Commercial Loans Real Estate Appraisal and Evaluation Policy

- EQUITY Bank's Real Estate Appraisal and Evaluation Policy is written to comply with Title XI of the *Financial Institutions, Reform and Recovery Enforcement Act of 1989 (FIRREA*), and the *Interagency Appraisal and Evaluation Guidelines* published in December 2010. The Interagency Guidelines require the bank's appraisal policy to include the following:

- To insure the independence of the person ordering, performing, and reviewing the appraisals and evaluations.
- Establish procedures for the selection of individual appraisers and procedures to monitor their ongoing performance.
- Ensure that appraisals comply with the ppraisal regulations and the *Interagency Guidelines*.
- Ensure that appraisals and evaluations contain sufficient information to support the credit decision
- Develop criteria for the content and appropriate use of collateral evaluations consistent with safe and sound banking practices
- Develop criteria to access whether an existing appraisal or evalution may be used to support a loan renewal
- Provide for the receipt and review of the appraisals or evaluation in a timely manner to facilitate a credit decision
- Implement internal controls that promote compliance with these programs standards, including controls to monitor third party arrangements that out-source appraisal management.
- Establish criteria for obtaining apprasials or evaluations for transactions that are not otherwise covered by the appraisal requirement when do you order an appraisal versus using an existing appraisal
- Establish procedure for monitoring portfolio collateral value

In addition, these policies establish standards to ensure that collateral values adequately protect the Bank's interest. The Bank's Appraisal and Evaluation Policy includes the following:

- Board Responsibility
- Selecting and Engaging an Appraiser and Use of an Appraisal Management Company
- Development of an Approved Appraisers List
- Transactions that Require an Appraisal
- Exempt Transactions
- Minimum Appraisal Standards
- Appraisal Report Options
- Appraisal Review
- Use of Existing Appraisal Reports
- Use of Master Appraisal Reports
- Monitoring portfolio collateral value on an ongoing basis
- Referrals
- Transactions that Require and Evaluation
- Minimum Evaluation Standards
- Qualifications of Individuals Selected to Perform an Evaluation
- Renewal, Refinancing and Other Subsequent Transactions
- Definitions

Board Responsibility

The Board of Directors is responsible for reviewing and adopting policies and procedures that establish an effective and independent real estate appraisal and evaluation program for all of its lending functions. The Board of Directors authorizes Chief Risk Officer to amend these policies in accordance with changes in bank regulations as they may occur. Any amendments to this policy made by the Chief Risk Officer shall be presented at the next Board meeting for ratification by the Board.

Selecting and Engaging an Appraiser and Use of an Appraisal Management Company

In the *Interagency Appraisal and Evaluation Guidelines* provides for "appraiser independence" in respect to the person ordering, performing, and reviewing an appraisals or evaluation of collateral value. This statement applies both to residential and commercial transactions. The agencies state that a regulated financial institution should ensure that independence from the loan production and loan approval process is maintained when selecting appraisers, ordering appraisals and reviewing appraisals. To maintain an independent process for transactions where an outside appraisal is required, EQUITY Bank will use an apparasaial management company (AMC) to order both its commercial and residential appraisals. Loan Administration is responsible for evaluating and selecting the AMC. Loan Administration is also responsible for reviewing the AMC's quality control procedures and quality control plan and for monitoring the performance of the AMC. The AMC will develop specific approved appraiser panels for both residential and commercial appraisers in concert with the bank's Chief Credit Officer. The AMC will select appraisers from the approved appraiser panels for both commercial and residential assignments based on the technical competence of the appraiser and the appraiser's knowledge of the market where the collateral is located. In all cases the selection of the appraiser will include the following:

- Appraisers will be engaged using the bank's standard Engagement Letter. The engagement letter outlines the bank's exceptions and delineates responsibilities between the Bank and the appraiser. The appraisal engagement will be between the AMC and the appraiser with the appraisal addressed to EQUITY Bank.
- The appraiser selected must be qualified to perform the appraisal requested and certified or licensed in the state in which the property being appraised is located.
- The individual selected to perform an appraisal shall not have direct or indirect interest, financial or otherwise, in the property or the transaction. This must be expressed in writing by the individual appraising the property.
- An appraiser used in the preparation of an appraisal report must render such reports in accordance with the bank's policies and standards.

