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CHAIRWOMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

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RANKING MEMBER

June 17, 2019

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: June 20, 2019, Housing, Community Development and Insurance Subcommittee hearing entitled, "What's Your Home Worth? A Review of the Appraisal Industry"

The Subcommittee on Housing, Community Development and Insurance will hold a legislative hearing entitled, "What's Your Home Worth? A Review of the Appraisal Industry" at 2:00 p.m. on Thursday, June 20, 2019, in room 2128 of the Rayburn House Office Building. This will be a single-panel hearing with the following witnesses:

- **David S. Bunton**, President, The Appraisal Foundation
- **Stephen S. Wagner** Senior Appraiser, Terzo & Bologna, Inc., on behalf of the Appraisal Institute
- **Jeff Dickstein**, Chief Compliance Office, Pro Teck Valuation Services, on behalf of the Real Estate Valuation Advocacy Association
- **Andre Perry**, David M. Rubenstein Fellow, Metropolitan Policy Program, the Brookings Institute
- **Joan N. Trice**, Founder, Collateral Risk Network

Background

Appraisals are a critical part of the mortgage lending process and the overall safety and soundness of the housing market. Appraisals provide a professional estimate of a home's market value that prospective homebuyers, lenders, mortgage insurers, investors, and governmental entities rely on to ensure that a mortgage does not exceed the value of the home that serves as collateral.

The current framework for regulating and overseeing the appraisal industry relies on states to take on the primary responsibility for direct regulation and oversight, while the Federal Government and private sector work together to provide greater uniformity in standards for appraisals across the nation. The Federal financial institutions regulatory agencies - defined as the Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and the National Credit Union Administration (NCUA) – set Federal requirements for appraisals performed in conjunction with federally-related transactions (FRTs). FRTs are real estate-related financial transactions that the Federal financial institutions regulatory agencies engage in, contract for, or regulate, for which an appraisal is required.[1]

[1] 12 U.S.C. 3350 (4)

Importantly, the Federal financial institutions regulatory agencies have discretion to decide when an appraisal is required. These agencies have exercised this authority by creating broad exemptions to the definition of FRTs for several categories of real-estate related financial transactions, including transactions at or below designated thresholds,[2] and loans that are wholly or partially insured or guaranteed by, or eligible for sale to, a federal agency or government-sponsored agency.[3] Thus, loans backed by the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), and the Department of Agriculture (USDA), Fannie Mae, and Freddie Mac are not considered FRTs for the purposes of appraisal requirements according the regulations promulgated by the federal financial institutions regulatory agencies. Instead, FHA, VA, USDA, Fannie, and Freddie establish their own standards for appraisals performed in conjunction with the mortgages that they back.

The Appraisal Subcommittee (ASC) plays an important role in monitoring, supporting and overseeing both private and state entities with respect to appraisals. The ASC is a Subcommittee of the Federal Financial Institutions Examination Council (FFIEC). The ASC is solely funded by a registry fee charged to appraisers[4] and is made up of seven members as designated by the heads of the Board, FDIC, OCC, NCUA, CFPB, the Department of Housing and Urban Development (HUD) and the Federal Housing Finance Agency (FHFA). The ASC's responsibilities include: monitoring state compliance with federal requirements and taking enforcement actions if necessary, maintaining a national registry of state-licensed and certified appraisers and appraisal management companies (AMCs), and maintaining a national appraisal complaint hotline. The ASC also monitors and makes grants to the Appraisal Foundation (the Foundation), which is a private, non-profit corporation, composed of real estate industry groups and government agencies, that has Congressional authority to set certain minimum appraisal standards and qualifications. The Foundation is funded through grants from the ASC as well as proceeds from the sale of educational materials.

Statistics show that the appraisal industry is struggling to recruit new, younger professionals. According to the Appraisal Institute, only 3 percent of professionals have less than 1 year of experience, only 4 percent have 1 - 2 years of experience, and only 4 percent have between 3 - 4 years of experience.[5] Further, 52 percent of professionals are age 51 or older, and just 10 percent are age 26 or younger.[6] Statistics on racial and gender diversity in the appraisal industry suggest that the industry does not reflect the demographics of the United States. According to the Appraisal Institute, there are roughly 82,000 appraisers in the U.S. with nearly 90 percent of appraisers identifying as white, 4 percent as Latino, and 3 percent as Black.[7] Moreover, 75 percent identify as male and 25 percent as female.[8]

De Minimus Threshold for FRTs

As explained above, the federal financial institutions regulatory agencies have created broad exemptions to the definition of FRTs for several categories of real-estate related financial transactions, including transactions at or below designated thresholds.[9] Currently, the threshold for real estate related

