November 15, 2018

MEMORANDUM TO: Board of Directors

FROM: Doreen R. Eberley
Director, Division of Risk Management Supervision

SUBJECT: Notice of Proposed Rulemaking to Increase the Appraisal Threshold for Residential Real Estate Transactions, Implement the Residential Rural Exemption, and Require Appropriate Appraisal Review

Summary of Recommendation

Staff recommends that the FDIC's Board of Directors approve the attached Notice of Proposed Rulemaking (NPR), entitled *Real Estate Appraisals,* for publication in the *Federal Register* for a sixty-day comment period. The NPR would amend regulations requiring appraisals of real estate for certain transactions. The proposed amendments would create a new definition of residential real estate transaction and increase the threshold for transactions requiring an appraisal from $250,000 to $400,000. Evaluations would continue be required for transactions exempt under the increased threshold.

The NPR also adds the residential rural exemption enacted as section 103 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) to the categories of exemptions under the appraisal regulations and requires an evaluation for such transactions. Finally, the NPR would require institutions to subject appraisals for federally related transactions to appropriate review for compliance with the Uniform Standards of Professional Appraiser Practice (USPAP), as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). If approved, the NPR would be issued jointly by the FDIC, the Board of Governors of the Federal Reserve System (Board) and the Office of the Comptroller of the Currency (OCC) (the Agencies).

I. Background

Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Title XI) requires the Agencies to adopt regulations prescribing standards for appraisals used in connection with federally related transactions within the jurisdiction of each agency. The purpose of Title XI is to protect federal financial and public policy interests in real estate-related transactions by requiring real estate appraisals used in connection with federally related transactions to be performed in writing, in accordance with uniform standards, by appraisers whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. Title XI directs the Agencies to prescribe appropriate standards[1] for Title XI appraisals in connection with federally related transactions under the Agencies' respective jurisdictions. At a minimum, Title XI appraisals must be: (1) performed in accordance with

[1] OCC: 12 CFR 34, subpart C; Board: 12 CFR 225.61(b); 12 CFR part 208, subpart E; FDIC: 12 CFR part 323.

USPAP; (2) written, as defined by the statute; and (3) subject to appropriate review for compliance with USPAP.

Title XI appraisal regulations identify categories of real estate-related financial transactions that do not require appraisals by certified or licensed appraisers in order to protect federal financial and public policy interests or to satisfy principles of safe and sound banking. Transactions that are not required to have Title XI appraisals are not federally related transactions under the statutory or regulatory definitions, because the definition only includes transactions that require the services of an appraiser.

Title XI authorizes the Agencies to establish a threshold level below which an appraisal by a certified or licensed appraiser is not required if the Agencies determine in writing that the threshold does not represent a threat to the safety and soundness of financial institutions. For these real estate-related financial transactions at or below the applicable thresholds and qualifying for the exemption, the Title XI appraisal regulations require financial institutions to obtain an appropriate evaluation of the real property collateral that is consistent with safe and sound banking practices. Title XI further requires that the Agencies receive concurrence from the Bureau of Consumer Financial Protection (BCFP) that such threshold level provides reasonable protection for consumers who purchase 1-to-4 unit single-family residences.

EGRPRA Review

During the recent review of regulations pursuant to the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA),[2] the Agencies received comments related to the Title XI appraisal regulations and the monetary thresholds which at the time, had been in place since 1994. In the EGRPRA Report issued in March 2017, the Agencies addressed these comments and stated that the Agencies would propose an increase to the threshold for commercial real estate (CRE) transactions. The Agencies determined that an increase to the residential threshold was not being proposed at that time but stated they would continue to consider possibilities for burden relief in connection with appraisals related to residential mortgage lending.

CRE Threshold Increase

In April 2018, the Agencies finalized a rule to define “commercial real estate transaction” as a “real estate-related financial transaction that is not secured by a single 1-to-4 family residential property” and raised the threshold from $250,000 to $500,000 for such transactions. As stated in the CRE notice of proposed rulemaking (CRE NPR), the Agencies declined to propose an increase to the residential threshold at that time, but invited comment on other factors that should be considered in evaluating the appraisal threshold for residential real estate transactions.

[2] EGRPRA requires that, not less than once every ten years, the Federal Financial Institutions Examination Council, Board, OCC, and FDIC conduct a review of their regulations to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions (IDIs).

II. Summary of the Proposed Revisions to the Appraisal Regulations

A. Threshold Increase for Residential Real Estate Transactions

Staff recommends proposing to increase the appraisal threshold for residential real estate transactions in an effort to reduce regulatory burden, while maintaining federal public policy interests in real estate-related transactions and the safety and soundness of regulated institutions. In reaching the decision to recommend the proposal, the Agencies' staff considered comments received through the EGRPRA process and in response to the CRE NPR, as well as cost and time savings considerations, a variety of house price and inflation indices,[3] and Home Mortgage Disclosure Act (HMDA) and Call Report data.

