

September 21, 2004

Jill M. Cotter, Manager/Lending
Community Financial Members FCU
Post Office Box 8050
Plymouth, MI 48170

Re: Commercial Appraisals for Member Business Loans (MBLs).

Dear Ms. Cotter:

You have asked if a federally insured credit union (FICU) subject to NCUA's MBL rule may use an appraisal based on the going concern value of the business when calculating the loan-to-value (LTV) ratio for an MBL. No, it cannot unless it receives a waiver.

NCUA's MBL rule generally requires a maximum LTV ratio for MBLs of 80%. 12 C.F.R. §723.7. The rule defines the LTV ratio as "the aggregate amount of all sums borrowed . . . on an item of collateral divided by the market value of the collateral used to secure the loan." 12 C.F.R. §723.21. An FICU must determine the LTV ratio for an MBL based on the market value of the property pledged to secure the loan.

The Uniform Standards of Professional Appraisal Practice (USPAP) defines going concern value as the "value of an operating business enterprise" and includes goodwill as "an integral component." USPAP 2003 Glossary, <http://www.appraisalfoundation.org/html/uspap2003/glossary.htm> (Sept. 8, 2004). This intangible business value, therefore, may decline significantly in events such as business downturns, civil lawsuits, management changes, noncompliance with licensing or tax laws, or bankruptcy. Furthermore, going concern value is not property in which a credit union can obtain a security interest. Inflating an appraisal by incorporating the going concern value, therefore, would be inconsistent with the MBL rule's LTV requirements and may cause significant losses due to the insufficiency of the collateral securing the MBL.

We appreciate that there may be circumstances where an FICU may want to consider the going concern value in making a lending decision, for example, in deciding to fund an MBL where the purpose of the loan is to acquire an existing business. Because going concern value is not a permissible measure of collateral value in calculating the LTV ratio under the MBL rule, an FICU must receive a waiver if a borrower has not offered sufficient collateral to secure the

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loan as required by the rule. 12 C.F.R. §§723.7, 723.10(d). We note that, in order to make MBLs for acquiring going concerns, an FICU must use a loan officer who is experienced in such MBLs and who can evaluate the borrower's ability to run the business and maintain its going concern value. 12 C.F.R. §723.5. We also believe that appropriate underwriting for these MBLs requires a competent business or intangible asset appraisal as contemplated by the USPAP, particularly Standards Rules 9 and 10.

Sincerely,

/S/

Sheila A. Albin
Associate General Counsel

OGC/CJL:bhs
04-0658