THE APPRAISAL FOUNDATION
Authorized by Congress as the Source of Appraisal Standards and Appraiser Qualifications

December 14, 2018

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 RIN 7100-AF30**

Ms. Misback:

The Appraisal Foundation is authorized by Congress to establish minimum appraisal standards and appraiser qualifications for appraisals used in real estate related financial transactions. We appreciate the opportunity to comment on the proposal to raise the threshold on residential real estate related transactions from $250,000 to $400,000.

The Appraisal Foundation strongly encourages you not to adopt any such action.

The Appraisal Foundation believes that increasing the appraisal threshold level would negatively affect safety and soundness in real estate lending practices. It would likely prompt many financial institutions to significantly reduce attention to collateral risk management. This position is supported by the Government Accountability Office (GAO) report[1] in January 2012, where no support was found to raise the current threshold amount. In fact, that GAO report reflected stakeholder support to reduce or eliminate the current threshold. To that end, The Appraisal Foundation believes additional outreach is necessary and strongly suggests conducting a hearing to receive input from mortgage insurers, credit rating agencies, investors, and consumer groups.

An appraisal performed by a licensed or certified appraiser that complies with the Uniform Standards of Professional Appraisal Practice is a lynchpin in the proper evaluation of real estate collateral. To maintain and promote proper risk management, safety and soundness policies, and consumer protection, The Appraisal Foundation urges you not to raise the current appraisal threshold amount.

If you have any questions or would like additional information, please contact me via e-mail at david@appraisalfoundation.org, or by calling (202) 624-3040.

Sincerely,

David S. Bunton
President

[1] Real Estate Appraisals: Appraisal Subcommittee Needs to Improve Monitoring Procedures. January 2012 http://gao.gov/assets/590/587735.pdf

United States Government Accountability Office

GAO

Report to Congressional Committees

January 2012

REAL ESTATE APPRAISALS

Appraisal Subcommittee Needs to Improve Monitoring Procedures

GAO-12-147

GAO Accountability * Integrity * Reliability

Highlights

Highlights of GAO-12-147, a report to congressional committees

Why GAO Did This Study

Real estate appraisals have come under increased scrutiny in the wake of the recent mortgage crisis. Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 created an oversight structure for appraisals and appraisers that involves state, federal, and private entities. This structure includes ASC, a federal agency responsible for monitoring these entities' Title XI-related activities. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) expanded ASC's Title XI role and required GAO to examine ASC's activities and exemptions to federal appraisal requirements. This report discusses (1) how ASC is carrying out its original Title XI responsibilities, (2) ASC's actions and plans to implement Dodd-Frank Act provisions, and (3) regulatory dollar thresholds for determining when an appraisal is required. To do this work, GAO reviewed ASC records and reports, surveyed state appraiser regulatory agencies, analyzed government mortgage data, and interviewed industry stakeholders.

What GAO Recommends

To help ensure effective implementation of ASC's original Title XI and additional Dodd-Frank Act responsibilities, ASC should clarify and report the criteria it uses to assess states' overall compliance with Title XI and develop specific policies and procedures for its other monitoring functions. GAO provided a draft of this report to ASC and seven other agencies. ASC and two other agencies agreed with the report's recommendations. One agency did not comment on the recommendations, and the others did not provide written comments.

View GAO-12-147. To view the e-supplement, click GAO-12-198SP. For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

January 2012

REAL ESTATE APPRAISALS

Appraisal Subcommittee Needs to Improve Monitoring Procedures

What GAO Found

The Appraisal Subcommittee (ASC) has been performing its monitoring role under Title XI, but several weaknesses have potentially limited its effectiveness. For example, Title XI did not originally provide ASC rulemaking and enforcement tools that could be useful in promoting state compliance. In addition, ASC has not reported or clearly defined the criteria it uses to assess states' overall compliance levels. Title XI charges ASC with monitoring the appraisal requirements of the federal financial institutions regulators, but ASC has not defined the scope of this function—for example, by developing policies and procedures—and its monitoring activities have been limited. ASC also lacks specific policies for determining whether activities of the Appraisal Foundation (a private nonprofit organization that sets criteria for appraisals and appraisers) that are funded by ASC grants are Title XI-related. Not having appropriate policies and procedures is inconsistent with federal internal control standards designed to promote effectiveness and efficiency and limits the accountability and transparency of ASC's activities.

