achieved.

- (6) In the circumstances specified in subsection (5) the review may be part of the originating loan officer's overall credit analysis, as long as the originating loan officer, abstains from directly or indirectly approving or voting to approve the loan.
- (7) A licensed financial institution should assess the level of in-house expertise available to review appraisals for complex projects, high-risk transactions, and out-of-market properties.
- (8) A licensed financial institution may find it appropriate to employ additional personnel or engage a third party to perform the reviews.

Explanatory note: When using a third party, a licensed financial institution remains responsible for the quality and adequacy of the review process, including the qualification standards for appraisal reviewers.

21. Depth of review

- (1) A licensed financial institution should implement a risk-focused approach for determining the depth of the review needed to ensure that appraisals and evaluations contain sufficient information and analysis to support the licensed financial institution's decision to engage in the transaction.
- (2) This process should differentiate between high and low-risk transactions so that the review is commensurate with the risk.
- (3) The depth of the review should be sufficient to ensure that the methods, assumptions, data sources, and conclusions are reasonable, well-supported, and appropriate for the transaction, property and market.

22. Resolution of deficiencies

- (1) A licensed financial institution should establish policies and procedures for resolving any inaccuracies or weaknesses in an appraisal identified through the review process, including procedures for:
 - (a) communicating the noted deficiencies to and requesting correction of such deficiencies by the appraiser.
 - (b) addressing significant deficiencies in the appraisal that could not be resolved with the original appraiser by obtaining a second appraisal that is performed by an appropriately qualified appraiser prior to the final credit decision.

- (2) A licensed financial institution should implement adequate internal controls to ensure that such communications do not result in any coercion or undue influence on the appraiser.

23. Documentation of the review

- (1) A licensed financial institution should establish policies for documenting the review of appraisals in the credit file.

- (2) Such policies should address the level of documentation needed for the review, given the type, risk and complexity of the transaction.

The documentation should describe the resolution of any appraisal or valuation deficiencies, including reasons for obtaining and relying on a second appraisal or review. The documentation should provide an audit trail that documents the resolution of noted deficiencies or details the reasons for relying on a second opinion of market value.

24. Third party arrangements

- (1) A licensed financial institution that engages a third party, such as an appraisal management company, to perform valuations on its behalf is responsible for understanding and managing the risks associated with the arrangement.

- (2) A licensed financial institution shall use caution where it engages a third party to administer

any part of its appraisal or evaluation function, including:

- (a) the ordering or reviewing of appraisals and evaluations;
 - (b) selecting an appraiser or person to perform evaluations; or
 - (c) providing access to analytical methods or technological tools.
- (3) A licensed financial institution is accountable for ensuring that any services performed by a third party, both affiliated and unaffiliated entities, comply with applicable laws and regulations and are consistent with supervisory guidance from the Central Bank.
- (4) Consistent with safe and sound practices, each licensed financial institution must have a written contract with a third party, that clearly defines the expectations and obligations of both the licensed financial institution and the third party, including that the third party will perform its services in compliance with the appropriate laws and regulations and consistent with supervisory guidance from the Central Bank.
- (5) Every licensed financial institution shall ensure that it has the resources and expertise necessary for performing ongoing oversight of third party arrangements.
- (6) Where a licensed financial institution outsources any part of its collateral valuation function, it shall exercise the appropriate due diligence in the selection of a third party.
- (7) The due diligence process should include sufficient analysis by the licensed financial institution to assess whether the third party provider can perform the services consistent with the licensed financial institution's performance standards and regulatory requirements.
- (8) A licensed financial institution should be able to demonstrate that its policies and procedures establish effective internal controls to monitor and periodically assess the collateral valuation functions performed by a third party.
- (9) A licensed financial institution is responsible for ensuring that a third party selects an

appraiser or a person who performs an evaluation is competent and independent, has the requisite experience and training for the assignment and thorough knowledge of the subject property market.

- (10) The minimum credentialing requirement stated here, although necessary, is not sufficient to determine that an appraiser is competent to perform an assignment for a particular property or geographic market.
- (11) A licensed financial institution should document the results of ongoing monitoring efforts and periodic assessments of the arrangement(s) with a third party for compliance with applicable regulations and consistency with supervisory guidance and its performance standards.
- (12) Where deficiencies are discovered, a licensed financial institution shall take remedial action in a timely manner.

