Testimony of
David S. Bunton, President
The Appraisal Foundation

What's Your Home Worth? A Review of the Appraisal Industry

U.S. House of Representatives
Committee on Financial Services
Housing, Community Development, and Insurance Subcommittee

June 20, 2019

1155 15th Street NW
Suite 1111
Washington, DC 20005
202-347-7722
www.appraisalfoundation.org

(this page intentionally left blank)

INTRODUCTION

Mr. Chairman and members of the Subcommittee, The Appraisal Foundation greatly appreciates the opportunity to appear before you today to offer our perspective on the regulation of real estate appraisers and the future of the profession.

There are many misconceptions about the Foundation and let me begin by stating that the Foundation is <u>not</u>:

- a government agency or regulatory body;
- created by Congress;
- an appraisal trade association.

Rather, the Foundation:

- is a non-profit 501(c)(3) educational organization;
- was founded by eight national appraisal organizations 32 years ago;
- sets standards of excellence, promotes education and upholds the public trust
- serves as an umbrella organization comprised of approximately 100 organizations and government agencies with an interest in valuation (Attachment 1);
- was created to foster professionalism in appraising;
- strives for excellence, consistency, unity and trust in the valuation profession.

We provide private sector expertise in the real property appraiser regulatory system. The Foundation was given specific authority by Congress in 1989 (Title XI of FIRREA) regarding the real property appraiser regulatory system. The Foundation does not have any regulatory authority, but it provides tools for the regulatory community. Specifically:

- individuals seeking to become a trainee appraiser, supervisory appraiser, state licensed or certified appraiser must meet the minimum qualification requirements established by the Foundation's Appraiser Qualifications Board (AQB);
- all states and territories must use licensing and certification examinations either issued or endorsed by the Foundation's AQB; and
- all state licensed and certified real estate appraisers must adhere to the *Uniform Standards of Professional Appraisal Practice* (standards of conduct) written by the Foundation's Appraisal Standards Board.

On behalf of the Foundation, as a fair, impartial, and objective resource on valuation-related issues, thank you for the opportunity to address the specific topics on which you are seeking our perspective.

OVERVIEW

This year marks the 30th anniversary of the adoption of the *Financial Institutions Reform, Recovery, and Enforcement Act* (FIRREA or Act) in which Congress ushered in groundbreaking reforms to ensure the safety and soundness of the federal financial deposits and heighten consumer protections. Title XI of FIRREA created the appraiser regulatory structure and required appraisers to meet qualifications and follow national uniform standards of practice set by The Appraisal Foundation (Foundation) and its Boards. At the time Title XI was adopted, the intent was that all mortgage transactions backed by the federal government came under the protections of the Act.

In the ensuing three decades, all U.S. jurisdictions set up appraiser licensing and enforcement agencies. They work to ensure that those who hold a real property appraiser credential are qualified and perform appraisals in accordance with professional standards. Currently, there are approximately 75,000 licensed and certified appraisers across the United States who are trained to competently and ethically perform appraisal assignments.

The qualification criteria to become an appraiser is more robust today with structured appraisal-specific education, practical experience, and a uniform, national examination in place to gauge minimum qualifications for those valuing the world's largest economy. Likewise, the *Uniform Standards of Professional Appraisal Practice* (USPAP) is viewed as the gold standard globally. USPAP has been successfully tested in our legal system by being the cornerstone of numerous regulatory and court decisions regarding valuation. Lenders and consumers have assurance that appraisals performed to the standards are fair, impartial, and objective, and completed without bias.

We applaud the recent bipartisan efforts of Congress to once again allow state licensed appraisers to perform appraisal assignments for Federal Housing Administration (FHA) loans. With similar bills pending in the House and Senate, we encourage your support for swift passage.

But, all is not well. The last thirty years were also witness to federal agencies doing their best to circumvent using these trained professionals. Likewise, the government sponsored enterprises are taking on riskier practices that leave appraisal protections on the sidelines. Through exemptions, appraisal waivers, promoting evaluations in lieu of appraisals, and encouraging lenders to use unlicensed individuals, the federal financial institutions regulatory agencies estimate that a mere 10 to 15 percent of all mortgage transactions backed by the federal government and U.S. taxpayers are currently subject to the protections Congress enacted through Title XI.

SPECIFIC TOPICS OF DISCUSSION REQUESTED BY THE SUBCOMMITTEE

The *De Minimus* Threshold and Federally Related Transactions

The *De Minimus* Threshold

In the summer of 1990, three years after the enactment of FIRREA, the federal financial regulatory agencies developed their appraisal regulations, including setting the *de minimus* threshold, below which real estate transactions would not have to be appraised by a state licensed or certified appraiser. The initial *de minimus* threshold was set by the agencies at $50,000, with the exception of the Federal Reserve Board, which set its threshold at $100,000.

In June of 1994, the federal financial regulatory agencies increased the *de minimus* to $250,000 for residential real estate transactions. Currently, there is a pending proposal to increase the *de minimus* once again to $400,000.

We strongly oppose an increase because it would further dilute the intent of Title XI of FIRREA. We are far from alone in this belief. The overwhelming majority of comment letters received by the agencies about the proposal were in opposition to the increase, and several commenters requested the agencies to hold a hearing on this topic. Unfortunately, the agencies declined to hold such a hearing. Title XI was put in place to ensure the safety and soundness of our deposit insurance fund. The value of the underlying collateral in a lending transaction needs to be determined by a professionally trained appraiser who adheres to performance standards and is credentialed by a state.