ASC faces potential resource and planning challenges in implementing some Dodd-Frank Act provisions. ASC has only 10 staff and is funded by appraiser registration fees that totaled $2.8 million in fiscal year 2010. The Dodd-Frank Act expands ASC's responsibilities and authorities. For example, the act requires ASC to establish a national appraiser complaint hotline and provide grants to state appraiser regulatory agencies, and it gives ASC limited rulemaking and enhanced enforcement authorities to help address prior weaknesses. As of October 2011, ASC had completed several implementation tasks that required no rulemaking or creation of new programs and was in various stages of progress on the others. The potentially resource-intensive nature of some remaining tasks will require careful planning. For example, operating a complaint hotline may require investments in information technology and the creation of screening and follow-up procedures. Also, implementing a grant program will require ASC to set aside funds, develop funding criteria, and oversee grantees. ASC is in the process of developing a strategic plan to help carry out these efforts with available resources.

GAO found that more than 70 percent of residential mortgages made from 2006 through 2009 were $250,000 or less—the regulatory threshold at or below which appraisals are not required for transactions involving federally regulated lenders. In recent years, however, the threshold has had a limited impact on the proportion of mortgages with appraisals because mortgage investors and insurers such as Fannie Mae, Freddie Mac, and the Federal Housing Administration have generally required appraisals for mortgages both above and below the threshold. While these entities currently dominate the mortgage market, federal plans to scale them back could lead to a more privatized market, and whether this market would impose similar requirements is not known. None of the appraisal industry stakeholders GAO spoke with argued for increasing the threshold. Some stakeholders said the threshold should be lowered or eliminated, citing potential benefits to risk management and consumer protection. Others noted potential downsides to lowering the threshold, such as requiring more borrowers to pay appraisal fees and requiring appraisals on more transactions for which cheaper and quicker valuation methods may be sufficient.

objectives are to be achieved, including the processes and resources required.

Most Recent Mortgages Were Below the Threshold for Appraisal Exemption, and Stakeholder Views on the Threshold Vary

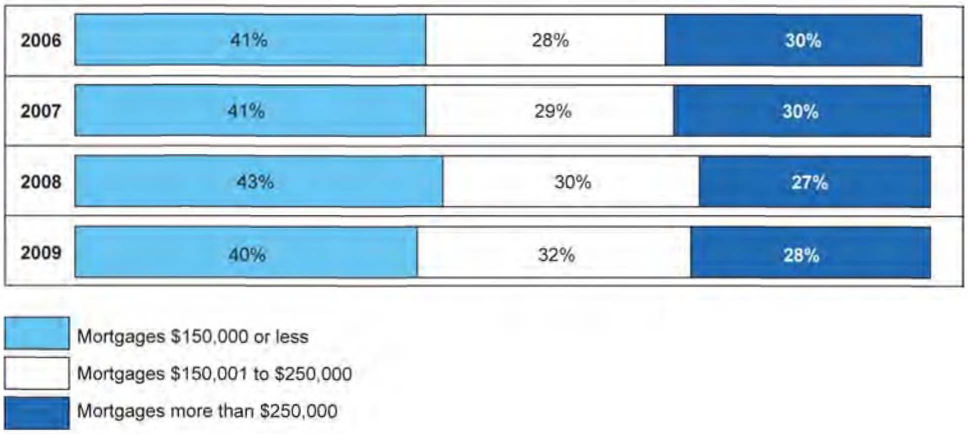
Our analysis of HMDA data found that approximately 71 percent of first-lien mortgages for single-family (one- to four-unit) homes originated from calendar years 2006 through 2009 were less than or equal to $250,000—the regulatory threshold at or below which appraisals are not required for federally related transactions.[66] As shown in figure 4, the percentage varied little by origination year, ranging from a low of 69 percent in 2006 to a high of 73 percent in 2008.[67] For all four years combined, 41 percent of the mortgages were $150,000 or less, and 30 percent were from $150,001 to $250,000. For the same 4-year period, we found that about 22 percent of mortgages for residential multifamily structures were at or below the $250,000 threshold, as were about 98 percent of mortgages for manufactured housing.[68]

