ASFMRA American Society of Farm Managers & Rural Appraisers
THE MOST TRUSTED RURAL PROPERTY PROFESSIONALS

Appraisal Institute®
Professionals Providing Real Estate Solutions

August 18, 2017

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
Mail Stop 9W-11, 400 7th Street SW.
Washington, DC 20219

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551

RE: Real Estate Appraisals, FDIC-2017-0090-0001; FRS-2017-0203-0001; OCC-2017-0011-0001

To Whom It May Concern:

On behalf of the more than 20,000 members of the largest professional associations of real property appraisers, we write today in response to the Federal Financial Institutions Examination Council's (Agencies") Joint Notice of Proposed Rulemaking ("Proposal") to implement an increase in the appraisal threshold for commercial real estate transactions.

We strongly support the Agencies' decision not to propose an increase to the residential appraisal or business (owner-occupied) loan threshold levels. During the outreach meetings, it was apparent that there was very little interest, even on the part of community banks, to increase the business loan threshold. Further, with the housing crisis still in the rear-view mirror, we agree with the Agencies that raising the residential appraisal threshold level would be inappropriate at this time.

That said, our organizations are strongly opposed to the proposed increase in the appraisal threshold level from $250,000 to $400,000 for commercial real estate loans. This proposal exemplifies "regulatory arbitrage," and it contradicts federal bank regulators' concerns regarding the state of the commercial real estate market and the quality of evaluation reports. Although the proposal represents a modest increase in the threshold level, as pricing in commercial real estate has increased, so have investment risks in commercial real estate. If anything, federal bank regulators should be calling for *heightened* due diligence by regulated institutions today -- not the loosening of a fundamental risk management activity.

This is particularly true for smaller community and regional banks, which our members report are less likely to have robust collateral risk management policies, practices and procedures. While most large banks with established commercial lending operations have internal appraisal departments that are staffed by qualified appraisers and appraisal reviewers (often professionally designated by organizations like the Appraisal Institute and the American Society of Farm Managers and Rural Appraisers), many smaller banks are not paying as close attention to risk management and collateral valuation. This is illustrated by bank failures over the past decade, which overwhelmingly occur amongst smaller institutions and, in large part, due to poor commercial lending decisions. Such failures can have a devastating ripple effect on the local communities, employees, business owners, vendors, the general public, taxpayers, etc. In smaller markets the failure of a community bank can lead to less competition and higher rates for consumers.

Those closest to this issue and assisting risk management activities within regulated financial institutions (bank chief appraiser and appraisal managers) do not support increasing the appraisal threshold levels. A recent survey indicated that an overwhelming majority believe that the appraisal threshold levels should remain at $250,000. Specifically, 76.6 percent of chief appraisers/appraisal managers strongly or somewhat disagree with raising the $250,000 threshold level; 87.5 percent of chief appraisers/appraisal managers strongly or somewhat disagree with raising the $1,000,000 owner-occupied commercial real estate threshold level. Further, an overwhelming majority (89.1 percent) of chief appraisers/appraisal managers strongly or somewhat agree that raising threshold levels could increase risk to lenders.[1]

While we appreciate 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 fluctuations. In addition, increasing the threshold level to address the issue of appraiser availability is a very shortsighted way to address the perceived problem. In this instance increasing the thresholds may allow financial institutions to close certain loans faster but taxpayers, consumers, etc., will have to bear the cost if things go badly. The solution to the perceived problem should not just involve taking steps to close a loan faster it should involve taking steps to close a loan better.

Further, during the EGRPRA comment period and outreach meetings, it was apparent that many of the appraisal concerns expressed by bank representatives were in relation to residential-related topics, such as Fannie Mae and Freddie Mac policies or new rules from the Consumer Financial Protection Bureau in relation to implementation of the Dodd-Frank Act. To this point, we note that the number of commercial real estate appraisers has remained relatively steady in recent years, as commercial lending activity has seen slight increases.

For these reasons, we strongly recommend against an increase in the commercial real estate loan threshold level.

Should the agencies proceed with the proposal, we urge that the qualification requirements for those completing evaluations be elevated, so as to offset the safety and soundness risks caused by the increase in the threshold level.