The impact of such an increase is enormous. The median existing-home price for all housing types in April was $267,300, according to the most recent report from the National Association of Realtors. A $400,000 *de minimus* would exempt most residential mortgage transactions. An individual's primary residence is often their single largest investment and neither lenders nor borrowers would be afforded the protection of having a trained professional determine whether an appropriate price is being paid for a property.

As stated above, when a loan amount is below the established *de minimus* threshold, financial institutions are not required to obtain an appraisal. In these transactions, lenders utilize alternatives to appraisals, which they call ***evaluations***. Evaluations have many similarities to appraisals, but there are some differences with respect to development and reporting (Attachment 2). In addition, there are some key distinctions between appraisals and evaluations. First, there are no codified requirements addressing the development and reporting for evaluations. The federal financial institutions have developed guidance[1], but a recent ruling underscored that such guidance is simply that, and is not enforceable.[2]

There are also no codified qualification requirements for individuals providing evaluations. The guidance does include some very generic references about qualifications, saying the individual *should* have appropriate education and experience to perform the evaluation. However, as stated above, this guidance is not binding and is unenforceable.

Because the guidance on evaluations does not require an individual to possess a credential of any type, there is no public accountability similar to what exists for individuals performing appraisals. If someone performing an evaluation failed to do so ethically and competently, there is nothing that would hold the individual responsible for such actions.

Recommendations:

- **Set parameters for the agencies to abide by when setting the threshold amount.**
    - Set a cap on the threshold amount that is well *below* the median home sales price.
    - Restrict the use of the threshold exemption to transactions where the loan to value ratio is less than 70 percent.
    - Require that the threshold exemption may only be used when the lender is going to hold the note for the term of the loan.

- **Codify requirements for the agencies' use of evaluations**
    - If lenders continue to utilize alternatives to appraisals (i.e., evaluations), require the use of credentialed appraisers in these transactions.
    - Require evaluations to be performed in compliance with USPAP.

Federally Related Transactions

Related to the *de minimus* is the issue of what constitutes a federally related transaction. When Congress passed FIRREA, the intent was that most residential mortgage transactions would be considered federally related transactions and thus come under the protections established by the Act.

In the early 1990s, the federal financial regulatory agencies adopted a series of regulations that resulted in 13 instances where a transaction is no longer considered a federally related transaction (Attachment 3). These "carve outs" greatly reduced the

[1] *Interagency Appraisal and Evaluation Guidelines*, December 2010
[2] *Interagency Statement Clarifying the Role of Supervisory Guidance*, September 2018

number of federally related transactions. Staff of these agencies have estimated that fewer than 15 percent of residential mortgage transactions come under the current definition of federally related transactions.

The agencies recently made their position clear that transactions coming under the term were limited. In a May 17, 2017 letter to the Association of Appraiser Regulatory Officials (AARO), they outlined the numerous exemptions to transactions that come under the definition (Attachment 4). Individuals involved in the appraiser regulatory system were alarmed to learn that they were operating under the false impression that the majority of residential mortgage transactions are federally related.

By raising the *de minimus* and very narrowly defining what constitutes a federally related transaction, the intent of Title XI of FIRREA has been eviscerated.

Recommendations:

- **Clarify the definition of "federally related transaction" to include all residential mortgage transactions that are backed by the federal government and thus American taxpayer.** While it seemed reasonable to give the agencies the ability to exempt certain transactions, the decimation of the term by agency regulation is clearly an abuse of power and disregards the Congressional intent of FIRREA.

- **Require all transactions involving Government Sponsored Enterprises (GSEs) to utilize state licensed or certified appraisers, and require USPAP-compliant appraisals for those transactions.** Because the GSEs are not statutorily mandated to use state credentialed appraisers or comply with USPAP, the lack of a legislative mandate could allow them to change their policies overnight.

Appraiser Independence

The Dodd-Frank Act took some steps to strengthen appraiser independence[3]; however, there is much more that can be done.

Many appraisers can relate experiences from years past of being pressured by lenders to "make the deal" or run the risk of not being compensated or being removed from an "approved appraiser list," prohibiting the appraiser from performing future appraisals for that lender. Appraisers are required to be independent, impartial, and objective, and such antics were obviously met with great disdain. Therefore, upon learning that federal legislation would address appraiser independence, many appraisers felt hopeful that they would be able to practice ethically without facing such intimidation.

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act (2010), revisions to 12 U.S.C. 1639e, 12 U.S.C. 3351, 12 U.S.C. 3353.

While Dodd-Frank included prohibitions against such behavior, it also resulted in a proliferation of Appraisal Management Companies (AMCs). AMCs are companies through which mortgage lenders contract for appraisals, and they are designed to act as a firewall between lenders and appraisers. Conceptually, appraisers were not necessarily opposed to the AMC model, as they foresaw an intermediary that might protect them from lender pressures experienced in the past. However, when appraisers realized that AMCs would be funded by taking a portion of the *appraiser's* fee, the entire system felt the shockwaves. Appraisers who had a track record of performing ethically and competently for many years were now asking, ***"Why do I have to sacrifice my income to avoid facing pressure and intimidation?"***

In addition, borrowers (who pay the appraisal fee when applying for a mortgage) typically have no idea that an AMC is involved in the transaction. A borrower paying a $400 appraisal fee, for example, assumes the appraiser receives that amount. However, the borrower is completely unaware that the AMC receives a share (sometimes a significant one) of that fee. This scenario can also be confusing to a borrower if an appraiser is required to comply with any AMC-specific requirements not imposed by the lender. If the borrower has questions about the appraisal and contacts the lender, the lender might not be able to fully explain why an appraisal was performed in the manner it was.