Development of Approved Appraisers List

The bank's AMC in concert with Loan Administration is responsible for reviewing the qualifications of all prospective appraisers. Appraisal firms shall not be placed on the bank's approved appraisal list. The bank may accept an appraisal prepared by a member of an appraisal firm not on the bank's approved appraiser list if another member of the firm who is on the list also signs and takes responsibility for the appraisal. At a minimum, the AMC will review and approve the following before recommending the appraiser for inclusion on the bank's approved appraiser panel:

- A resume of the appraiser's educational background, professional training and experience and references;
- A resume of the appraiser's experience detailing the types of appraisals he or she has performed;
- Proof of current license or certification by the appropriate state authority; and
- Proof that the appraisers have a least $500,000 in E & O coverage.
- Three sample appraisals of the same type of properties that he or she will be asked to appraise for the Bank.
- All appraisers on the bank's approved appraisal list will be reviewed every year in respect to their competence.

Upon completing their review, the Chief Credit Officer will submit the names of qualified appraisers to the Board of Directors for initial approval, and for re-approval annually. To disclose, and avoid, potential conflicts of interest, the submission will include a summary of each appraiser's direct and indirect indebtedness to the Bank. After receiving Board approval, the names of approved appraisers will be added to the bank's List of Approved Appraisers. The Chief Credit Officer in concert with the AMC has the authority to remove appraisers from the approved list. Loan Administration is responsible for maintaining the list of approved appraisers.

Transactions That Require an Appraisal

In accordance with Bank regulations and Bank policy, a written appraisal prepared by a state-licensed or state-certified appraiser will be required for the following real estate related transactions:

Loan Amounts	Loan Type	Requirements
> $1,000,000	All real estate related or business purpose loans	Appraisal by a state certified appraiser
$250,000 – $1,000,000	1-4 Family Residential transactions	Appraisal by a state certified appraiser
	Non-residential transactions (includes income producing properties)	Appraisal by a state certified appraiser
	Complex residential transactions (1)	Appraisal by a state certified appraiser

Unless specifically expressed as state certified appraiser, a certified or licensed appraiser must be used.

(1) A complex residential transaction involves a property in which the ownership or market conditions are atypical. Examples include, but are not limited to: age of improvements, architectural style, size of improvements, and size of lot, neighborhood land use, potential environmental hazard liability, leasehold interests, or other unusual factors.

Irrespective of the above requirements, Bank management shall, from time-to-time, set appraisal requirements by product type that are more conservative than the policy requirements. Additionally, Loan Administration has the authority to require an appraisal, as deemed appropriate, based on the risk characteristics of the proposed transaction.

Exempt Transactions

Appraisal Regulations provide a certain real estate-related financial transactions to be exempt from the requirement of an appraisal prepared by a state-licensed or state-certified appraiser. If the transaction meets any of the conditions below, an appraisal may not be required. However, it is the Bank's policy to require an evaluation as defined in this policy, see Transactions that Require an Evaluation.