Residential Threshold

Our organizations are pleased that the Agencies recommended in the recent Joint Report to Congress to keep the current residential appraisal threshold at $250,000. We maintain that it is prudent to ensure that an appraisal is performed, which provides an important safety and soundness protection for lenders. The appraisal additionally helps consumers by ensuring that the value of the property supports the mortgage assumed.

This threshold for requiring appraisals has been raised twice since its inception, first from the original $50,000 level to $100,000, then up to $250,000. We see no current justification to raise the threshold level once again, and our view of appraisals being the “gold standard” in valuation is validated by their requirement for government agency loans, as well as the vast majority of loans backed by the government-sponsored enterprises. As it stands now, too many federally-related transactions fall below $250,000 and require no appraisal at all, which sacrifices the safety and soundness of lending institutions, and exposes the public to unregulated valuation products.

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[1] Appraisal Threshold Levels – Survey of AI Professionals. December 2015. Available at http://www.appraisalinstitute.org/assets/1/7/Appraisal_Threshold_Levels_Survey.pdf

Business Loan Threshold
Likewise, we are pleased that the Agencies have not recommended an increase in the business (or owner-occupied) loan threshold. This is consistent with statements made by representatives of the banking sector, who expressed little–to-no concern about the current threshold level during several outreach meetings.

We note that many of the loans that would be impacted by a proposed increase in the business loan threshold level are guaranteed by the Small Business Administration. Currently, the SBA requires an appraisal for all loans above $250,000.

Below, are responses to specific questions posed by the Agencies:

Question 1. The agencies invite comment on the proposed effective date, including whether this time period is appropriate and, if not, why.

A reasonable period of time (6 months-to-1 year) should be provided to all institutions to establish protocols and procedures across business lines.

Question 2. The agencies invite comment on the proposed definition of commercial real estate transaction.

Including single family 1-4 unit construction loans as commercial real estate transactions would necessitate the appraisal being completed by a general certified appraiser. This assumes the loan amount is above the current threshold ($250,000). In reality, general certified appraisers in most urban markets seldom, if ever, complete appraisals of residential properties with 1-4 units.

Additionally, evaluations are not typically performed by valuation professionals in today's regulatory environment. Evaluations typically are completed by real estate brokers or real estate salesmen who are trained to obtain the highest price. This is very different from an appraiser, who is trained to give an unbiased value opinion. By taking the appraiser out of the transaction, there are no good safeguards on these transactions.

Question 3. The proposed definition of commercial real estate transaction would include loans to consumers for the initial construction of their dwelling or transactions financing the construction of any building with 1-to-4 dwelling units, so long as the loan does not include permanent financing, with the effect of permitting these loans to qualify for the higher $400,000 threshold. The agencies invite comment on the consumer, regulatory burden, and other implications of the proposal. What would be the implications of not including these loans in the definition, which would leave the current $250,000 threshold in place?

The impact of keeping the threshold at $250,000, for the situation and property type noted, is greater certainty about the risk inherent in a phased construction project. Evaluations, by definition, lack the detailed market analysis required of a phased construction project which can be impacted by changing market conditions during the construction period.

Question 4. The agencies invite comment on the consumer, regulatory burden, and other implications of the proposed exclusion of construction-to-permanent loans from the definition of commercial real estate transaction, meaning that the current $250,000 threshold would apply. What would be the implications of including construction-to-permanent loans in the definition of commercial real estate transaction, thus allowing these loans to qualify for the higher $400,000 threshold?

Construction to permanent loans are riskier for a lender than conventional residential lending. More due diligence is appropriate as risk is increased, not less. Often there are changes to plans and details that will impact value. Our most experienced members state that many construction-to-permanent loans do not end up financing what was originally underwritten. Given that the appraiser is the single neutral party in any real estate lending transaction, raising the threshold in

this scenario only heightens the risk to the lender and increases the probability for a negative consumer outcome.

Question 5. The agencies invite comment on the proposed level of $400,000 for the threshold at or below which regulated institutions would not be required to obtain appraisals for commercial real estate transactions.

See comments above.

Question 6. How would having three threshold levels ($250,000 for all transactions, $400,000 for commercial real estate transactions, and $1 million for qualifying business loans) rather than two threshold levels applicable to Title XI appraisals within the appraisal regulations affect burden to applicable institutions?