25. Compliance process

- (1) Deficiencies in a licensed financial institution's valuation program that result in violations of these prudential standards reflect negatively on management.
- (2) A licensed financial institution's valuation policy should establish internal controls to promote an effective valuation program.
- (3) The compliance process shall:
 - (a) maintain a system of adequate controls, verification, and testing to ensure that appraisals and valuations provide credible market values;
 - (b) insulate the persons responsible for ascertaining the compliance of the licensed financial institution's appraisal and valuation function from any influence by loan administration staff;
 - (c) ensure the licensed financial institution's practices result in the selection of

appraisers and evaluators with the appropriate qualifications and demonstrated competency for the assignment;

- (d) establish procedures to test the quality of the appraisal review process;
- (e) use, as appropriate, the results of the licensed financial institution's review process and other relevant information as a basis for considering a person for a future appraisal assignment;
- (f) report appraisal deficiencies to appropriate internal parties and, if applicable, to external authorities in a timely manner.

26. Monitoring collateral values

- (1) A licensed financial institution shall monitor collateral risk on a portfolio and on an individual credit basis, at a minimum, on an annual basis.
- (2) A licensed financial institution should have policies and procedures that address the need for obtaining current collateral valuation information to understand its collateral position over the life of a credit and effectively manage the risk in its real estate credit portfolios.
- (3) The policies and procedures also should address the need to obtain current valuation information for collateral supporting an existing credit that may be modified or considered for a loan workout.
- (4) Under their appraisal policies, the Central Bank reserves the right to require a licensed financial institution to obtain an appraisal when there are safety and soundness concerns on an existing real estate secured credit.
- (5) A licensed financial institution should be able to demonstrate that sufficient information is available to support the current market value of the collateral and the classification of a problem real estate credit.
- (6) Where sufficient information is not available, the Central Bank may direct a licensed

financial institution to obtain a new appraisal or evaluation.

27. Portfolio collateral risk

- (1) Licensed financial institutions should ensure that the bank's criteria for reviewing the loan portfolio addresses the deterioration in the credit since origination or changes in market conditions.
- (2) In assessing whether changes in market conditions are material, a licensed financial institution should consider the individual and aggregate effect of these changes on its collateral protection and the risk in its real estate lending programs or credit portfolios.

Changes in market conditions could include material changes in current and projected vacancy, absorption rates, lease terms, rental rates, and sale prices, including concessions and overruns and delays in construction costs. Fluctuations in discount or direct capitalization rates also are indicators of changing market conditions. Prudent portfolio monitoring practices include criteria for determining when to obtain a new appraisal or valuation.

- (3) Where a licensed financial institution's reliance on collateral becomes more important, its policies and procedures should:
 - (a) ensure that timely information is available to management for assessing collateral and associated risk;
 - (b) specify when new or updated collateral valuations are appropriate or desirable to understand collateral risk in the transaction(s);
 - (c) delineate the valuation method to be employed after considering the property type, current market conditions, current use of the property and the relevance of the most recent appraisals or evaluation in the credit file.
- (4) Consistent with sound collateral valuation monitoring practices, a licensed financial institution may use a variety of techniques for monitoring the effect of collateral valuation trends on portfolio risk.

- (5) Sources of relevant information may include external market data, internal data, or reviews of recently obtained appraisals and evaluations. This includes current leases or rental agreements on income producing properties on an annual basis.
- (6) A licensed financial institution should be able to demonstrate that it has sufficient, reliable, and timely information on market trends to understand the risk associated with its lending activity.
- (7) Financial Institutions should conduct sensitivity analysis and/or stress testing in the appraisal of real estate.

28. Payment for appraisal services

- (1) Each licensed financial institution is responsible for paying appraisers and others that provide appraisal and valuation services in a timely manner. Under no circumstances should appraisers or others that provide appraisal and valuation services be paid by a different party other than the financial institution. This is to avoid the possibility that the payment be made by borrowers, which can lead to a conflict of interest.
- (2) A licensed financial institution shall not hold payment based on the outcome of the loan application or some other event.
- (3) Appraisers and others providing valuation services are performing an independent and objective function for the licensed financial institution and must be paid regardless of the outcome of a loan determination or other event.
- (4) A licensed financial institution is expected to make payment for appraisal services within thirty days of receipt and acceptance of the service.
- (5) Where the service is not acceptable the licensed financial institution must inform the

appraisers and others providing valuation services within ten business days that the service is unacceptable, the reasons why the information is needed for correction.

- (6) Any appraisal or valuation services ordered and received by a licensed financial institution must be part of the permanent loan file regardless of their acceptance or rejection with a full explanation of where the service was not acceptable.

29. Referrals

A licensed financial institution should file a complaint with the appropriate regulatory officials when it suspects that an appraiser has failed to comply with applicable laws, or engaged in other unethical or unprofessional conduct.