[66]This figure excludes mortgages for manufactured homes. We examined HMDA data for manufactured and multifamily properties separately. Data limitations prevented similar analysis of real estate-secured business loans, which have an appraisal exemption threshold of $1 million. The volume of business loans that are $1 million or less—commonly referred to as small business loans—is substantial. According to an analysis by the Federal Reserve Bank of Richmond, $372 billion in small business loans secured by commercial real estate were made in 2009. However, some portion of those loans may not have met regulatory criteria for the appraisal exemption, which requires the primary source of repayment to be operating cash flow from the business rather than rental income or the sale of real estate.

[67]The 2009 data were the most recent data for which we could complete our data processing and reliability steps within the time frame of our review.

[68]For purposes of HMDA reporting, a multifamily property is a residential structure that houses five or more families. Even though apartment and condominium buildings can house five or more families, they comprise individual ownership-deeded units reported as one-to-four family dwellings. HMDA reporting uses HUD's definition of manufactured housing, which is housing that is factory-built and essentially ready for occupancy upon leaving the factory and being transported to a building site.

Figure 4: Percentage of First-Lien Mortgages for Single-Family Homes Above and Below $250,000, 2006-2009 Originations



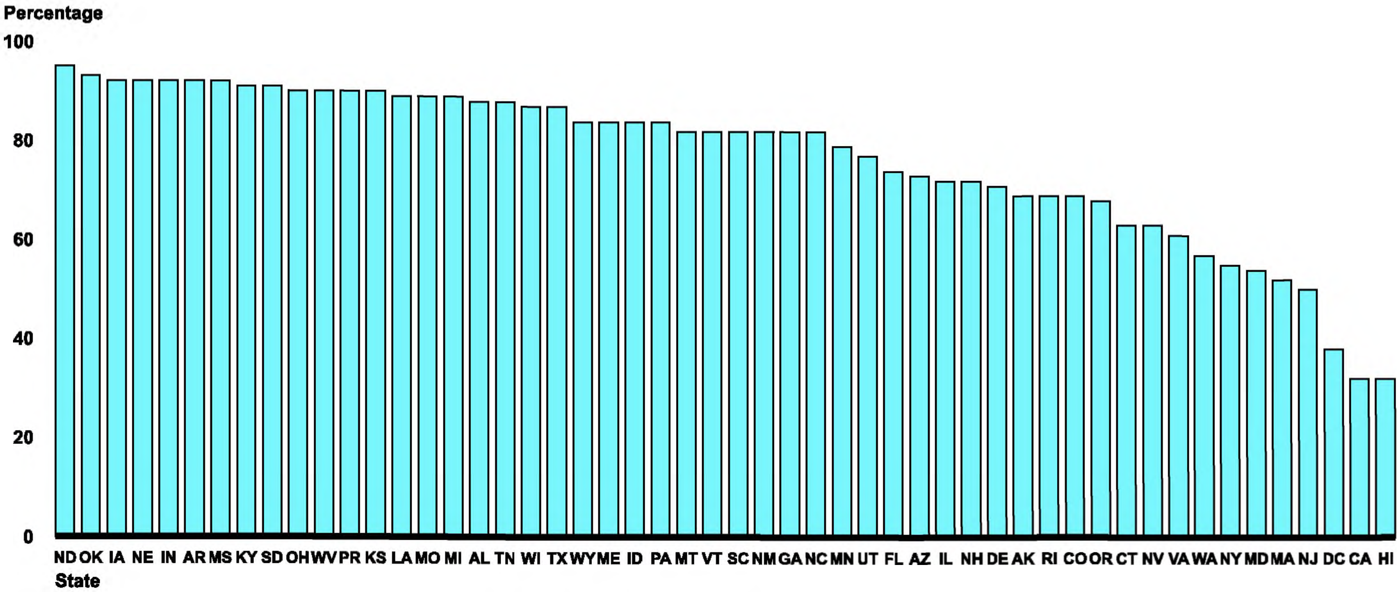
Source: GAO analysis of HDMA data.

Note: Figure excludes mortgages for manufactured homes.