Level of Appraisal Threshold Increase

Several price indices show that housing prices have risen significantly since the $250,000 threshold was established in 1994. In proposing to raise the residential threshold, the Agencies' staff is approximating changes in housing prices on an indexed basis at the low point of the most recent cycle, which generally occurred in 2011. For example, the Case-Shiller Index reflects that a house that sold for $250,000 in 1994 would sell for about $445,000 in December 2011. The FHFA Index reflects that a house that sold for $250,000 in 1994 would sell for approximately $415,000 during this same time period. This conservative approach, using the low point of the cycle, takes into consideration the potential exposure to institutions of potential declines or volatility in house prices during business cycles. To compare to the low point in the recent cycle, a house that sold for $250,000 in 1994 would sell for $641,000 per the Case-Shiller Index and $612,000 per the FHFA index in 2018.

Coverage of the Threshold

Staff analysis of the 2017 HMDA data show that of the transactions originated by FDIC-insured institutions and affiliated institutions, about half are exempted from the Title XI appraisal regulations because they were insured by other government agencies or sold to the government-sponsored enterprises (GSEs). Of the remaining transactions not subject to this exemption, 750,000, or 56 percent are currently exempted because they are under the existing $250,000 threshold.

Staff of the Agencies estimate that increasing the appraisal threshold from $250,000 to $400,000 would annually exempt an additional 214,000 residential real estate loans originated by FDIC-insured institutions or affiliated institutions from the Agencies' appraisal requirements. While these 214,000 loans represent only three percent of the total number of HMDA-reported residential originations, they represent an additional 16 percent of the loans originated by FDIC-insured institutions or affiliated institutions that are not insured by other government agencies or sold to the GSEs. This increase in the number of loans that would no longer be subject to the Title XI appraisal regulations would provide burden reduction for FDIC-insured institutions and affiliated institutions.

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[3] In particular, the Agencies analyzed the Standard & Poor Case-Shiller Home Price Index (Case-Shiller Index) and the Federal Housing Finance Agency House Price Index (FHFA Index), as well as the Consumer Price Index (CPI).

Burden Relief in Rural Areas

Many commenters in the EGRPRA process and to the CRE NPR noted that the requirement to obtain appraisals has increased costs and resulted in delays in rural areas in particular. Section 103 of EGRRCPA added an exemption for certain mortgage loans in rural areas, but the exemption is only available when institutions document that they are unable to obtain appraisers within reasonable cost and timeframes, among other requirements. The NPR is broader in scope than the Section 103 exemption in that it would eliminate the Title XI appraisal requirement for all residential real estate transactions at or below $400,000, without conditions. The Agencies' review of the 2017 HMDA data reflects that setting the appraisal threshold to $400,000 would potentially increase the share of exempt transactions from 82 percent to 91 percent of the number of residential originations by FDIC-insured institutions or affiliated institutions that are not insured by other government agencies or sold to the GSEs and that are secured by residential property located in a rural area.

Safety and Soundness Considerations for Increasing the Threshold for Residential Real Estate Transactions

Transactions below the threshold would continue to require an evaluation instead of an appraisal under the proposal. Analysis of supervisory experience and available data, taking into account the continuing evaluation requirement for transactions exempted by the threshold, indicates that the proposed threshold level of $400,000 for residential real estate transactions is unlikely to pose a threat to the safety and soundness of financial institutions.

The Agencies' staff estimates that the proposed threshold increase would increase the number of transactions originated by FDIC-insured institutions or affiliated institutions that are not insured by other government agencies or sold to the GSEs from 56 percent to 72 percent, but the dollar volume of exempted transactions would increase from 20 percent to 35 percent, meaning that the majority of the dollar volume of transactions would still be subject to the Title XI appraisal regulations. When the threshold was raised in 1994, based on available data at the time, the Agencies estimated that the aggregate dollar volume of exempted transactions that were new home sales was 85 percent of all new home sales, and the aggregate dollar volume of exempted transactions that were existing home sales was 82 percent of all existing home sales. Thus, the Agencies' staff expects the proposed threshold level to have a much smaller impact on the safety and soundness of regulated institutions than the current threshold level did when introduced in 1994.

Charge-off data from the Call Report suggest that the loss experience associated with residential real estate loans generally stayed at a relatively consistently low rate except during the most recent crisis. Based on supervisory experience and a review of material loss reviews conducted by the Agencies' Inspectors General, the Agencies' staff observed that the substantial increase in losses on residential real estate transactions during the most recent crisis has been attributed to a number of factors, such as a weakening economy, declining home values, overstating the market value of homes in appraisal reports, increasing demand for residential mortgage backed securities, relaxing underwriting practices, and the expanded use of higher risk loan products.

