

February 19, 2015

The Honorable Richard Shelby
Chairman
U.S. Senate Committee on Banking, Housing &
Urban Affairs
304 Russell Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
U.S. Senate Committee on Banking, Housing &
Urban Affairs
713 Hart Senate Office Building
Washington, DC 20510

Dear Chairman Shelby and Ranking Member Brown:

On behalf of the nearly 22,000 members of the largest professional organization of real property appraisers, thank you for the opportunity to submit comments relating to the recent Banking Committee hearings entitled, "Regulatory Relief for Community Banks and Credit Unions." We applaud your Committee for reviewing burdensome regulations, and offer the following comments, as real estate appraisal is one of the most heavily regulated professions in the United States.

De minimis Appraisal Threshold

The Committee received testimony about the availability of appraisers in certain rural real estate markets, and a question was asked of the federal financial institution examining agencies about the current appraisal requirement threshold, which currently stands at \$250,000 for residential loans and \$1 million for business loans. The witness from the Federal Reserve indicated that the agencies had the appraisal threshold under review. Under Title XI of the Financial Institutions Reform and Recovery Act of 1989 (FIRREA), the agencies have the ability to maintain the appraisal threshold. In the early 1990s, the threshold initially was proposed to be set at \$50,000, increased to \$100,000 in a proposed rule, and raised dramatically to the \$250,000 level, where it has remained since 1994.

Several facts related to the current "de minimis" appraisal threshold should be pointed out, as follows:

1. Banks are not required to obtain an appraisal for any loan below the *de minimis* appraisal threshold, which means that the current \$250,000 residential threshold exempts a majority of all residential real estate loans in the United States. According to the Federal Housing Finance Agency, the current House Price Index stands at \$220,000¹. Accordingly, the vast majority of rural residential real estate loans already fall well below the current appraisal requirement.
2. Loans backed by government agencies and government-sponsored enterprises also are exempt from the appraisal requirements, which means that loans insured by the Federal Housing Administration have their own appraisal requirements, and loans bought by Fannie Mae and Freddie Mac are determined by the agencies themselves. By statute, the FHA maintains an appraisal requirement for all loans largely because of the risks associated with the FHA insurance fund, while the government-sponsored enterprises generally require appraisals for purchase-mortgage situations.
3. The period leading up to the 2008 financial crisis saw Fannie Mae and Freddie Mac reduce their appraisal requirements over time, gradually incorporating allowances for "drive-by" appraisals and automated valuation models on a high percentage of loans purchased. This ultimately proved to be a mistake, as illustrated in part by the rampant collateral valuation failures at both agencies. Since the crisis, Fannie Mae and Freddie Mac generally have adhered to an underlying appraisal

¹ See <http://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/MonthlyHPINovember012215.pdf>

requirement, we believe, for sound reasons. Fannie Mae and Freddie Mac have also recently released FAQs related to rural appraisal concerns, dispelling several myths that permeate the banking community about GSE Seller/Servicing guideline requirements relating to comparable sales and other appraisal considerations². We believe understanding around these myths can be addressed through enhanced banker education.

4. The Dodd-Frank Act established additional appraisal requirements in certain situations for banks, including a second appraisal requirement in “higher priced” mortgages, or subprime loans, and full interior inspection appraisals for property “flipping” situations. The Consumer Financial Protection Bureau has established several exemptions to these requirements in final rules published last year, but it is worth noting that these requirements are different than those established under Title XI of FIRREA. The Dodd Frank appraisal requirements are minor and very limited in scope, impacting less than 5 percent of all loans in the United States by our estimates.
5. Lastly, our review of failed banks resulting from the financial crisis, including many community banks, indicates that the vast majority had problems adhering to basic appraisal requirements, despite citations from federal bank regulatory agencies. According to our research, more than two-thirds of failed community banks previously had been cited for appraisal violations by bank regulators for such misdeeds as failing to obtain current appraisals or perform adequate appraisal reviews; relying on stale appraisals; inadequate controls of the lending function, including appraisals; and poorly explained upward adjustments to the appraisal values.

Availability of Appraisers

While the Appraisal Institute appreciates community bank concerns about the availability of appraisers in some rural parts of the United States, we strongly caution against tailoring a national policy around one particular market condition. Any one real estate market may experience rapid growth, but that growth actually may *increase* the importance of appraisals, as real estate is prone to market cycles, helping to avoid boom and bust cycles.

