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February 5, 2019

Ann E. Misback, Secretary,
Board of Governors of the Federal Reserve System,
20th Street and Constitution Avenue, NW.,
Washington, DC 20551
Re: Docket No. R-1639 and RIN 7100; Real Estate Appraisals
Email: regs.comments@federalreserve.gov

Mitchell E. Plave, Special Counsel
Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency,
400 7th Street, SW., Suite 3E-218, Mail Stop 9W-11,
Washington, DC 20219
Re: Docket ID OCC-2018-0038; Real Estate Appraisals
Email: regs.comments@occ.treas.gov

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
Re: FDIC RIN 3064-AE87 – Real Estate Appraisals
Email: Comments@FDIC.gov

Re: Request for Comments on Proposal to Increase the Residential Real Estate Appraisal Threshold

Dear Ms. Misback, Mr. Plave and Mr. Feldman:

The Iowa Bankers Association (IBA) is a trade association representing 98 percent of the more than 300 state- and national-chartered banks and federal thrifts operating in the state of Iowa. The IBA submits this letter to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (the "agencies") in response to their request for comments on a proposal to amend regulations requiring appraisals of real estate for certain transactions.

The agencies' proposal would increase the threshold level at or below which appraisals are not required for residential real estate transactions from $250,000 to $400,000 as well as implement provisions of the 2018 Economic Growth, Regulatory Relief and Consumer Protection Act providing an additional appraisal exemption for certain transactions secured by properties located in "rural areas." The proposal would also continue to require evaluations that are consistent with safe and sound business practices for transactions exempted by the increased threshold and codify the long-standing regulatory expectation that for all federally related transactions for which an appraisal was required, be subject to appropriate review for compliance, stipulating the review make a determination of meeting Uniform Standards of Professional Appraisal Practice (USPAP) standards.

The IBA thanks the agencies for their responsiveness to the comments received from the public in connection with the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) process as well as the rulemaking to increase the appraisal threshold for commercial real estate appraisals. We appreciate the agencies efforts to balance the impact of regulatory changes on the safety and soundness of the banking industry, while ensuring consumers' best interests continue to be served.

ADDITION OF THE "RESIDENTIAL REAL ESTATE TRANSACTION" DEFINITION

First, we wish to express our support for the addition of the definition of "residential real estate transaction" and the consistent use of the same term in the threshold exemptions for real estate transactions requiring appraisals. We agree defining "residential real estate transaction" as a real estate-related financial transaction secured by a single 1-to4 family residential property is consistent with the commercial real estate transaction provisions that became effective in 2018 and provides clarity to the regulation. The reader can more easily distinguish two separate transaction types based upon collateral and the exemption that applies to each.

INCREASE IN RESIDENTIAL REAL ESTATE TRANSACTION THRESHOLD

IBA members are generally supportive of the exemption threshold increase from $250,000 to $400,000, emphasizing the proposal is of particular importance for loans secured by a single 1-to-4 family residential property that are originated and held in the bank's own portfolio. In a survey of our members, with 70 plus respondents, multiple reasons for supporting the increase were expressed but three notable reasons are cited below.

- **Evaluations are typically used for low-risk transactions.** Transaction value alone is not the appraisal – valuation determinant. Only 27 percent of survey respondents indicated they obtain appraisals only when required to do so by the agencies rules because the transaction value exceeds the applicable threshold. Rather, the majority of respondents indicated they often obtain an appraisal by a state-licensed or certified appraiser for loans that are <u>under</u> the appraisal exemption threshold. Seventy-three percent of survey respondents indicated the determinant as to whether or not an appraisal is warranted is based upon multiple risk factors including the loan product requested by the consumer, estimated loan-to-value, the borrower's debt-to-income ratio, the borrower's credit history, current stability the of real estate market in which the collateral property is located, uniqueness of the collateral property, etc. The point here is the determination as to whether or not an appraisal is obtained is made on a loan-by-loan basis based upon the overall risk presented by the transaction taking into account all relevant factors; not the transaction value alone.

  To illustrate, a bank may require an appraisal by a state-licensed appraiser for a $100,000 loan to an applicant who is only putting 5% down on the purchase price and has limited credit history or when the property is located in a community experiencing economic challenges due to recent manufacturing layoffs. Whereas, the same lender may determine a valuation is sufficient for another established borrower with the bank, who has a solid credit history, and is requesting a $400,000 loan secured by residential property in a neighboring community with a tax assessed value of $800,000. While the loan amount is higher on the second example, the credit exposure of the institution is far less and does not warrant the established borrower bear the added cost of an appraisal by a state licensed or certified appraiser.