Another key aspect appearing to fall short of Congressional intent is *enforcement* of appraiser independence requirements. While Dodd-Frank required the creation of an "Appraisal Complaint National Hotline" by the Appraisal Subcommittee[4], the hotline does not track complaints to determine whether alleged violations of appraiser independence actually occurred, whether action was taken, or whether an entity committing such violations revised its policies to avoid future violations. The hotline created provides some valuable information on where complaints can be filed, but without a process to track such complaints through resolution, it is not possible to tell whether any remediation or improvement has occurred. An unscrupulous lender that may not believe change is needed due to lax enforcement could very well continue to operate in that manner. The cumulative effect may result in appraisers feeling pressured or intimidated, causing them to leave the profession and reduce the number of appraisers available to provide valuation services.

Recommendations:

- **Require AMC fees to be paid by the lender** – Lenders are not required to use AMCs. Lenders may satisfy appraiser independence requirements by establishing an internal firewall within their institutions. Lenders wishing to "outsource" this function to AMCs should bear the burden of this cost, not pass it on to the appraiser. In the past, lenders paid the full fee to appraisers.

[4] Dodd-Frank Wall Street Reform & Consumer Protection Act (2010), revisions to 12 U.S.C. 3351

- **Require AMC fees to be identified separately in closing documents** – Borrowers paying an “appraisal” fee should have the right to know exactly where that fee goes.

- **Require mandatory tracking and reporting related to complaints of violations of appraiser independence** – To accurately gauge the effectiveness of appraiser independence requirements, it is necessary to evaluate complaints to determine if violations occurred, and what steps were taken to remediate such actions.

<u>The Impact of Technology on the Appraisal Profession</u>

Technological advances in the appraisal profession offer the opportunity to streamline the valuation process and make it more efficient and less costly. However, these new technology programs have their limitations, and we should never lose sight of the fact that accurate appraisals are the basis of the public’s trust in the valuation profession.

Recognizing the role of professional appraisals in promoting the public trust, Congress passed Title XI of FIRREA in 1989. It tasked The Appraisal Foundation with the creation of appraiser qualifications and standards that are designed to lead to independent and reliable appraisals performed according to ethical guidelines.

Since the passage of Title XI, we have seen the advent of “big data” and evolving technology, and the introduction of Alternative Valuation Products, including Automated Valuation Models (AVMs). Some individuals believe a computer can provide an equally “accurate” opinion of value to appraisers. As these technologies become more refined, it’s likely that, in certain cases, that may be true.

In areas with extremely homogenous housing and ample sources of market data, a well-written AVM may be an appropriate way to analyze the collateral on a relatively low-risk loan. Estimates of real property value can be determined by computer, taking into account the number of bedrooms and bathrooms in a home, square footage, property size, and other objective factors.

However, there are many markets consisting of properties with varying ages, construction quality, condition, renovation levels, lot sizes, view amenities, etc.—not to mention special financing arrangements or seller concessions. It is in these markets where a professional appraiser is needed to apply the type of judgment that a computer cannot replicate. While a computer can do a great job of “crunching” numbers, its output is only as good as its input. If the information required to properly analyze market activity is not entered by a trained professional with a solid understanding of the marketplace, the ensuing results may be suspect. (See Attachment 5, “Why Appraisers Matter”)

In summary, human appraisers, working with the tools of technology, are needed to determine the overall appeal and market value of a property. The consequences of an inaccurate or incomplete appraisal are significant and can impact the purchaser, as well as, in the case of federally backed mortgages, the federal government and the taxpayer. Paying a purchase price that exceeds the value of a property based on an inflated appraisal can cost consumers thousands of dollars and potentially lead to a default.

Despite our concerns, we recognize that technology has its place in the future of the valuation profession and we embrace it when it doesn't compromise public trust. For example, Dodd-Frank directed federal regulators in 2010 to work with The Appraisal Subcommittee and the Foundation to develop standards for AVMs[5]. Nine years later, regulators have not reached out to the Foundation to do this work; however, we are anxious to be helpful in this regard.

Technology has allowed Fannie Mae and Freddie Mac to aggregate the data appraisers have produced for their mortgage loans over many years, resulting in one of the most significant databases ever created related to residential real estate. Sharing that data with appraisers would give them more information and enable them to develop an accurate appraisal more quickly and efficiently.

The Foundation is using technology to address a lack of certified appraisers willing to supervise trainees in rural areas. Congress shares the belief that we need to recruit more appraisers to alleviate long delays in many regions of the country. As a result, we are creating the Practical Applications of Real Estate Appraisal (PAREA) program to help alleviate the problem many trainees have experienced, where they have been unable to find supervisors to oversee their practical experience requirements. This program uses technology to provide practical experience in a simulated environment. PAREA is in the early stages of development and we hope to identify a dedicated funding source to bring it to market.

We look forward to working with Congress, our regulators, stakeholders, and the appraisal profession to take full advantage of technology in a way that advances the industry and promotes the public trust.

Recommendations:

- **Contact the Federal financial institution regulatory agencies to seek an explanation for the nine-year delay in establishing quality control standards for AVMs and a timeline for the completion of the draft standards**.

- **Direct the Federal Housing Financing Authority (FHFA), the overseer of Fannie Mae and Freddie Mac, to make their residential databases available to appraisers in good standing, incorporating all the necessary privacy safeguards.** Appraisers collectively supply the data to these databases and it is critical to give them access.