- A transaction where the transaction value is $250,000 or less.
- A lien on real estate taken as collateral in an abundance of caution. This exemption may be used where the borrower's income, net worth, credit history, etc. qualifies the borrower for an unsecured loan but the Bank takes real estate as collateral as a cautionary measure.
- A lien on real estate taken for purposes other than the real estate's value. This exemption may be used in situations where a lien on real estate is taken to preserve or control other collateral or the value of other collateral. For example, in a loan to a manufacturing company secured by the company's equipment, a bank might also require a lien on the manufacturing facility to preserve the "going-concern" value of the borrower. (A going-concern value is the value of a proven property operation.)
- A business loan of $1,000,000 or less that is not dependent on the sale of, or rental income from, real estate as the primary source of repayment.
- A lease on real estate, unless the lease is the economic equivalent of a purchase or sale of the leased real estate.
- The loan is insured or guaranteed by the U.S Government or government-sponsored agency.
- A transaction involving an existing extension of credit (renewal, refinancing or modification), provided there has been no material adverse change in the financial condition of the borrower and one of the following two circumstances apply:
    - There has been no obvious and material change in the local real estate market conditions or the physical quality of the property that threatens the adequacy of the Bank's real estate collateral after the transaction.
    - No new moneys will be advanced other than (1) as agreed to in the original transaction, or (2) the reasonable funds necessary to cover closing costs of the follow-on transaction.

Minimum Appraisal Standards

Appraisal Regulations require minimum standards for appraisal reports performed in connection with federally-related real estate transactions. To ensure compliance with these standards, the Bank's policy requires that each appraisal:

- Conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP);
- Be written and contain sufficient information and analysis to support the opinion of value expressed and to support the Bank's decision to make the loan;

- Analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased building, non-market lease terms, and tract developments with unsold units;
- Be based on the regulation's definition of market value;
- Contain a description of the actual physical condition of the property as of the appraisal date as well as the current and proposed zoning and its effect on the property; and
- Be performed by a state-licensed or state-certified appraiser.

To help the Bank with underwriting and loan monitoring requirements, appraisals may also include prospective values, based on projected events such as ongoing development, lease-up, stabilized occupancy, etc. In such cases, the appraisal must clearly identify any prospective value, describe the prospective event, and provide the projected date on which the event is expected to occur. Prospective values are usually used when underwriting an acquisition and development or construction project, but not when a loan is secured by existing improvements.

Appraisal Report Options

It is the bank's policy to require both a self-contained or summary appraisal for all commercial real estate related transactions and a uniform residential appraisal for all 1- 4 family residential transactions requiring an appraisal. For a detailed description of the types of appraisal reports and report formats refer to appraisal reports below. For most real estate transactions, bank policy does not permit the use of restricted use appraisal reports for credit underwriting purposes. As such, use of restricted use appraisals for credit underwriting purposes must be approved by the Loan Administration. In other cases, a restricted use appraisal may be used for ongoing collateral monitoring or when an evaluation is allowed, refer to Transactions that Require an Evaluation.

Appraisal Review

The goal of the appraisal review is to determine whether the methods, assumptions, and conclusions of an appraiser are reasonable and appropriate for the loan request under consideration. The appraisal report shall also be reviewed to ensure compliance with appraisal regulations, the bank's policies, and USPAP standards. Also, the review should be performed by a person independent of the transaction and and is competent through training, experience and education to perform the review. The bank's Appraisal Review Policy requires that all appraisal reports be reviewed by Loan Administration (or by the banks designated AMC), and that the review be documented.

The appraisal review should at a minimum include a review and description of the following:

- Identification of property by location and description.
- Name of borrower.
- Name of appraiser.
- Effective date of the appraisal.
- Date of review and date of inspection of property by reviewer (if applicable).
- Scope of the appraisal.

- Scope of the review.
- Statement concerning the adequacy of the data contained in the appraisal.
- Statement as to whether the appraisal methods used comply with USPAP and other pertinent appraisal regulations.
- Statement as to whether the assumptions used by the appraiser are reasonable.
- Verification that all appropriate appraisal methods were used as specified in the Engagement Letter
- Verification that reconciliation of values derived from different appraisal methods is reasonable.
- Appraisals that are ordered by another financial institution should be reviewed a least at the same level that EQUITY would review an apparasaial commissioned directly.

- For loans that where there have greater risk (i. e. secured by singe purpose real estate, secured by out of market real estate, or have marginal debt service coverage ratio) a statement as to whether the conclusion of market value is reasonable and, if not reasonable, inclusion of reason why. This statement will be prepared by another licensed appraiser and will directly address the value of the real estate.