The proportions of mortgages originated from 2006 through 2009 that were below the threshold varied considerably by state. The percentage of first-lien mortgages for single-family homes that were less than or equal to $250,000 ranged from a low of 32 percent in California and Hawaii to a high of 95 percent in North Dakota. Two states, New Mexico and South Carolina, represented the median percentage of 82 percent (see fig. 5.) The only places in which more than half of the mortgage originations were greater than $250,000 were California, the District of Columbia, and Hawaii. In states that experienced some of the steepest declines in house prices during the 4 years we examined, the proportion of annual mortgage originations that fell below the threshold increased substantially over the period. For example, the proportion rose 25 percentage points in Nevada, 17 percentage points in California, and 8 percentage points in both Arizona and Florida.[69]

[69]The proportion rose from 55.6 percent to 80.2 percent in Nevada, 25.1 percent to 42.4 percent in California, 72.4 percent to 80.2 percent in Florida, and 70.2 to 78.6 in Arizona. According to FHFA's purchase-only house price index, these four states had the greatest decline in average home prices from the first quarter of 2006 through the fourth quarter of 2009.

Figure 5: Percentage of First-Lien Mortgages for Single-Family Homes at or Below $250,000 by State, 2006-2009 Originations Combined



Source: GAO analysis of HDMA data.

Note: Figure excludes mortgages for manufactured homes.

Despite the sizable proportion of residential mortgages at or below $250,000, the threshold has had limited impact in recent years on the percentage of mortgages with an appraisal because mortgage lenders, investors, and insurers generally require them for mortgages, regardless of amount. Due to the sharp contraction of the private mortgage market that began in 2007, the large majority of mortgage originations are currently purchased or insured by the enterprises and HUD's Federal Housing Administration (FHA), which require appraisals on most mortgages.[70] In 2010, enterprise-backed mortgages accounted for more than 65 percent of the market and FHA-insured mortgages accounted for about 20 percent.[71] As we reported in July 2011, data for the two

[70]Regulations exempt loans that qualify for sale to the enterprises or are insured or guaranteed by a federal agency from Title XI appraisal requirements. OCC: 12 C.F.R. Part 34, subpart C; Federal Reserve: 12 C.F.R. Part 208, subpart E and 12 C.F.R. Part 225, subpart G; FDIC: 12 C.F.R. Part 323; NCUA: 12 C.F.R Part 722.

[71]These market shares are expressed in terms of dollar volume and do not include home equity loans.

enterprises combined showed that they required appraisals for 85 percent of the mortgages they bought in 2010 and 94 percent of the mortgages they bought in 2009 that were underwritten using their automated underwriting systems.[72] FHA requires appraisals for all of the home purchase mortgages and most of the refinance mortgages it insures. Furthermore, lender valuation policies may exceed investor or insurer requirements in some situations. For example, lender risk-management policies may require the lender to obtain an appraisal even when the enterprises do not, or the lender may obtain an appraisal to better ensure that the mortgage complies with requirements for sale to either of the enterprises.

The $250,000 threshold could become more consequential if the roles of the enterprises and FHA are scaled back in the future. The administration and Congress are considering options that would diminish the federal role in mortgage finance and help transition to a more privatized market by winding down the enterprises and reducing the size of FHA.[73] If this were to occur, the proportion of mortgage originations not subject to the appraisal requirements of these entities could increase. If private investors and insurers were to impose less stringent appraisal requirements than the enterprises or FHA, more mortgages of $250,000 or less may not receive an appraisal. However, whether the private market will require appraisals for mortgages below the threshold is unclear at this time.

[72] GAO-11-653. Available enterprise data for 2006 through 2008 showed that appraisals were required for almost 90 percent of mortgages, although the data covered a smaller proportion of the enterprises' total mortgage purchases than the data for 2009 through 2010. Because the enterprises' requirements are minimum requirements, lenders can and sometimes do exceed them. The enterprises do not require an appraisal when their underwriting analysis indicates that the default risk of a mortgage is sufficiently low to instead require validation of the sales price (or loan amount in the case of a refinance) by an AVM-generated estimate of value.

[73] Department of the Treasury and Department of Housing and Urban Development, *Reforming America's Housing Finance Market: A Report to Congress* (February 2011).