We see no evidence of a national shortage of appraisers. We are attaching a copy of the most recent copy of the U.S. Appraiser Population estimates, which illustrate that the total population of certified and licensed real estate appraisers stands at around 80,000 nationwide³. We note that the markets for residential appraisers and commercial real estate appraisals are vastly different, with the number of residential real estate appraisers declining at a rate commensurate with the decline in the residential real estate market, while the commercial real estate market has remained relatively steady, even increasing in recent years. Recent declines in the ranks of residential appraisers actually indicate an *oversupply* of residential appraisers, if anything. We urge the Committee to consider the differences between residential and commercial real estate before taking legislative action to fully assess problems and solutions. To this point, it is unclear to us from the testimony whether community banks were facing difficulty with residential appraisals or commercial appraisals or both.

Collateral Underwriter

Fannie Mae recently announced the availability of a new program for mortgage loan sellers to conduct an electronic quality control assessment of appraisals. “Collateral Underwriter” utilizes data collected from previous appraisals prepared on loans sold to Fannie Mae and other analytics to score appraisals via a risk rating system. Scores of 4 or 5 are viewed by the system as carrying higher collateral risk, with scores of 1 or 2 illustrating less collateral risk, according to the system. The scores are not a rating of the *appraiser*, but of the *appraisals* as they relate to data maintained by Fannie Mae.

The release of Collateral Underwriter has widespread effects on the mortgage lending process and accompanying analytical processes. Collateral Underwriter is borne out of the idea that Fannie Mae’s pre-

² See <https://www.fanniemae.com/content/faq/appraisal-property-report-faqs.pdf>

³ See [http://www.appraisalinstitute.org/assets/1/7/us-appraiser-demographics_\(1\).pdf](http://www.appraisalinstitute.org/assets/1/7/us-appraiser-demographics_(1).pdf)

2008 crisis appraisal policies failed, a point that cannot be disputed. Clearly, outsourcing all appraisal review responsibilities to mortgage loan sellers was a mistake. To be clear, Fannie Mae never even saw appraisals prepared for loans that it bought unless the loan went into foreclosure. On this point, we strongly support efforts to conduct more due diligence on appraisals ***prior to*** purchasing loans, which programs like Collateral Underwriter attempt to do.

Quality assurance tools have been on the market for many years, but Collateral Underwriter is different in that the databases that support the tool are larger than any proprietary system and the program is delivered by the largest loan purchaser in the market. We note that the program accompanies assurances by the Federal Housing Finance Agency to address repurchase relief, so we believe that while the program is voluntary, many loan sellers will pay close attention to what Collateral Underwriter says to gain cover from repurchase risk.

This carries with it many questions and concerns about unintended effects on mortgage lending, real estate appraisal and, ultimately, systemic risk. Some context is necessary. Leading up to the 2008 financial crisis, the Fannie Mae and Freddie Mac seller/servicing guidelines also were viewed only as “guidelines,” but they gradually became viewed by mortgage participants as “rules” that must be followed by loan sellers. We do not believe that such rules-based approaches produce more credible appraisals, and actually may increase collateral risk, especially if developed and maintained in a vacuum.

Similarly, we are concerned that Collateral Underwriter messages and alerts will be viewed by mortgage loan sellers as rules for appraisal reviewers to follow. Such a development could jeopardize the independence of the appraisal process and create a systemic risk, as the system potentially becomes self-fulfilling.

Part of our concern here is the continued allowance of mortgage loan sellers to use underwriters and others with marginal appraisal review qualifications to manage appraisal review processes. Generally, our members report having less difficulty with treating quality assessment tools such as Collateral Underwriter like a rules-set where qualified reviewers are in place. This is because qualified reviewers can spot trivial concerns and focus on meaningful alerts that have bearing on the quality of the appraisal. Many times these issues are addressed in narrative comments by the appraiser, but this requires that someone actually read and thoroughly review the appraisal. This stands in contrast to many situations today where underwriters and others simply request that appraisers “clear” or “override” Collateral Underwriter alerts, which appraisers cannot do.

Lenders in rural areas have reason to be concerned about rules-based approaches, because such rules generally do not work well in non-conforming markets. We already are hearing that some loan sellers, out of ignorance, may not fund loans that have appraisals with high Collateral Underwriter risk ratings of 4 or 5, even though appraisals with such risk ratings actually may be well supported and credible, but just vary from Fannie Mae’s databases (which may contain incorrect information). On the other hand, appraisals with risk scores of 1 or 2 may conform to Collateral Underwriter rule-sets, but may not be well-supported or credible when scrutinized by a qualified reviewer.