The Call Report data do not reflect performance by loan size, but the Agencies do not have data or other information showing that raising the appraisal threshold would result in increased loss rates. However, the Agencies do note that loss rates did not increase in the 13 years after the threshold was raised from $100,000 to $250,000 in 1994, and that loss rates returned to more historical levels in 2014 after the implementation of more prudent underwriting practices. The Agencies also note that a majority of residential real estate transactions are sold to GSEs or insured by other agencies, which reduces the overall impact of the Agencies' appraisal requirements on the mortgage market generally.

Evaluation Requirement

The Title XI appraisal regulations require regulated institutions to obtain evaluations for three categories of real estate-related financial transactions that the Agencies have determined do not require a Title XI appraisal, including real estate-related financial transactions within the current $250,000 threshold. The Agencies' staff proposes to continue to require evaluations consistent with safe and sound business practices for institutions entering into residential real estate transactions within the proposed $400,000 threshold, and notes that evaluations prepared by qualified, competent, and independent individuals who provide appropriate supporting information can provide an estimate of market value that regulated institutions and consumers can consider.

Potential Cost and Time Savings for Institutions and Consumers Using Evaluations Versus Appraisals

Comments provided in response to the CRE NPR indicated that evaluations in general cost substantially less than appraisals, and that the cost of internally prepared evaluations is sometimes borne by the financial institution, rather than passed on to the consumer. The Agencies' staff also believes that there may be less delay in finding appropriate personnel to perform an evaluation than to perform a Title XI appraisal, particularly in rural areas.

Consumer Protection Considerations and BCFP Concurrence

The Agencies' staff acknowledges that appraisals can provide protection to consumers by helping to ensure that the value of the property supports the purchase price and the mortgage amount. The Agencies' staff also observes that transactions exempted by an appraisal threshold are required to have an appropriate evaluation. Such evaluations must be provided to consumers, which provides some measure of consumer protection, even though it is possible that some evaluations might be more difficult for consumers to understand or may lack information about the property typically included in a standard appraisal. The Agencies' staff also notes that consumers generally now have significantly more access to information relevant to residential real estate values than when the appraisal threshold was last increased in 1994.

Title XI authorizes the Agencies to establish a threshold level at or below which a Title XI appraisal is not required if concurrence is received from the BCFP that the threshold level provides reasonable protection for consumers who purchase 1-to-4 unit single-family residences.

Although BCFP concurrence is not necessary until the final rule stage of this rulemaking, the Agencies' staff is consulting with the BCFP regarding the NPR.

B. Conforming and Technical Amendments

In the CRE final rule, the agencies defined a CRE transaction as "a real estate-related financial transaction that is not secured by a single 1-to-4 family residential property." The agencies are proposing to extend this definitional framework by defining a residential real estate transaction as "a real estate-related financial transaction that is secured by a single 1-to-4 family residential property."

Further, under the appraisal regulations, any federally related transaction with a transaction value of $250,000 or more that does not involve an appraisal of 1-to-4 family residential property is required to have an appraisal performed by a State certified appraiser. In order to make this requirement consistent with other proposed changes to the appraisal regulations, changes to regulatory text are proposed to incorporate the definition of "residential real estate transaction" and to reflect that the threshold is increased to $400,000. Similar conforming changes are made to the definition of complex 1-to-4 family residential property appraisal.

Additionally, the NPR would amend the appraisal regulations to reflect the rural exemption provided in section 103 of EGRRCPA in the list of exempt transactions in the appraisal regulations. The NPR would require evaluations for these transactions, as evaluations have been required for threshold-based exemptions since at least 1994 and certain other exempt originations, and they reflect the Agencies' long-standing view that safety and soundness principles require institutions to obtain an understanding of the value of real estate collateral underlying real estate-related transactions they originate.

The NPR also would make a conforming amendment to the Agencies' appraisal regulations to require regulated institutions to subject appraisals for federally related transactions to appropriate review for compliance with USPAP, pursuant to section 1473(e) of the Dodd-Frank Act.

III. Effective Date and Solicitation of Comments

The Agencies believe that all provisions, other than the evaluation requirement under section 103 of EGRRCPA and the appraisal review provision, grant or recognize an exemption or relieve a restriction, and thereby propose to waive the 30-day delayed effective date and set an effective date for these provisions of the first day after publication of the final rule in the *Federal Register*.

The Riegle Community Development and Regulatory Improvement Act provides that amendments to regulations prescribed by a Federal banking agency that impose new requirements on an IDI must take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form. Accordingly, the Agencies are proposing an effective date of the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form for the evaluation requirement under section 103 of EGRRCPA and the appraisal review provision.

The Agencies are inviting comments on all aspects of the NPR.

Recommendation

Staff recommends the Board approve the attached Resolution to adopt and authorize the publication in the *Federal Register* of the attached NPR for a sixty-day comment period.

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Attachments