In all cases the appraisal review is to be signed by the reviewer and is to be attached to the appraisal report and maintained in the loan file. Appraisals that do not meet the requirements of the review will not be accepted by the Bank.

Use of Existing Appraisal Reports

In some instances the bank is requested to make loans to finance or refinance real estate using an existing appraisal which was performed by a qualified appraiser for the bank or other federally-regulated financial institution. To determine the validity and use of the appraisal for credit underwriting purposes several factors must be taken into consideration. These factors include:

- The age of the appraisal
- The change in terms and availability of financing
- Natural disasters
- The condition of the property
- Changes in underlying economic and market assumptions, such as capitalization rate and lease terms
- Improvements to the subject property or competing properties
- The volatility of the changes in the market conditions,
- Limit or over supply of competing properties
- Changes in zoning, building material and building technology
- The possibility of contamination by hazardous material

Existing appraisals may be used for credit underwriting purposes, if the following conditions are met:

- The appraisal report must have been ordered by and prepared for a financial institution and not the borrower or other third party;
- The appraisal report must have been made in accordance with this policy and complies with USPAP. The appraisal report must be reviewed and the review documented using the Bank's Appraisal Review Forms; and
- The appraisal is less than twelve (12) months old.

It is against the banks policy to accept readdressed appraisals. Altering an appraisal report in a manner that conceals the original client or intended users of the appraisal is misleading and violates the appraisal regulations and the Uniform Standards of Professional Appraisal Practice (USPAP).

Use of Master Appraisal Reports

For residential construction financing of identical properties constructed by the same builder in the same subdivision, the bank may use a master appraisal for each model in lieu of requiring separate appraisals for individual units. In those cases, a copy of the master appraisal will be kept in each unit file. For purposes of this policy, "identical properties" means a property located on a comparable lot, with the same floor plan and only minor variations in specifications. However, a master appraisal cannot be used if the loan amount in $500,000 or more, or the master appraisal is more than twelve (12) months old.

Renewal, Refinancing, and Other Subsequent Transactions

The bank's policy requires a new appraisal or a new evaluation of value for any renewal, refinancing, and modification of an existing transaction when any one of the following conditions exists:

- There has been a material change real estate values in the market or in the physical aspects of the property that threatens the Bank's collateral protection
- The renewal or extension totals twelve (12) months or more on loans exceeding $250,000 when the repayment is dependent upon the real estate
- Where new money is advanced (except reasonable closing costs)

A new appraisal or re-evaluation is not required in the following circumstances:

- When the bank advances new monies to protect its interests in the property (repairs, taxes, etc.)
- The existing appraisal is still valid and appropriate for use in the new transaction, and
    - The loan has performed satisfactorily according to the original terms or since any subsequent modifications for which the appraisal was obtained
    - The credit worthiness of the loan has not deteriorated since the last

appraisal

- The loan officer has investigated and determined that there has been no material change in change the real estate values in the market conditions or in the physical aspects of the property that threatens the Bank's collateral protection
- No new money (except reasonable closing costs) is being advanced

The loan officer must document the validity and appropriateness for using an existing appraisal report to support the loan decision. The supplemental memo is to be attached to the previous appraisal or evaluation and maintained in the loan file.

Monitoring portfolio collateral value on an ongoing basis

EQUITY Bank's Credit Administration area will monitor the collateral risk in its loan portfolio on an ongoing basis. Examples of ways to monitor portfolio collateral risk include reviewing external data source and reviewing recently completed appraisals and evaluations for specific collateral types.

Referrals

The Bank's policy requires that any state-licensed or state-certified appraiser who violates USPAP, applicable state law, or engages in other unethical or unprofessional conduct be referred to the state appraiser regulatory authority. It shall file a similar complaint if it suspects that an appraiser was improperly coerced in the preparation of an appraisal. If the management of EQUITY Bank, a loan officer, or other bank employee believes that any of these activities has or is occurring a brief written summary of concerns is to be referred to the Chief Credit Officer for review and recommendation of appropriate actions. Action may include suspension or removal from the bank's Approved Appraiser List and referral to the state appraiser regulatory authority.