[5] Dodd-Frank Wall Street Reform & Consumer Protection Act (2010), revisions to 12 U.S.C. §3354

Diversity in the Appraisal Profession

Diversity within the appraisal profession does not reflect the racial composition of the U.S. proportionately. A recent survey conducted by The Appraisal Foundation found that 73 percent of respondents identified as male while 23 percent identified as female. 90 percent identified as Caucasian, 4 percent identified as Hispanic or Latino, 2 percent identified as Black or African American, and 1 percent identified as Asian. The findings of this survey were similar to other surveys conducted by various appraisal organizations.

The Foundation realizes there is much to be done to increase diversity in the profession. We are committed to working with our affiliated organizations to ensure that the appraisal profession reflects the broad diversity of consumers reliant on valuation services.

The Foundation is pleased to report increased gender diversity on our Board of Trustees (BOT) and our two independent boards, the Appraiser Qualifications Board (AQB) and the Appraisal Standards Board (ASB). For the first time in the 32-year history of the Foundation, the ASB is majority female. The BOT is 33 percent female. Both of these boards exceed the percentage of women in the appraisal profession.

The Foundation actively participated in International Women's Month in March by profiling our women leaders in industry trade publications and highlighting why a career in appraising is a good choice for women. The Foundation understands that when creating gender and racial diversity, it must be an intentional effort. The Foundation committed to greater gender diversity several years ago, and we are seeing the fruits of those efforts now.

Another Foundation project that may help to increase racial diversity within the appraisal profession is our Veterans Outreach Initiative. This past May, we developed a resource webpage that provides veterans with information about a career in appraising and a network of Appraisers who are veterans. Brad Swinney, U.S. Army Veteran and member of the AQB, recently noted, "We firmly believe that warriors who protected the greatest nation make for proud guardians of the public trust through valuation, which helps protect the greatest economy in the world." Since the page has launched, the response from appraisers who are veterans wanting serve on the network and veterans looking to speak with appraisers has surpassed our expectations.

Pew Research recently found that as the United States of America has become more racially and ethnically diverse, so too has the U.S. military. The research found that racial and ethnic minority groups made up 40 percent of Defense Department active-duty military in 2015; up from 25 percent in 1990. As the most racially and ethnically diverse class of veterans are returning home and transitioning to a new career, we want them to consider the benefits of becoming an appraiser.[6]

While our veterans' outreach activities will help reach a racially and ethnically diverse audience, we continue to explore additional avenues. The AQB established a review program for college degrees in real estate. Under this program, the AQB analyzes real estate-related degrees, at no cost to the school, to determine how the education required to obtain a degree can be applied to the *Required Core Curriculum* in the *Real Property Appraiser Qualification Criteria*. State appraiser regulatory agencies use this information when reviewing the educational qualifications of applicants that hold such degrees. To date, the AQB has analyzed 20 undergraduate and graduate programs. The AQB is working to expand its real estate degree review program to colleges with large student populations of veterans as well as to historically black colleges and universities.

The Foundation is also engaged in activities to reach first-time and low-income homebuyers. To help demystify the appraisal process, the Foundation created a homebuyer educational module titled, "What Every Homebuyer Should Know About an Appraisal." The Foundation developed this program to assist presenters of first-time homebuyer education classes around the country. It includes vital information and resources for consumers on what an appraisal entails, how an appraiser determines value, and how to interpret an appraisal report. This information and our other consumer resources should help homebuyers not fall victim to predatory lending schemes – schemes that disproportionally targeted racial and ethnic minorities during the years leading up to the financial crash in 2008. We are pleased that these modules are being used by national affordable housing organizations.

Much of these efforts are due to our long-standing relationship with the National Society of Real Estate Appraisers (NSREA), the largest trade organization representing African American real estate appraisers. NSREA is a member of The Appraisal Foundation Advisory Council (TAFAC). TAFAC member organizations represent various professions and occupations with an interest in valuation including appraisers, home builders, real estate brokers, financial institution regulators, federal land acquisition agencies, the secondary mortgage market, and the private mortgage insurance industry.

While these programs have seen some successes, the valuation profession must do more to increase diversity among appraisers**. The Foundation is committed to working jointly with the professional appraisal organizations to continue efforts to increase minority participation in the valuation profession and to enhance protections for minority homebuyers, and to identify more ways to achieve those goals.**

---

[6] Parker, K, Cilliuffo, A., & Stepler, R., (2017, April 13) 6 Facts about the U.S. military and its changing demographics. Pew Research Center, Fact Tank. Retrieved June 17, 2019 from https://www.pewresearch.org/fact-tank/2017/04/13/6-facts-about-the-u-s-military-and-its-changing-demographics/

Performing Appraisals without Bias

To comply with the *Uniform Standards of Professional Appraisal Practice* (USPAP), appraisers are required to be independent, impartial, and objective, and to perform assignments without bias. An appraiser failing to comply with these basic tenets of fairness and equality would be in violation of the ETHICS RULE in USPAP, which is the most significant breach an appraiser could commit. Such a violation would likely result in the revocation or required surrender of an appraiser's credential.