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[2] *See* OCC: 12 CFR 34.43(a); Board: 12 CFR 225.63(a); FDIC: 12 CFR 323.3(a).
[3] *See* OCC: 12 CFR 34.43(a)(9) and (10); Board: 12 CFR 225.63(a)(9) and (10); and FDIC: 12 CFR 323.3(a)(9) and (10); NCUA: 12 CFR 722.3(a)(7) and (8).
[4] The ASC is also in the beginning stages of implementing a new fee on AMCs.
[5] Appraisal Institute, "U.S. Valuation Profession Fact Sheet," Dec. 2017.
[6] *Id*.
[7] *Id*.
[8] *Id*.
[9] *See* OCC: 12 CFR 34.43(a); Board: 12 CFR 225.63(a); FDIC: 12 CFR 323.3(a).

transactions is $250,000. In May 2018, Congress passed the "Economic Growth, Regulatory Relief, and Consumer Protection Act," introduced by Senator Crapo (S.2155), which included a provision that lifted the de minimus threshold to $400,000 only if the property is in a rural area, the lender has contacted at least three appraisers in the market area, and the lender has documented that no appraiser was available within 5 business days beyond customary and reasonable fee and timeliness standards for comparable assignments.[10] In December 2018, the OCC, Board, and FDIC published a proposed regulation that would lift the de minimus threshold to $400,000 for all transactions without exceptions. They estimate that the proposed rule would have exempted an additional 214,000 residential real estate originals which represent 3 percent of total HMDA originations and 16 percent of regulated transactions.[11] Implementation of the proposed rule would mean that the housing finance system would rely more heavily on Fannie Mae, Freddie Mac, and the FHA to ensure that appraisals are required for most mortgage loans. But this reliance is already being tested with Fannie Mae and Freddie Mac both taking steps to expand exemptions from appraisal requirements for certain loans.[12]

The National Consumer Law Center and other advocates raised several concerns with the proposed regulation in a comment letter, including the lack of data on foreclosure rates to understand the potential impact on consumers, the lack of any fair housing analysis, and the inherent contradiction with Congressional intent when S.2155 so recently provided very narrow circumstances under which the threshold could be lifted to $400,000. The Appraisal Institute and other industry groups also opposed the proposed rule, asserting that there is no justification for lowering the threshold, and raising concerns that the "evaluations" that would substitute traditional appraisals in exempted transactions are of questionable value. The National Association of Home Builders and others weighed in in support of the proposed rule as a welcome reduction of regulatory burdens.

Appraiser Independence

In the lead up to the financial crisis, there were serious problems with inflated appraisals, which set consumers up for unnecessary foreclosures, contributed to significant losses by federal entities backing those mortgages, and undermined the safety and soundness of the housing finance system as a whole.[13] These inflated appraisals were in part due to lenders imposing inappropriate pressure on appraisers to hit certain target amounts.[14] In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) included several reforms related to appraisals that were aimed at enhancing federal oversight and establishing new federal requirements governing appraisals, including new requirements around appraiser independence. For example, Dodd-Frank made it explicitly unlawful to: influence an appraiser in the pricing of a transaction; mischaracterize the appraised value of the property; withhold or threaten to withhold timely payment for an appraisal report or services rendered when the report or services are provided for in accordance with the contract between the parties; or have any direct or indirect financial or other interest in the property being appraised if you are an appraiser or appraisal management company (AMC).[15]

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[10] Section 103 of S. 2155 from the 115th Congress
[11] OCC: RIN 1557-AE57; Board: RIN 7100-AF30; FDIC: RIN 2063-AE87
[12] *See. e.g.* Fannie Mae press release, "Fannie Mae Announces Day 1 Certainty Initiative," Oct. 24, 2016.
[13] *See. e.g.* Jennifer S. Wagner, Testimony before the Subcommittee on Housing and Insurance, Committee on Financial Services, Nov. 16, 2016
[14] *Id*.
[15] P.L. 111-203 Section 1472