Appraisal Industry Stakeholders Have Differing Views on Revising the Exemption Thresholds

The perspectives of appraisal industry stakeholders we spoke with—including appraisers, lenders, and federal and state regulators—did not provide a consensus view on whether or how the $250,000 threshold or the $1 million threshold that applies to real estate-secured business loans should be revised. Although no stakeholders advocated higher thresholds, a number recommended lowering or eliminating them, while others thought no changes were necessary. In addition, some stakeholders suggested alternatives to fixed, national dollar thresholds.

Appraiser industry groups, lending industry representatives, and some of the state regulators we contacted said that the appraisal exemption thresholds should be lower, in part to help manage the risk assumed by lending institutions. For example, 14 of the 50 state appraiser regulatory agencies that responded to our survey indicated that the $250,000 threshold should be lowered to either $50,000 or $100,000. Several of the parties we spoke with pointed out that the median sales price of homes in the United States is below $250,000, which exempts numerous mortgage transactions from regulatory appraisal requirements. An NCUA official noted that in large numbers, smaller home mortgages or business loans can pose the same risks to lending institutions as larger ones, so smaller loans should not necessarily be exempt from appraisal requirements. Additionally, appraisal industry stakeholders indicated that "evaluations" that may be performed as an alternative to an appraisal may include methods that are less credible and reliable, such as AVMs. These stakeholders acknowledged that while appraisal requirements are currently driven by the enterprises and FHA, the roles of these entities could change.

Additionally, while appraisals for residential mortgages are not intended to validate the purchase price of the property in question, some stakeholders believe that they serve a consumer protection function by providing objective information about the market value of a property that consumers can use in making buying decisions. One appraisal industry representative said this information can help homebuyers avoid immediately owing more on a property than the property is worth, a situation that can make resale or refinancing difficult or cost-prohibitive. The Dodd-Frank Act requires that any revisions to the $250,000 threshold take into account consumer protection considerations through the concurrence of CFPB.[74]

Other appraisal industry stakeholders, including some state appraiser and bank regulatory officials, felt that the appraisal thresholds should remain where they are. For example, 17 of the 50 state appraiser regulatory agencies that responded to our survey indicated that the $250,000 threshold should not be changed. A few of these stakeholders stated that lowering the threshold would potentially require more homebuyers to pay for appraisals, which are generally more expensive than other valuation methods. For example, according to mortgage industry participants, a typical appraisal can cost a consumer $300 to $450 on average, while a property valuation by an AVM can cost $5 to $25.[75] In addition, one appraisal industry participant said that lower thresholds could subject more real estate-related transactions for which an appraisal is not necessary to appraisal requirements. For example, he indicated that when the property in question is collateral for a loan that is much less than the probable value of the property, a cheaper and faster valuation method such as an AVM may be sufficient. An FDIC official said it was not clear that the exemption thresholds needed to be revised and noted that even for transactions below the thresholds, regulated financial institutions are expected to have a risk-based approach that determines when they will use an appraisal versus another method.

Some appraisal industry stakeholders said that changes in real estate market conditions and variation in housing markets argued for thresholds tied to median property values at the state or regional level. For example, some of the respondents to our state survey noted that a national $250,000 threshold is largely irrelevant in some areas of the country. As previously shown in figure 5, in several states, over 90 percent of recent mortgages were $250,000 or less. Some stakeholders felt that the thresholds should not be based solely on the loan amount and should include other factors that affect credit risk, such as the borrower's debt burden.

[74]Pub. L. No. 111-203, § 1473(a) (codified at 12 U.S.C. § 3341(b)).

[75]Appraisal costs can vary considerably depending on the location and size of the property, among other factors. See GAO-11-653.