- **Evaluations do save consumers money.** When the risk associated with the transaction warrants an evaluation is a sufficient collateral valuation tool, consumers do save money and transactions can close more quickly. 78 percent of our survey respondents indicated evaluations are typically done by a bank employee and the customer is not typically charged for the service. The remaining 20 percent of respondents indicated they use a qualified third party for the evaluation service. When a third party is used, the customer typically pays for the service but 81 percent of survey respondents indicated that when an evaluation is used lieu of an appraisal, the consumer saves 50% or more on the cost of evaluation versus an appraisal.
- **Simple economics warrants the increase.** In the preamble to the proposal, the agencies note that house price indices have increased since 1994, when the $250,000 threshold was first established. According to the Bureau of Labor Statistics consumer price index, prices in 2018 were 69.44% higher than prices in 1994. The dollar experienced an average inflation rate of 2.22% per year during this period. In other words, $250,000 in 1994 is equivalent in purchasing power to $423,594.80 in 2018, a difference of $173,594.80 over 24 years. When considering inflation, the appraisal threshold adjustment is not an increase, but rather an exercise in keeping up with inflation. Based upon the Bureau of Labor Statistics, a bank making a $250,000 loan is 1994 essentially is taking on the same inflation-adjusted risk in 2019 when making a $423,000 loan. Simple economics warrant the increase in the threshold.

INCREASED USE OF EVALUATIONS

The agencies pose multiple questions related to increased use of evaluations and inquire if institutions will expand their use of evaluations if the proposal to raise the residential threshold is finalized. The agencies also ask for what type of types of eligible transactions are they most likely to obtain evaluations.

- **An increase in the threshold amount will not change most institution's approach to collateral valuation.** It's interesting to note when survey respondents were asked if their appraisal policy (or appraisal-evaluation decision process) would change due to the increase in the appraisal threshold amount, 82 percent responded their institution would NOT change its current process. Rather, they would continue to apply the same risk-based principals in determining whether or not an evaluation is appropriate for the particular transaction. Increasing the threshold from $250,000 to $400,000 simply provides institutions with greater flexibility in assessing the risk associated with a broader expanse of transactions – those up to $400,000 in value. Meaning, if a transaction below the $400,000 threshold meets the institution's evaluation guidelines and is deemed low-risk, the institution would have the option to obtain an evaluation in place of an appraisal under the revised rule; whereas, currently the institution's hands are tied and an appraisal must be obtained.
- **Evaluations are used more frequently with the lower-risk transactions.** Survey respondents indicated evaluations are more frequently used for non-purchase transactions such as home equity loans, home equity lines of credit, and transactions where a collateral interest is taken in abundance of caution. When evaluations are used for purchase transactions, the transactions are typically lower risk due to the amount of down payment the borrower injects into the purchase, other collateral offered or the overall financial strength of the borrower. Our members indicate their evaluations adhere to the interagency guidelines and are subject to review by their prudential regulators during safety and soundness examinations. Seventy-seven percent of respondents reported their

prudential regulators have never expressed concerns related to the quality and content of evaluations used by the institution with another 18 percent reporting their regulator at one time expressed concerns but the institution modified its program accordingly and those regulatory concerns no longer exist.

- **Advances in technology have improved evaluation quality and expanded content.** The agencies ask what valuation information, if any would consumers lose in practice if more evaluations are performed rather than appraisals. Advances in technology continue to improve and assist financial institutions in providing more detailed evaluation that more accurately reflects current market property value. Because the IBA's membership is largely small community banks, many have not invested technology solutions like "Automated Valuation Models" (AVMs) which quickly analyzes various data points by accessing public sale records and property information to produce an estimate on the current value of a home or property. (Only 14 percent of respondents indicate regular use of AVMs in their valuation programs.) However, much of the same data used by appraisers in completing USPAP-compliant appraisals is now available electronically with the click of a mouse from public databases. Nearly all of Iowa's 99 counties have public access online to information related to property values for tax purposes. These sites provide not only property tax information but information related zoning of the property, sales history of the property, and important construction details about the home (type of roof, foundation, exterior materials, size of finished area, number of bedrooms, bathrooms, garage, etc.). In addition the same public databases have search tools which allow the user to search property sales, filtering results by location, home/building style, occupancy status, sales date range, sales price range, total living area, number of bedrooms and baths, property condition and more. It is important to note this information is made available publicly, at no charge for evaluation development. This real time information was not readily available until the last decade or so causing wide variances in evaluation content and quality, making evaluation quality dependent upon the research skills of, and time available to, the person performing the valuation. That is no longer the case; due to the ease with which this important data can be accessed, evaluation content and quality has become more consistent and accurate.
- **Evaluations offer consumer benefits as well.** As stated above, evaluations are far less expensive for consumers. As stated earlier, our survey results indicate evaluations are frequently obtained for lower-risk transactions such as home equity loans, lines of credit, refinances with low loan-to-value ratios, etc. Consumers entering into these transactions are not relying the value derived from the evaluation for purposes of selling the property, making an investment decision or other speculative purposes. Rather, the evaluation is being done for the sole purpose of the credit transaction – to support the collateral offered by the consumer supports the credit requested. If an evaluation can be used for the credit decision purpose, at no cost to the consumer (or less cost to the consumer when a third party evaluation is obtained), the consumer benefits. Evaluations are also often easier for consumers to read and understand as they are typically more textual than appraisals and explain comparison made with other recent sales in "plain English" rather than longer, more-complex format of a USPAP-compliant appraisal.
- **Valuation independence is not jeopardized by the increase in the appraisal threshold.** The request for comments also asks what challenges, if any, the institution faces in meeting the requirements and standards for valuation independence, when internally prepared evaluations are used. The concept of "valuation independence" is not new; it has existed in 12 CFR 1026.42 since 2011[1]. Many of our member banks qualify for the "small creditor"[2]