Due to the importance of this issue, the Appraisal Standards Board (ASB) of The Appraisal Foundation has developed strict prohibitions in USPAP to which appraisers must adhere. The ASB has also developed guidance designed to ensure appraisers understand how to comply with these fundamental obligations. Addressing this point, the Conduct section of the ETHICS RULE in USPAP states:

> ***An appraiser must not use or rely on unsupported conclusions relating to characteristics such as race, color, religion, national origin, gender, marital status, familial status, age, receipt of public assistance income, handicap, or an unsupported conclusion that homogeneity of such characteristics is necessary to maximize value.***

To ensure appraisers clearly understand this prohibition, the ASB published Advisory Opinion 16, *Fair Housing Laws and Appraisal Report Content*. This guidance, which can be found in the USPAP publication, states, in part:

> ***Fair housing law(s) preclude the use of certain specific information or supported conclusions related to protected group(s) in some assignments. Accordingly, an appraiser should be knowledgeable about the laws that affect the subject property of an assignment. Laws and regulations on fair lending and fair housing (such as the Fair Housing Act; the Equal Credit Opportunity Act (ECOA), and the laws and regulations of applicable federal, state, and local jurisdictions) continue to evolve. Further, appraisers must continue to provide appraisals that do not illegally discriminate or contribute to illegal discrimination.***

Thus, appraisers complying with USPAP do **not** produce unfair or discriminatory valuations.

In some cases, when an appraiser's opinion of value is questioned, there are some who mistakenly believe the appraiser "sets the value" for the property. However, this could not be further from the truth. When providing opinions of *market value*, the very premise is that the appraiser is simply *reflecting* the actions in the marketplace, not determining them. An excerpt of the definition of *market value* used by federally regulated financial institutions specifically requires the appraiser to recognize actions in the marketplace:

"The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus."

Further characteristics of that definition underscore that the appraiser's opinion of market value is to be based exclusively on the actions of the marketplace:

- *Buyer and seller are typically motivated*
- *Both parties are well informed or well advised, and acting in what they consider their own best interests*
- *A reasonable time is allowed for exposure in the open market*
- *The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale*

With respect to Fair Housing, USPAP Advisory Opinion 16 recognizes an appraiser's obligation to accurately reflect the actions of the marketplace, and cautions the appraiser:

> ***An appraiser should research the actions of participants in the subject's market to identify factors having a direct favorable or unfavorable influence on marketability or value. Failure to extract pertinent market information (e.g., sales, rents, occupancy rates, expense ratios, capitalization or discount rates, construction costs, depreciation, or exposure times) from the subject's market could produce conclusions that are misleading and/or illegally discriminatory.***

Therefore, appraisers are required to base their analyses, opinions, and conclusions on the actions of the marketplace, and are prohibited from developing conclusions that could be discriminatory.

Recommendation:

- **Require compliance with USPAP** – As stated previously, appraisers complying with USPAP do not produce unfair valuations. However, there are some who are advocating that not all valuation assignments need to be performed in compliance with USPAP. Allowing valuations to occur without the obligations for ethical and competent practice set forth in the battle-tested USPAP standards creates a possibility for unfair or discriminatory valuations.

CONCLUSION

As we observe the 30th anniversary of Title XI, there is much to celebrate. The Act created a regulatory system designed to ensure that real estate appraisals are conducted in a way that is fair, objective, impartial and ethical. It helps protect the integrity of the deposit insurance system and promote public trust in real estate appraisals. Over the decades, it has advanced professionalism through robust education, training and testing. The real estate appraisal profession is stronger than ever, and this has been achieved without the use of appropriated funds.

However, as we have outlined in this testimony, the intent of the law has not been fully realized. Congress' intent and the law's potential have been circumvented by regulatory exemptions, waivers and other actions that have kept a majority of residential real estate transactions outside of its protections. Our testimony includes recommendations on how we propose to correct this.

The Appraisal Foundation appreciates the opportunity to share our perspectives with you today and we urge this Subcommittee and all members of Congress to continue to use the Foundation as a resource on valuation-related matters.

The Appraisal Foundation

Authorized by Congress as the Source of Appraisal Standards & Appraiser Qualifications

The Appraisal Foundation Advisory Council:

ORGANIZATIONS OF APPRAISERS

American Society of Appraisers *
American Society of Farm Managers and Rural Appraisers *
Appraisers Association of America *
Association of Independent Mortgage Experts
Association of Machinery and Equipment Appraisers
Association of Texas Appraisers
Canadian National Association of Real Estate Appraisers
Columbia Society of Real Estate Appraisers *
Equipment Appraisers Association of North America
Illinois Coalition of Appraiser Professionals
Instituto de Evaluadores de Puerto Rico *
International Association of Assessing Officers *
International Right of Way Association *
International Society of Appraisers *
Maryland Association of Appraisers
Massachusetts Board of Real Estate Appraisers *
Midwest Appraisers Association
National Association of Appraisers
National Society of Real Estate Appraisers
North Carolina Professional Appraisers Coalition *
North Carolina Real Estate Appraiser Association
Ohio Coalition of Appraiser Professionals
Real Estate Valuation Advocacy Association
Royal Institution of Chartered Surveyors
South Carolina Professional Appraisers Coalition *
Virginia Coalition of Appraiser Professionals
West Virginia Council of Appraiser Professionals

USERS OF APPRAISALS

American Bankers Association *
American Institute of Certified Public Accountants
Conference of State Bank Supervisors
Counselors of Real Estate
Farm Credit Council *
Federal Agricultural Mortgage Corporation
Institute for Professionals in Taxation
Mortgage Bankers Association
National Association of Federal Credit Unions
National Association of Home Builders
National Association of Mortgage Brokers
National Association of Realtors *
National Auctioneers Association
National Council of Real Estate Investment Fiduciaries
Relocation Appraisers & Consultants
Worldwide ERC