In our view, it does increase the complexity of the appraisal regulations, likely raising more questions from the banking community, particularly small community banks that are less likely to have a rigorous compliance operation in place. As noted above, many of the business loans that could be impacted by the business loan threshold are eligible for SBA financing, and the SBA rules are different from those of the Agencies.

Question 7. The agencies invite comment on the safety and soundness impact of the proposed $400,000 threshold for commercial real estate transactions.

See comments above.

Question 8. The agencies invite comment on the data used in this analysis, and what alternative sources of data would be appropriate for this analysis.

See comments above.

Question 9. The agencies invite comment on the proposed requirement that regulated institutions obtain evaluations for commercial real estate transactions at or below the $400,000 threshold.

This question is misstated by the Agencies, and we urge that the record be corrected. We disagree that banks would be required to obtain evaluations for commercial real estate transactions at or below the $400,000 threshold. Banks would be *allowed* to obtain evaluations, but still could obtain appraisals should they choose to do so. Ideally, the Agencies also would emphasize the importance of competency in appraisals and evaluations, given concerns that have been expressed by the regulators and bankers about the quality of evaluations.

Question 10. What type of additional guidance, if any, do institutions need to support the increased use of evaluations?

It is more than 20 years since the Final Rule on Real Estate Appraisals was released, and there is still widespread confusion about the existing exemptions. This proposal will only add to that confusion.

Question 11. To what extent does the use of evaluations reduce burden and cost over the use of appraisals? To what extent are evaluations currently done by in-house staff versus outsourced to appraisers or other qualified professionals?

As to the first question: Use of evaluations does reduce cost. However, their usage does not reduce *financial risk* and instead increases it. Unidentified increased risk is a misunderstood burden on the lender. The consumer may not bear the added direct cost, but loan officers are not neutral parties to the transaction and they lack fiduciary responsibility. Again, appraisers are the sole neutral party to a transaction. They are only advocates for their opinions. Loan officers, and sometimes their underwriters, are advocates for more loan closings. To remove a disinterested

third party (the appraiser) or to decrease the reliability of the value opinion reporting only serves to increase risk.

As to the second question: That is lender-specific and varies by lender. The valuation process (appraisals and evaluations) have to be clearly independent of lender and management influence.

<u>Question 12.</u> The agencies invite comment and supporting data on the appropriateness of raising the current $1,000,000 threshold for qualifying business loans and the associated implications for safety and soundness.

See comments above.

<u>Question 13</u>. What unique risks do institutions associate with qualifying business loans?

Generally, small businesses are at greater risk of failure than larger, and often better-capitalized firms. Cash flow is a problem that many small businesses face and declines in the local/national economy hit small businesses harder. Lenders that are over-weighted with small business loans are at greater risk. Further, these loans are typically held in portfolio, adding to the bank's risk profile.

<u>Question 14</u>. What percentage of total real estate lending at financial institutions, by number of loans and dollar volume of lending, are qualifying business loans?

It surprises us that the Agencies do not have a sense of this figure. It illustrates to us all the more reason why the Agencies should refrain from increasing the business loan threshold, as the Agencies would be establishing policy without adequate information or research.

<u>Question 15</u>. What is the average size of a qualifying business loan at financial institutions? What are the incidences of default on qualifying business loans compared to other commercial real estate transactions that institutions have observed over time?

Same as above.

<u>Question 16</u>. The agencies invite comment on the clarity of the application of the current threshold for qualifying business loans, and on any difficulty that financial institutions have experienced in interpreting the limitation on source of repayment.

It is our organization's belief that many loan officers are poorly trained in the classification of loans as real estate or business.

<u>Question 17.</u> As discussed earlier, the agencies have articulated several bases for declining to propose an increase in the residential threshold. The agencies request comment on whether there are other factors that should be considered in evaluating the current appraisal threshold for 1- to-4 family residential properties.

See comments above.

Thank you for this opportunity to share our views on this pivotal issue.

Should you have any questions or need additional information, please contact Brian Stockman, Executive Vice President/Chief Executive Officer, American Society of Farm Managers and Rural Appraisers, at 303-692-1211 or bstockman@asfmra.org or Fred Grubbe, Chief Executive Officer, Appraisal Institute, at 312-335-4100 or fgrubbe@appraisalinstitute.org.

Sincerely,

American Society of Farm Managers and Rural Appraisers
Appraisal Institute