[1] 76 FR 79772, Dec. 22, 2011, as amended at 80 FR 32687, June 9, 2015

[2] Creditors with assets of $250 million or less for either of the past two calendar years.

provisions in the rule and are able to ensure evaluation independence by requiring the staff member preparing the valuation abstains from the credit decision process and setting of the loan terms, with a different staff member performing the review of the evaluation. Our members that have such limited staff that they cannot separate the valuation preparation and valuation review process from the loan production, or do not have staff with the background and expertise to perform the evaluation, often hire qualified third parties to complete the evaluation. Again, these are procedures and processes that have been tested through the regulatory exam process and found to meet regulatory expectations: 82 percent of our survey respondents indicate their prudential regulator has never expressed concerns related to their evaluation independence process and 15 percent more report that past regulatory concerns have been resolved through modified procedures.

APPRAISAL REVIEW REQUIREMENT

Finally, the agencies ask for institution concerns posed by adding a requirement to review all appraisals "subject to appropriate review with the Uniform Standards of Professional Appraisal Practice" (USPAP). Currently the appraisal rule indicates, at a minimum, the appraisal must must "conform to generally accepted appraisal standards", "be written ... and support the institution's decision to engage in the transaction" and "analyze and report appropriate deductions and discounts."

The 2010 Interagency Appraisal and Evaluation Guidelines[3] instructs "an institution should review appraisals <u>and evaluations</u> to ensure that they comply with the Agencies' appraisal regulations and <u>are consistent with supervisory guidance and its own internal policies</u>. This review also should ensure that an appraisal or evaluation <u>contains sufficient information and analysis to support the decision to engage in the transaction.</u>" Neither the current rule nor guidance raise the review process to the standard of ensuring compliance with the USPAP standards. More than half our survey respondents expressed concern related to "raising the bar" for the review process to ensure compliance with the USPAP standards. Many small banks have staff that possess the requisite education, expertise, and competence to perform the review of evaluations and appraisals commensurate with the complexity of the transaction, type of real property, and market but have not been formally trained to the level of the USPAP standards. Our members express concern that such a requirement would add considerable overhead expense to the institution, further squeezing the institution's already thin margins or conversely, force the institution to outsource the review function to a third party, further increasing consumer costs.

Also, it's important to note the 2010 Guidelines apply the review process to both appraisals <u>and evaluations</u>, while the proposal adds the USPAP-compliant review requirement to the Minimum <u>Appraisal</u> Standards provisions. It is not clear in the proposal if the USPAP-compliant review expectation is applicable only to appraisal, or also evaluations. Which then makes one ask, how can an evaluation, which is not subject to the USPAP standards, be reviewed to such a standard? Should the agencies move forward with this provision, the 2010 Guidelines would likely need to be updated to provide additional guidance, comparing and contrasting review expectation for evaluations versus appraisals.

CLOSING COMMENTS

The IBA supports the proposed changes to the agencies appraisal requirements as they provide workable solutions to everyday challenges faced by institutions experiencing appraiser shortages and consumers facing ever-increasing loan costs while balancing the safety and soundness of the

[3] December 2, 2010, https://www.fdic.gov/news/news/financial/2010/fil10082a.pdf

institution. The proposed increase in the residential real estate threshold to $400,000 will provide immediate relief to those lenders and borrowers entering into lower risk transactions that do not warrant the need for an appraisal completed by a state licensed or certified appraiser.

Sincerely yours,

Ronette Schlatter, CRCM
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