GOVERNMENT AGENCIES AND ORGANIZATIONS

Association of Appraiser Regulatory Officials
Fannie Mae
Federal Highway Administration
Federal Transit Administration
Freddie Mac
General Services Administration
Internal Revenue Services
US Department of Agriculture, Farm Service Agency
US Department of Agriculture, Forest Service
US Department of Agriculture, Natural Resources Conservation Service
US Department of Agriculture, Rural Development
US Department of Energy, Bonneville Power Administration
US Department of Housing and Urban Development
US Department of Justice
US Department of the Army
US Department of the Interior, the Office of Valuation Services
US Department of the Navy
US Department of Veteran Affairs

**Also a Sponsoring Organization of The Appraisal Foundation*

05/07/19

The Appraisal Foundation

Authorized by Congress as the Source of Appraisal Standards & Appraiser Qualifications

The Appraisal Foundation Industry Advisory Council:

FOR-PROFIT ORGANIZATIONS

Allstate Appraisal
Amrock
AVMetrics
Bank of America
BBG
CBRE
Clarocity Corporation
Cushman & Wakefield
CoreLogic|FNC, Inc.
First American Mortgage Solutions, LLC
Genworth Mortgage Insurance Corporation
HouseCanary
JPMorgan Chase
JLL Valuation & Advisory, LLC
Lowery Property Advisors
LW Hospitality Advisors
Miller Samuel, Inc.
Morgan Stanley Mortgage Capital
Mortgage Information Services
National Association of Jewelry Appraisers
Newmark Knight Frank Valuation & Advisory
OnCourse Learning
PCV Murcor Real Estate Services
PNC Bank
Property Sciences Group
Pro-Teck Services
Prudential Financial
Servicelink
Solidifi
Stewart Valuation Services
TrUnion Appraisal Services
Valbridge Property Advisors
Valuation Vision
Weichert Workforce Mobility
Wells Fargo Bank
William Fall Group

05/07/19

Item	*Evaluation*	*Appraisal Report*	*USPAP Cite*
Evaluator must be unbiased	✓	✓	SR 2-3
Evaluator must be independent and have no direct, indirect, or prospective interest, financial or otherwise, in the property or the transaction	✓	✓	SR 2-3 NOTE: USPAP allows an interest if disclosed
Identify the Client		✓	SR 2-2(a)(i)
State the Intended Use		✓	SR 2-2(a)(ii)
Description of the Property, and its Current and Projected Use	✓	✓	SR 2-2(a)(iii) SR 2-2(a)(ix)
State the Interest Being Appraised		✓	SR 2-2(a)(iv)
Estimate property's *market value* in its actual condition, use and zoning as of the effective date, with any limiting conditions	✓	✓	SR 2-2(a)(v) SR 2-2(a)(vi) SR 2-2(a)(viii)
Describe methods used to confirm the property's actual physical condition and the extent to which an inspection was performed	✓	✓	SR 2-3 NOTE: The certification addresses the level of inspection performed and by whom
Describe the analysis that was performed and the supporting information that was used in valuing the property	✓	✓	SR 2-2(a)(vii) SR 2-2(a)(viii)
Explain the exclusion of the sales comparison, cost, or income approaches		✓	SR 2-2(a)(vii)

Item	*Evaluation*	*Appraisal Report*	*USPAP Cite*
Describe the supplemental information that was considered when using an analytical method or technological tool	✓	✓	SR 2-2(a)(viii)
Indicate all sources of information used in the analysis, as applicable, to value the property including: – External data sources (such as market sales databases and public tax and land records); – Property-specific data (such as previous sales data for the subject property, tax assessment data, and comparable sales information); – Evidence of a property inspection; – Description of the neighborhood; or – Local market conditions.	✓	✓	SR 2-2(a)(vii) SR 2-2(a)(viii)
If an opinion of highest and best use was developed, summarize the support and rationale for that opinion		✓	SR 2-2(a)(x)
Clearly and conspicuously state all extraordinary assumptions and hypothetical conditions used, and state that their use might have affected the assignment results		✓	SR 2-2(a)(xi)
Include information on the preparer when an evaluation is performed by a person, such as the name and contact information, and signature (electronic or other legally permissible signature) of the preparer	✓	✓	SR 2-3

§ 323.3 Appraisals required; transactions requiring a state certified or licensed appraiser.

(a) *Appraisals required.* An appraisal performed by a state certified or licensed appraiser is required for all real estate-related financial transactions except those in which:

(1) The transaction value is $250,000 or less;

(2) A lien on real estate has been taken as collateral in an abundance of caution;

(3) The transaction is not secured by real estate;

(4) A lien on real estate has been taken for purposes other than the real estate's value;

(5) The transaction is a business loan that:

(i) Has a transaction value of $1 million or less; and

(ii) Is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment;

(6) A lease of real estate is entered into, unless the lease is the economic equivalent of a purchase or sale of the leased real estate;

(7) The transaction involves an existing extension of credit at the lending institution, provided that:

(i) There has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the institution's real estate collateral protection after the transaction, even with the advancement of new monies; or

(ii) There is no advancement of new monies, other than funds necessary to cover reasonable closing costs;

(8) The transaction involves the purchase, sale, investment in, exchange of, or extension of credit secured by, a loan or interest in a loan, pooled loans, or interests in real property, including mortgaged-backed securities, and each loan or interest in a loan, pooled loan, or real property interest met FDIC regulatory requirements for appraisals at the time of origination;

(9) The transaction is wholly or partially insured or guaranteed by a United States government agency or United States government sponsored agency;

(10) The transaction either:

(i) Qualifies for sale to a United States government agency or United States government sponsored agency; or

(ii) Involves a residential real estate transaction in which the appraisal conforms to the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation appraisal standards applicable to that category of real estate;

(11) The regulated institution is acting in a fiduciary capacity and is not required to obtain an appraisal under other law; or

(12) The FDIC determines that the services of an appraiser are not necessary in order to protect Federal financial and public policy interests in real estate-related financial transactions or to protect the safety and soundness of the institution; or

(13) The transaction is a commercial real estate transaction that has a transaction value of $500,000 or less.

Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency
National Credit Union Administration

May 17, 2017

Debra Rudd
President
Association of Appraiser Regulatory Officials
13200 Strickland Road
Suite 114-264
Raleigh, North Carolina 27613

Dear Ms. Rudd:

This letter responds to letters from former presidents Nikole Avers and Anne M. Petit, dated August 11, 2015, and June 9, 2016, respectively, to Arthur Lindo, Chairman of the Appraisal Subcommittee (ASC) of the Federal Financial Institutions Examination Council (FFIEC) on behalf of the Association of Appraiser Regulatory Officials (AARO). The questions posed in both letters concern the definitions of "real estate-related financial transaction" and "federally related transaction" in Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Title XI)[1] and implementing regulations (the Appraisal Regulations), adopted by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the National Credit Union Administration (NCUA) (collectively, "the agencies").[2] The ASC has referred these letters to the agencies because the letters concern the Appraisal Regulations.

Congress defined the terms "real estate-related financial transaction" and "federally related transaction" in Title XI.[3] The agencies' Appraisal Regulations, consistent with the Title XI definition, define the term "real estate-related financial transaction" as any transaction involving:

> (1) the sale, lease, purchase, investment in or exchange of real property, including interests in real property, or the financing thereof;
> (2) the refinancing of real property or interests in real property; or
> (3) the use of real property or interests in property as security for a loan or investment, including mortgage-backed securities.[4]

---

[1] Public Law No. 101–73, Title XI, 103 Stat. 511 (1989); 12 U.S.C. § 3331, *et seq.*

[2] See 59 Fed. Reg. 29482 (June 7, 1994); *see also* 12 C.F.R. Part 225 Subpart G (FRB); 12 C.F.R. Part 323, Subpart A (FDIC); 12 C.F.R. §§ 34.41 – 34.47 (OCC); 12 C.F.R. §§ 722.1 – 722.7 (NCUA).

[3] 12 U.S.C. §§ 3350(4) and 3350(5).

[4] 12 C.F.R. § 34.42(i) (OCC); 12 C.F.R. § 225.62(i) (FRB); 12 C.F.R. § 323.2(i) (FDIC); 12 C.F.R. § 722.2(h) (NCUA).

The Appraisal Regulations also carry forward the Title XI language when defining the term "federally related transaction" (FRT) as any real estate-related financial transaction entered into that (1) the agencies, or any of their regulated institutions engage in or contract for; and (2) requires the services of an appraiser.[5] The Appraisal Regulations include categories of real estate-related financial transactions that do not require the services of an appraiser and thus are not FRTs.[6]

The impact of real estate transactions that would be exempt from the appraisal requirements was discussed in the preamble to the Appraisal Regulations issued in 1994. The preamble stated, "[i]n their appraisal regulations, the agencies identify categories of real estate-related financial transactions that do not require the services of an appraiser in order to protect federal financial and public policy interests or to satisfy principles of safe and sound banking. These real estate-related financial transactions are not federally related transactions under the statutory and regulatory definitions. Accordingly they are subject to neither Title XI of FIRREA nor those provisions of the agencies' regulations governing appraisals."[7]

The Appraisal Regulations provide that a real estate-related financial transaction that "is wholly or partially insured or guaranteed by a United States government agency or a United States government-sponsored agency"[8] is exempted and thus not an FRT. The agencies have clarified that this exemption from the definition is intended to cover only those transactions that meet all underwriting requirements of the federal insurer or guarantor, including its appraisal requirements, in order to receive the insurance or guarantee.[9] Similarly, transactions that qualify for sale to or meet the appraisal standards of a U.S. government agency or U.S. government – sponsored agency are exempted from the Appraisal Regulations and, thus, not FRTs.[10]

While the Appraisal Regulations require appraisals only for FRTs, other requirements apply to transactions that meet an exemption. For example, for real estate-related financial transactions at or below the specified dollar thresholds[11] and certain transactions involving existing extensions of credit,[12] the Appraisal Regulations require banking organizations to obtain

---

[5] 12 C.F.R. § 34.42(f) (OCC); 12 C.F.R. § 225.62(f) (FRB); 12 C.F.R. § 323.2(f) (FDIC); 12 C.F.R. § 722.2(e) (NCUA).

[6] 12 C.F.R. § 34.43(a) (OCC) 12 C.F.R. § 225.63(a) (FRB); 12 C.F.R. § 323.3(a) (FDIC); 12 C.F.R. § 722.3(a).

[7] 59 Fed. Reg. 29482 (June 7, 1994).

[8] 12 C.F.R. § 225.63(a)(9) (FRB); 12 C.F.R. § 34.43(a)(9) (OCC); 12 C.F.R. § 323.3(a)(9) (FDIC); 12 C.F.R. § 722.3(a)(7) (NCUA).

[9] See *Interagency Appraisal and Evaluation Guidelines*, 75 FR 77450, 77467 (December 10, 2010) ("Interagency Appraisal Guidelines"); 59 FR 29493 – 29494.