Transactions that Require Evaluations

In summary even though an evaluation may be otherwise allowed by this policy an evaluation should not be used for a loan where the combined loan-to-value ratio will be in excess of the supervisory loan-to-value limits, unique properties, properties outside the banks primary lending area, transactions involving existing extensions of credit with significant risk to the bank and loans to borrowers with high risk characteristics. If a transaction does not qualify for the use of an evaluation than an appraisal shall be required of the real estate.

A formal opinion of market value prepared by a state-licensed or state-certified appraiser is not always necessary. Instead, less formal evaluations of real estate may suffice for transactions exempt from the appraisal requirements. The Bank's policies therefore allows for the use of an appropriate evaluation when the transaction:

- Has a transaction value of less than $250,000
- Is a business purpose loan of $1,000,000 or less and the transaction is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment
- For existing loans, provided there has been no material change in the market conditions or physical aspects of the property, even with the advancement of new monies; or with no advancement of the new monies except for necessary closing costs. See Exempt Transactions.

In summary, even though an evaluation may be otherwise allowed, an evaluation should not be used for a loan where the combined loan-to-value ratio will be in excess of the supervisory loan-to-value limits, for properties with unique characteristics, properties outside the banks primary lending area, transactions involving existing extensions of credit with significant risk to the bank and loans to borrowers with high risk characteristics. If a transaction does not qualify for the use of an evaluation than an appraisal will be required to value the real estate.

Minimum Evaluation Standards

An evaluation is performed for exempt transactions and criteria for its contents are not as strict as those for appraisals. Evaluations of the real property require an inspection of the real estate by the loan officer. In most cases the basis for the evaluation is the tax card or tax assessed value but must be supplemented sales and listing information specific to the property. Departures from this method are permitted if substantiated and documented in the credit file. The evaluation should be documented using the Bank's evaluations forms and should contain the following:

- Name and address of the preparer
- Provide an estimate of the real estate's market value and any limiting conditions
- Effective date of the evaluation
- Description of the real estate collateral, its condition, location and its current and projected use
- Description of the source(s) of information used in the analysis

- Description of the analysis and supporting information (including calculations, supporting assumptions and if used a discussion of sales comparable, listed properties, tax values, construction costs, etc.)
- Description of the neighborhood and local market conditions
- Photographs of any improvements on the subject property, and a location map
- Borrower's name, account number and note number

A bank employee other than the loan officer for the account is required to evaluate the property.

That employee should sign and date the evaluation. The evaluation is to be maintained in the credit file.

Qualifications of individuals who perform Evaluations

The person who performs an evaluation does not need to be either state-certified or state-licensed, but he or she must have demonstrated real estate-related training or experience and must be knowledgeable of the market in which the subject property is located. In addition this person must:

- Be capable of rendering an unbiased opinion of value
- Be independent of the lending function or abstain from voting of the approval of the loan
- Have no interest, direct or indirect, financial or otherwise in the property or the transaction

All evaluations shall be documented using the bank's Real Estate Evaluation Form and filed in the loan file.

Definitions

An **Appraisal** is a written statement independently and impartially prepared by a qualified state-licensed or state-certified appraiser, which sets forth an opinion as to the market value of a property as of a specific date, supported by the presentation and analysis of relevant market information. An appraisal can be prepared by a qualified state-licensed or state-certified appraiser. An appraisal must meet specific regulatory guidelines.