To its credit, Fannie Mae has attempted to dispel some of these concerns in a Lender Letter released earlier this month⁴. The Letter does a commendable job of addressing concerns about the standing of Collateral Underwriter in the market and use by mortgage loan sellers. Still, our fears about Collateral Underwriter being viewed as a set of rules remain given past experiences with guidelines implemented by mortgage loan sellers. We encourage the Committee to review this development to ensure that Collateral Underwriter is not treated like a set of rules by mortgage loan sellers and that no systemic risks are

⁴ See <https://www.fanniemae.com/content/announcement/II1502.pdf>

created. Further, we encourage the Committee to examine whether Fannie Mae's appraisal review policies, in light of housing finance reform, ensure that credible reviews take place.

Evaluations

Though appraisals are not required for loans of \$250,000 or less, under federal bank regulatory policy, lenders must obtain an "evaluation" to understand the collateral risk involved with the loan. Many evaluations are completed by staff of financial institutions, but many also are outsourced to third parties such as real estate brokers, who often prepare broker price opinions to assist a bank in the creation of an evaluation. We believe that appraisers are the best source for all valuation services, including evaluations; however, the current regulatory regime imposed by FIRREA makes this very difficult because of certain requirements found in the Uniform Standards of Professional Appraisal Practice. USPAP appraisals are required above the *de minimis* threshold, but there is nothing to prohibit an appraiser from providing "evaluation" services, except that USPAP creates certain competitive disadvantages to appraisers in this space. For instance, unlike any real estate broker preparing a broker price opinion, appraisers are required to maintain certain record keeping requirements related to any valuation service, including evaluations. Advisory Opinion 13 in USPAP indicates the following regarding evaluations:

"An evaluation, when performed by an individual acting as an appraiser, is an appraisal. In addition to complying with USPAP, the appraiser must be aware of and comply with any additional assignment conditions and reporting requirements imposed on the assignment."

In other words, USPAP prohibits a licensed or certified appraiser from preparing an evaluation without also complying with USPAP.

We are supportive of states enacting laws that give appraisers greater flexibility for the standards under which they are preparing valuation services, as there are several generally recognized standards available to U.S. appraisers today. However, we believe that appraisers would benefit from a clear and explicit exemption from USPAP wherever an appraisal exemption is allowed. We believe this would service users of appraisal services well, as it would enable them to obtain cost-competitive valuation services from the most qualified sources in the market.

We note that this issue was addressed in a bill that was considered in the House last session. H.R. 5148, the "Access to Affordable Mortgages Act of 2014," which passed the House Financial Services Committee in the last Congress, granted an exemption from conducting appraisals in accordance with the USPAP for certain "high risk mortgage loans." H.R. 5148 creates flexibility for lenders to turn to appraisers to provide cost-competitive valuation services.

Unauthorized Activities

We need to make real estate appraisal an attractive profession for younger generations to explore and pursue. This is ultimately the best way to avoid a shortage in the future of highly qualified valuation experts. While appraisals should be prepared in accordance with minimum standards related to things like ethics and competency, great pains should be taken to avoid the appraisal practice (methods and techniques) from being dictated by rules and regulations. Appraisal methods and techniques, or generally, the three approaches to value (the sales comparison, cost and income capitalization approaches), should be left to the judgment of appraisers. This is one of the things that makes real estate appraisal attractive as a profession – it's an applied science. Our experience with nearly 100 years as a profession indicates that there is an exception to every rule in real estate, and that's because the real estate market in the United States is so diverse. Methods and techniques that work in a homogenous neighborhood in Washington, DC, may not work in the rural upper Midwest, which illustrates the importance of professional judgment on the part of an appraiser.

Appraisal Institute on
Regulatory Relief for Community Banks and Credit Unions
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Today, we are facing the potential for a new and unauthorized set of rules to dictate the appraisal process. The Appraisal Foundation, a private nonprofit organization that was authorized by Congress under Title XI of FIRREA to promulgate USPAP and establish minimum licensing requirements for appraisers, recently established a third board called the "Appraisal Practices Board." The creation of this board was undertaken under suspect circumstances, about which we previously have testified to Congress. Despite these and other concerns about conflicts of interest created, given its existing authorizations from Congress, the Appraisal Foundation continues to encourage state appraiser regulatory agencies and others to adopt works of the Appraisal Practices Board for mandatory compliance by certified and licensed appraisers. This would have strong negative effects on the appraisal process and impose new liabilities and regulatory burdens on appraisers and users of appraisal services. We believe it places the entire profession in jeopardy.

We encourage any effort by the Committee to promote regulatory relief to consider including and enacting regulatory relief measures for appraisers, including limitations around the authority of the Appraisal Foundation in the areas of appraisal practice in light of the existing authorizes bestowed by Congress. .

Thank you for the opportunity to comment, and we will be happy to answer any questions you might have.

Sincerely,

Appraisal Institute

cc: All members of the U.S. Senate Committee on Banking, Housing and Urban Affairs