[10] 12 C.F.R. § 225.63(a)(10) (FRB); 12 C.F.R. § 34.43(a)(10) (OCC); 12 C.F.R. § 323.3(a)(10) (FDIC); 12 C.F.R. § 722.3(a)(8) (NCUA).

[11] 12 C.F.R. § 225.63(a)(1) and (5) (FRB); 12 C.F.R. § 34.43(a)(1) and (5) (OCC); 12 C.F.R. § 323.3(a)(1) and (5) (FDIC); 12 C.F.R. § 722.3(a)(1) and (5) (NCUA).

[12] 12 C.F.R. § 225.63(a)(7) (FRB); 12 C.F.R. § 34.43(a)(7) (OCC); 12 C.F.R. § 323.3(a)(7) (FDIC); 12 C.F.R. § 722.3(a)(7) (NCUA).

an evaluation consistent with safe and sound banking practices.[13] Regardless of whether or not a real-estate related financial transaction is a FRT, the agencies expect banks to have policies and procedures for conducting and overseeing appraisals and evaluations that are consistent with the *Interagency Appraisal and Evaluation Guidelines*.

For ease of reference, we have attached the final rule for Real Estate Appraisals published in the Federal Register on June 6, 1994, as well as the *Interagency Appraisal Guidelines*.

Should you have any further questions with regard to this issue, please contact FRB: Gillian Burgess, Senior Counsel, Legal Division, (202) 736-5564; FDIC: Mark Mellon, Counsel, Legal Division, (202) 898-3884; OCC: Mitchell Plave, Special Counsel, Law Department, (202) 649-5490; or NCUA: John Brolin, Senior Staff Attorney, (703) 518-6540.

Sincerely,

Arthur Lindo
Senior Associate Director
Division of Banking Supervision and Regulation
Board of Governors of the Federal Reserve System

for MH

Marianne Hatheway
Deputy Regional Director
Boston Area Office
Division of Risk Management Supervision
Federal Deposit Insurance Corporation

Richard B. Taft
Deputy Comptroller for Credit Risk
Office of the Comptroller of the Currency

Timothy Segerson
Deputy Director
Office of Examination and Insurance
National Credit Union Administration

Attachments:
Federal Register, *Real Estate Appraisals*, Final Rule, June 6, 1994, pages 29482-29503.
Interagency Appraisal and Evaluation Guidelines, December 10, 2010.

[13] 12 C.F.R. § 225.63(b) (FRB); 12 C.F.R. § 34.43(b) (OCC); 12 C.F.R. § 323.3(b) (FDIC); 12 C.F.R. § 722.3(b) (NCUA).

Why Appraisers Matter

Automated valuation models are tools, not solutions.

By John S. Brenan

Because you may be reading this on a laptop, tablet, or smartphone, you already know that today we use technology in ways we never imagined even a few years ago. Who could have dreamed of ordering something online and having it delivered within hours? Now we're anticipating deliveries via driverless cars and flying drones.

With these advances, will computers inevitably replace appraisers when it comes to valuing homes? That question is the subject of much debate. In some limited transactions, an automated valuation model may be used appropriately today instead of an appraisal. Based on the specifics of the property and the transaction details, an appraisal may be unnecessary. For example, I'd be irate if I owned a $2 million home free and clear but had to pay a large fee for an appraisal in order to take out a $50,000 line of credit. However, if I'm looking to buy a $500,000 home with 10 percent down, is it reasonable for a lender to rely on artificial intelligence to determine whether the collateral is adequate? Not likely.

I couldn't agree more with the sentiments of Karen Belita, a data scientist with the National Association of REALTORS®, who wrote in a blog post, "When it comes to online home value estimates, the number one caveat for consumers is that these estimates are not a substitute for formal appraisals, comparative market analyses, and the in-depth expertise of real estate professionals." Bravo. Indeed, AVMs are not appraisals. It's possible that as technology evolves, AVMs may be used to a greater degree. But today, in many cases, an automated valuation is suspect if there is a lack of available data or the property isn't a "cookie cutter." Many of us have checked our own properties against the finding of an AVM and thought, "Yeah, right." When it comes to AVMs, your mileage may vary.

So why aren't automated models more reliable in more transactions? Because *computers* don't buy houses; *people* do. An AVM does a great job of analyzing tangible features such as a property's age, number of bedrooms and baths, square footage, and lot size. However, a property's overall appeal is something that has been, at least to date, extremely difficult to quantify. It's a uniquely human phenomenon; a property's overall appeal reflects a combination of characteristics. While not everyone has the same preferences, some unusual features will likely face significant market reluctance.

But wait, you say, aren't appraisers required by the Uniform Standards of Professional Appraisal Practice to be "independent, impartial, and objective"? Absolutely. Still, appraisers are not machines. They must have relevant data and logic to support their analyses, opinions, and conclusions, but they also incorporate the concept of market value reflecting the interests of consumers who are "typically motivated" and "well-informed."

Recognizing that AVMs play a role in developing an appraisal, the authors of USPAP acknowledge their relevance with respect to their use of regression, adaptive estimation, neural network, expert reasoning, and artificial intelligence. But appraisers remain better than AVMs at recognizing motivations and knowledge levels of market participants.

The output of an AVM is not, by itself, an appraisal. It may become a basis for one if the appraiser believes the output to be credible for use in a specific assignment. *If the appraiser believes it to be credible*. Today, that's a very big "if." So unless and until AVMs can better emulate the human factor, an ethical and competent appraiser remains indispensable.

As published in REALTOR Magazine, September-October, 2018 and accessible at: https://magazine.realtor/news-and-commentary/commentary/article/2018/09/why-appraisers-matter