Subsequent regulations issued by the federal financial institutions regulatory agencies implementing provisions in Dodd-Frank on appraiser independence require lenders to separate their loan officers from the staff that selects appraisers.[16] In order to comply with these requirements, lenders typically rely on AMCs to select appraisers to ensure separation of staff. However, AMCs are not always independent companies and are sometimes wholly owned by lenders who rely on them, raising questions about whether the independence of appraisers is truly being preserved. Although lenders are not allowed to interfere with appraisers, real estate agents can and do engage with appraisers, and some appraisers have raised concerns about undue pressure from real estate agents.[17] A number of empirical studies have demonstrated that appraisals tend to be biased upwards, and over 90 percent of the time, either confirm or exceed the associated contract price.[18] Some appraisers argue that federal standards for conducting appraisals require that appraisers look at the contract price as part of their evaluation and that it is reasonable for the appraisal to confirm the contract price in a majority of cases particularly in the context of a strong housing market because the buyer's willingness to pay is an important indication of the value.[19] Advocates like NCLC generally report that Dodd-Frank and corresponding regulations have been effective at eliminating the kind of fraud and inappropriate pressure that we saw in the lead up to the crisis,[20] but questions remain about whether further steps are needed to better preserve appraiser independence.

Disparities in Home Values in Minority Communities

A 2018 study by the Brookings Institute found that in the average metropolitan area, homes in neighborhoods where the share of the population is 50 percent black are valued at roughly half the price as homes in neighborhoods with no black residents.[21] Further, the study found that differences in home and neighborhood quality do not fully explain the disparities in property values.[22] Specifically, the study found that "homes of similar quality in neighborhoods with similar amenities are worth 23 percent less in majority black neighborhoods, compared to those with very few or no black residents" and "across all majority black neighborhoods, owner-occupied homes are undervalued by $48,000 per home on average, amounting to $156 billion in cumulative losses."[23] William Pittenger, a former bank regulator and Chief Appraiser for a bank based in Florida, who has explained that, "part of the problem is that suburban property standards dominate the appraisal industry and can lead to gross misinterpretations of life in a racially diverse urban setting. As late as the 1970s, the guidebooks used to train appraisers included very specific instructions to lower the value of homes in African-American and Latino neighborhoods. While that kind of overt racism is now illegal, more subtle biases still exist."[24]

The Role of Technology in Appraisals

Emerging technologies within the appraisal market, such as report templates that catalogue and auto-populate certain data fields as well as big data capabilities that allow for enhanced searchability and

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[16] FIL-82-2010 "Interagency Appraisal and Evaluation Guidelines," Dec. 2010.
[17] WorkingRE, "Appraiser Pressure: What Agents/Brokers Need to Know about Filing Complaints"
[18] *See e.g.* FHFA, "Appraisal Accuracy, Automated Valuation Models, and Credit Modeling in Rural Areas," Apr. 2018.
[19] *See e.g.* The Appraiser Coach, "Why Most Appraisals SHOULD come in Just Above the Purchase Price,"
[20] Jennifer S. Wagner, Testimony before the Subcommittee on Housing and Insurance, Committee on Financial Services, Nov. 16, 2016
[21] The Brookings Institute, "The Devaluation of Assets in Black Neighborhoods: The Case of Residential Property," Nov. 2018.
[22] *Id.*
[23] *Id.*
[24] CityLimits.org, "Cityview: The Price is Wrong," March 1, 1997

predictive analytics, have streamlined the report writing process and increased productivity for practitioners as well as entities that rely on appraisal data. The role of technology can also be important in recruiting, training, and retaining younger and diverse professionals. Automated valuation models (AVMs), which are computerized models to determine the collateral worth of a mortgage, are increasingly common and they in various forms that differ primarily based on the kinds of data inputs used and the algorithms used to process that data. AVMs are often used to supplement traditional appraisals, but under Dodd-Frank, are not allowed to substitute or be the sole basis for an appraisal if an appraisal is required. For transactions that are exempt from a requirement to obtain a traditional appraisal, lenders may rely on AVMs exclusively. With the expansion of, and proposed expansions of, transactions that are not required to obtain a traditional appraisal, there are growing concerns about the accuracy of AVMs as standalone valuations.[25]

Legislative Proposals

- H.R. 2852, the "Homebuyer Assistance Act of 2019," introduced by Rep. Sherman (D-CA) would allow licensed appraisers to conduct appraisals for FHA-backed mortgages, rather than only certified appraisers. This would bring FHA standards in line with those set by Fannie Mae and Freddie Mac and help alleviate appraiser shortages in certain areas. This bill would also set minimum requirements for education specific to FHA appraisals that appraisers must undergo to be eligible to conduct FHA appraisals.

- MAJ_01. This discussion draft would provide the ASC with increased flexibility to set fees assessed on AMCs and increased flexibility in allocating the proceeds of such fees. It would also allow trainee appraisers to be added to a national registry.

[25] William E. Garber, Testimony before the Subcommittee on Housing and Insurance, House Committee on Financial Services, Nov. 16, 2016.