Appraisal Reports. There are three types of appraisal reports:

- **Self-Contained Appraisal Report -** This type of appraisal is a complete narrative report that includes a comprehensive level of detail used to prepare a credible analysis. The report must conform to USPAP standards without departure and includes all three approaches to value (Costs, Sales Comparison, and Income). This type of report is often used to appraise complex commercial real estate transactions, proposed developments, and income producing properties.
- **Summary Appraisal Report** – The main difference between the self-contained appraisal report and the summary appraisal report is the level of detail. The report summarizes the appraiser's findings rather than fully describing the analysis. A Summary Appraisal Report is the often used to appraise residential properties and non-complex commercial properties.
- **Restricted Use Appraisal Report** – This type of appraisal is a capsulated report with the detail and analysis retained by the appraiser. This type of report states only the conclusions of the appraiser with no explanation on how they were derived. Due to the lack of sufficient supporting information and analysis, this type of report should not be used to underwrite most real estate related transactions.

A **Business Loan** is an extension of credit to any corporation, general or limited partnership, business trust, joint venture, sole proprietorship (including an individual engaged in farming) or other business entity of $1,000,000 or less and the transaction is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment.

An **Evaluation** is an “opinion” of value that may be less formal than an appraisal and does not have to comply with the USPAP standards or licensing or certification requirements. An evaluation is prepared by an individual, usually a real estate lender, other bank employee or real estate sales agent or broker, with real estate related training or experience and who has knowledge of the market in which the subject property is located. Broker price opinions (BPO’s) will not be used in evaluations of value by the bank. Automated Valuation Models (AVM’s) will be used only after the AVM model is specifically validated. All evaluations using an AVM shall include an inspection of the real estate including an inspection of the interior of the property.

Market Value is defined as the most probable price which 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, and knowledgeably, and assuming the price is not affected by undue stimulus. 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:

- Buyer and seller are typically motivated,
- Both parties are well informed or well advised, and each acting in what they consider their best interest,
- A reasonable period of time is allowed for exposure in the open market,
- Payment is made in terms of cash in US dollars or in terms of financial arrangements comparable thereto, and
- 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.

Real Estate or Real Property – Real estate or real property means an identified parcel or tract of land, with improvements, and includes easements, right of way, undivided or future interests, or similar rights in a tract of land, but does not include mineral rights, timber rights, growing crops, water rights, or similar interests severable from the land when the transaction does not involve the associated parcel or tract of land.

Real Estate Related Transactions include (1) the financing or the purchase, lease investment in or exchange of real property or an interest in real property; (2) the refinancing of the aforesaid real property transactions; and (3) the use of real property as security for a loan or investment.

State-Certified General Appraiser is one who has satisfied all of the education, experience, and examination requirements for general certification as established by the state. A state-certified general appraiser may appraise any type of real property and is bound by the competency provision of the Uniform Standards of Professional Appraisal Practice. After certification, the appraiser must meet the continuing education requirements as established by the state.

State-Certified Residential Appraiser is one who has satisfied all of the education, experience, and examination requirements for residential certification as established by the state. A state-certified residential appraiser may appraise all one-to-four family residential units without regard to transaction value or complexity or any nonresidential property where a certified general appraiser is not required. The appraiser is bound by the competency provision of the Uniform Standards of Professional Appraisal Practice. After certification, the appraiser must meet the continuing education requirements as established by the state.

State Licensed Appraiser is one who has satisfied all of the education, experience, and examination requirements for licensing as established by the state. A state-licensed appraiser may appraise non-complex one-to-four family residential units having a transaction value of less than $1 million, any nonresidential property having a transaction value of less than $250,000, and any other real property that does not specifically require the use of a state-certified general or state-certified residential appraiser. The appraiser is bound by the competency provision of the Uniform Standards of Professional Appraisal Practice. After certification, the appraiser must meet the continuing education requirements as established by the state.

Transaction Value means:

- For loans or other extensions of credit, the amount of the loan or extension of credit;
- For sales, leases, purchases, and other investments in or exchanges or real property, the market value of the real property interest involved; and
- For the pooling of loans or interests in real property for resale or purchase, the amount of the loan or market value of the real property calculated with respect to such loan or interest in real property.

Uniform Standards of Professional Appraisal Practice (USPAP) –refer to USPAP Standards