Conclusions

The critical role of real estate appraisals in mortgage underwriting underscores the importance of effective regulation of the appraisal industry. Title XI of FIRREA created a complex regulatory structure that relies upon the actions of many state, federal, and private entities to help ensure the quality of appraisals and the qualifications of appraisers used in federally related transactions. ASC performs an important function within that structure by, among other things, monitoring the requirements and activities of some of the key entities—state appraiser regulatory agencies, the federal financial institutions regulators, and the Appraisal Foundation. Although ASC is carrying out its monitoring function, it has not developed appropriate policies and procedures for some of its activities, potentially limiting its effectiveness. First, ASC could improve how it assesses and reports on states' overall compliance with Title XI. Specifically, developing and disclosing clear definitions of the compliance categories could help ensure consistent and transparent application of the categories and provide more useful information to Congress about states' implementation of Title XI. Second, ASC could better delineate its role in monitoring the appraisal requirements of the federal financial institutions regulators and thereby strengthen accountability for this function. Third, ASC could enhance its policies for determining which Appraisal Foundation activities are eligible for grants to help ensure consistent funding decisions and improve the transparency of the grant process. Addressing these areas would also improve ASC's compliance with federal internal control standards designed to promote the effectiveness and efficiency of agency operations.

Provisions in the Dodd-Frank Act will help ASC carry out its Title XI monitoring functions but will also create challenges that will require effective long-term planning. The limited rulemaking and enhanced enforcement authorities the act provides to ASC address prior weaknesses in its ability to promote states' compliance with Title XI. Implementing these authorities will involve significant follow-on steps, including drafting regulations and developing criteria and processes to remove problem appraisers from the national registry. Other tasks stemming from the Dodd-Frank Act, such as establishing an appraiser hotline and a state grant program, require resources and involve difficult decisions. ASC is facing these tasks at a time when its costs have been increasing, and its revenues from national registry fees have fallen because of a decline in the number of appraisers. To help address these challenges, ASC has for the first time undertaken a strategic planning process. Although this process was not far enough along for us to examine the details of ASC's plan, setting goals and identifying processes and resources necessary to achieve them could help ASC align its new responsibilities with its mission and aid in resource allocation decisions.

Recommendations for Executive Action

To help ensure effective implementation of ASC's Title XI and Dodd-Frank Act responsibilities and improve compliance with federal internal control standards, we recommend that the Chairman of ASC direct the ASC board and staff to take the following three actions:

- clarify the definitions used to categorize states' overall compliance with Title XI and include them in ASC's compliance review and policy and procedures manuals, compliance review reports to states, and annual reports to Congress;
- develop specific policies and procedures for monitoring the appraisal requirements of the federal financial institutions regulators and include them in ASC's policy and procedures manual; and
- develop specific criteria for assessing whether the grant activities of the Appraisal Foundation are Title XI-related and include these criteria in ASC's policy and procedures manual.

Agency Comments and Our Evaluation

We provided a draft of this report to ASC, CFPB, FDIC, the Federal Reserve, FHFA, HUD, NCUA, and OCC for their review and comment. We received written comments from the Chairman, ASC; the Assistant Director for Mortgage Markets, CFPB; the Executive Director, NCUA; and the Acting Comptroller of the Currency, which are reprinted in appendixes V through VIII. We also received technical comments from FDIC, the Federal Reserve, and OCC, which we incorporated where appropriate. FHFA and HUD did not provide comments on the draft report.

In their written comments, ASC, NCUA, and OCC agreed with our recommendations. ASC noted that it had already taken preliminary actions to address our recommendations and would consider the report's findings as it continues to implement its new authority under the Dodd-Frank Act. OCC also acknowledged the challenges ASC faces in implementing its new responsibilities and authority under the act.

CFPB neither agreed nor disagreed with our recommendations but said that the report provided a comprehensive analysis of ASC's role and highlighted resource and operating constraints that may challenge ASC's ability to implement its new duties under the Dodd-Frank Act. CFPB also noted that if federal regulators contemplate revising the $250,000 appraisal exemption threshold, CFPB would evaluate whether the proposed change would provide reasonable protection for homebuyers. Additionally, CFPB indicated that it hoped to designate an ASC board member in the near future and that, in the meantime, CFPB serves on the ASC board in an advisory capacity.

We are sending copies of this report to the appropriate congressional committees, the Chairman of ASC, the Chairman of FFIEC, the Chairman of FDIC, the Chairman of the Federal Reserve, the Acting Director of FHFA, the Secretary of Housing and Urban Development, the Chairman of NCUA, the Acting Comptroller of the Currency, the Director of the Bureau of Consumer Financial Protection, and other interested parties. In addition, the report is available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff members have any questions about this report, please contact me at (202) 512-8678 or shearw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix IX.

William B. Shear

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