

Federal Banking Agencies Issue COVID-19 Relief Allowing Deferral of Real Estate Appraisals

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While the impact of the COVID-19 pandemic on the real estate industry is still unfolding, the Fed, FDIC and OCC announced an interim final rule on April 14, 2020 to ease the requirement for regulated institutions to obtain appraisals and evaluations in connection with real estate loans.

Specifically, this rule defers the requirement for federally regulated banks to obtain appraisals and evaluations by up to 120 days after the closing of all residential or commercial real estate loan transactions, excluding transactions for the acquisition, development or construction of real estate because of the additional risks involved with these financings. Further, this temporary relief does not waive the appraisal requirement and only applies to closings that occur through December 31, 2020, unless the rule is extended.

Typically, federally regulated banks are required to obtain a written appraisal complying with the Uniform Standards of Professional Appraisal Practice (USPAP) issued by the Appraisal Standards Board (ASB) in connection with real estate lending transactions. Given restrictions on non-essential business activities and social distancing protocols issued by many localities, the 120-day deferral is designed to encourage banks to continue lending notwithstanding circumstances that prevent the physical site visits commonly conducted in preparing USPAP compliant appraisals.

Notably, while exterior and interior inspections are typically performed in issuing USPAP appraisals, agency regulations do not require physical inspections so long as the appraiser can otherwise determine the characteristics of a property through, among other things, any combination of asset records, photographs, property sketches and recorded media. Additionally, the ASB issued [Q&As](#) on March 17, 2020 noting that while interior inspections are customarily part of the scope of work, USPAP permits an appraiser to make an extraordinary assumption about the interior of the property if a

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health or other emergency situation precludes an in-person inspection so long as the appraiser has a reasonable basis for the assumption and can still perform a credible analysis.

As one would expect, banks are nonetheless required to continue to comply with internal underwriting standards for assessing the collateral value of the subject property and the borrower's creditworthiness and repayment ability. The agencies additionally require that banks develop an appropriate risk mitigation strategy if the appraisal or evaluation ultimately reveals a market value significantly lower than the expected market value. Interestingly, any risk mitigation strategy is to balance safety and soundness risk to the institution with mitigation of harm to the COVID-19 affected borrower. It is unclear how this balance would be struck in a COVID-19 world.

Will these rule changes help to restore liquidity to the *commercial* real estate markets? Early indications are probably not. The rule changes are set against a backdrop of accelerating deterioration of real estate fundamentals making for an extremely challenging underwriting environment. To the extent commercial mortgage lenders restart new originations in the near term, the flexibility already included in existing appraisal regulations to forego an in-person interior inspection of a property may be a basis on which some lenders would proceed albeit with an appraisal. If a lender were to take advantage of these rules, we would expect structure around the uncertainty with respect to valuation, e.g., the loan would initially be funded at a *very* conservative leverage level with an earn-out for the balance once an appraisal is obtained.

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