



EXAMINING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Examining Circular

Subject: Discounted Cash Flow Model

TO: Deputy Comptrollers, Department and Division Heads and All Examining Personnel

PURPOSE

This issuance establishes the recently distributed Discounted Cash Flow Model as the only one OCC examiners may use in evaluating loans supported by real estate or other real estate owned. It outlines the appropriate use of the model. More information on discounted cash flow and its use by the federal financial institution regulators may be found in BB 91-43.

BACKGROUND

This OCC model provides national bank examiners with a tool to help credit analysis. The focus of an examiner's review of a commercial real estate loan is the borrower's ability to repay the loan. In evaluating the overall risk associated with a commercial real estate loan, examiners consider many factors. One such factor is the nature and degree of protection provided by the cash flow and the value of the underlying collateral. Similar factors are considered with respect to other real estate owned.

A discounted cash flow analysis is an appropriate method for estimating the value of income producing real estate property. The discounted cash flow analysis is generally used for projects that have not obtained a stable income stream, but also may be used for properties with complicated lease structures or irregular income streams.

USE OF THE MODEL

Examiners should use only the most recently distributed version of the OCC Discounted Cash Flow model and the associated documentation. Examiners must discard any others they may have. This requirement is imposed to ensure that all examiners are using a consistent approach that conforms to the interagency guidelines on the valuation of real estate.



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The OCC model is for use by national bank examiners. It does not replace any model used by a bank or its appraiser to determine discounted cash flow. It should be used by examiners following OCC examination procedures presented in the Comptroller's Handbook for National Bank Examiners and BB 91-43.

Examiners should give reasonable deference to assumptions by qualified appraisers and should not challenge assumptions that differ in only a limited way from norms for similar properties. When the examiner establishes that facts or assumptions are not reasonable, appropriate or current, the model provides a way to develop an alternative estimate of value for credit evaluation purposes. In such situations, the examiner must be able to support alternative facts or assumptions he/she uses. "Worst case" scenarios that are unlikely to occur are not appropriate. Examiners should discuss any facts or assumptions they question with bank management and attempt to resolve differences.

DOCUMENTATION

If, in the examiner's judgment, it is necessary to alter an assumption in the analysis of a loan, that decision should be fully documented. The OCC model provides a field to detail support for alternative assumptions. Workpapers should also document why assumptions were altered. Finally, the examination report should include a discussion of any material differences and/or disagreements with management over the valuation assumptions.

RESPONSIBLE OFFICE

Questions concerning the valuation of real estate and discounted cash flow should be directed to the Office of the Chief National Bank Examiner at (202) 874-5190. Questions concerning the operation of the model should be directed to the Supervisory Research Division at (202) 874-5630.

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