During the 1980s real estate crisis, flawed and fraudulent appraisals sometimes masked the risk in speculative real estate loans at federally insured institutions. At that time there were no universally accepted appraisal content standards, no system of licensing appraisers, no appraiser education and experience qualification standards, and no laws requiring the use of appraisals. The underwriting of high-risk real estate projects supported by misleading and poorly documented appraisals contributed significantly to the insolvency of many banks and savings and loans during this time. In response, Congress passed the appraisal reform provisions of Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).

In part, Title XI mandated the development of a regulatory structure built on state agencies with the authority to sanction appraisers who do not conform to appraisal standards (see box, “An Overview of the Appraisal Regulatory Framework”). These state appraiser agencies have pursued disciplinary actions against certain appraisers. The National Registry database, a comprehensive source of information on disciplinary actions that have been brought against individual appraisers, shows that since 1994 the states have imposed 630 suspensions, 725 revocations, 230 voluntary surrenders in lieu of disciplinary action, and 4,440 other actions such as fines, remedial education, and probationary periods. These statistics represent a relatively high number of sanctions in relation to the nation’s 79,000 state licensed and certified appraisers, demonstrating how critical the appraiser referral process is to maintaining the quality of the profession.

Bank examiners play a key role in alerting state agencies to inappropriate appraiser activity. Title XI charges the Federal Deposit Insurance Corporation (FDIC) and the other federal bank and thrift regulatory agencies with making referrals of appraisers who have submitted flawed appraisals. In certain situations, the agencies also have the authority to sanction appraisers directly. This article explains when and how appraiser referrals are made and provides an overview of the appraiser referral process at the FDIC.

When an Appraiser Referral Should Be Made

An examiner makes a referral to a state appraiser agency when an...
**Table 1**

<table>
<thead>
<tr>
<th>The appraiser...</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Readdresses” an appraisal⁶</td>
<td>Conceals that the original client was the loan applicant</td>
</tr>
<tr>
<td>Accepts a contingent fee</td>
<td>Accepts a fee contingent on the appraisal obtaining a predetermined value</td>
</tr>
<tr>
<td>Inaccurately describes improvements</td>
<td>Overstates square footage and number of rooms</td>
</tr>
<tr>
<td>Misrepresents the condition of property</td>
<td>States that the property is in good condition when major repairs are needed</td>
</tr>
<tr>
<td>Fails to disclose extraordinary assumptions and hypothetical conditions</td>
<td>Does not disclose that the estimated value depends on obtaining a change in zoning</td>
</tr>
<tr>
<td>Presents faulty analysis</td>
<td>Uses appraisal methodology applicable for higher valued owner-occupied condos when the property is rental apartment units</td>
</tr>
<tr>
<td>Omits relevant information</td>
<td>Fails to disclose that a number of new office building permits have been issued that would adversely affect the absorption of the proposed office building</td>
</tr>
<tr>
<td>Includes misleading information</td>
<td>In the case of a property that requires a zoning change, appraisal describes the current political environment as favorable when it is probable the incumbent zoning officials will be replaced by anti-growth candidates</td>
</tr>
<tr>
<td>Includes a series of material technical errors that will affect the credibility of the valuation</td>
<td>Appraisal includes multiple errors such that there is no way to conclude that the valuation is realistic</td>
</tr>
<tr>
<td>Fails to follow the supplemental appraisal standards contained in the agencies’ appraisal regulation ⁷</td>
<td>Reports the sum of retail values of units for a tract development project as representing the market value of the whole property</td>
</tr>
</tbody>
</table>

The appraiser is involved in ethical violations or the appraisal does not comply with the procedures in the Uniform Standards of Professional Appraisal Practice (USPAP). The USPAP, the generally accepted standards for professional appraisal practice in North America, is referenced in Title XI, the appraisal regulations implemented by the federal banking agencies, and state laws as the source for appraisal standards. Table 1 summarizes situations that typically prompt a referral to a state appraiser agency.

The information in Table 1 is not all-inclusive. A referral also should be considered when an appraiser’s failure to use standard appraisal methodology in compliance with the USPAP could reasonably be expected to result in a state disciplinary action. It is important to note that not all mistakes or inadequate documentation require a referral. Common typographical and clerical errors that do not affect the assigned value of the property should not be referred unless a pattern or practice of exceptions on a number of appraisals is identified.

Once the decision has been made to initiate a referral to a state appraiser agency, field examiners and other FDIC regional office staff work together. The steps in processing an appraiser referral

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⁶ To readdress is to alter references to the original client to mislead the reader about who originally engaged the appraiser.

are outlined in the box entitled “Processing an Appraiser Referral at the FDIC.”

**Enforcement and Criminal Referrals**

Title XI of FIRREA also granted the federal banking agencies authority to sanction appraisers directly. An FDIC regional office would consider an enforcement action when an appraiser participates in a violation of law or regulation, breach of fiduciary duty, or unsafe or unsound practice that causes a financial loss to an insured depository institution. For example, if a flawed real estate appraisal contributed to identifiable loss or exposure to loss in classified and charged-off loans, other real estate, or restructured troubled debt, an enforcement action could result. In addition, if an appraisal is used to defraud an insured financial institution, the appraiser could be referred to law enforcement authorities on a Suspicious Activity Report Form.10

**The FDIC’s Experience**

FDIC regional offices have reviewed and forwarded referrals to state appraiser agencies since the early 1990s. Much less commonly, the FDIC also has initiated enforcement actions and made criminal referrals. Generally, referral activity has been greater in geographic areas where insured financial institutions are experiencing problems. The existence of flawed or fraudulent appraisals becomes more apparent to examiners when lax underwriting standards contribute to a higher volume of real estate credits that reach nonperforming status. At that point, examiners are scrutinizing loans in default more closely.

The FDIC has issued enforcement actions and criminal referrals involving egregious conduct on the part of appraisers. For example, in Kansas and Missouri during the mid-1990s, the FDIC determined that appraisers were submitting property valuations to fit a specific bank’s loan requirements. In this situation, loan officers supplied the necessary information as well as target appraisal values. In addition to inflating the value of the properties, the appraisals did not comply with the USPAP. In some

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8 The FDIC’s appraiser referral process is described in Regional Director Memo Transmittal Number 94-119, Classification #6810, August 1, 1994, Complaints Against Appraisers.

9 Title XI recognizes two types of appraisers: certified and licensed. In general, certified appraisers are more knowledgeable and experienced than licensed appraisers.

10 The Bank Fraud Statute, 18 U.S.C. 1344, makes it a crime to defraud an insured financial institution. Loans based on fraudulent appraisals could be referred to law enforcement authorities on a Suspicious Activity Report Form prescribed pursuant to Part 353 of the FDIC Rules and Regulations.
An Overview of the Appraisal Regulatory Framework

Before the enactment of Title XI, there were no universally accepted appraisal content standards, no system of licensing appraisers, no appraiser education and experience qualification standards, and no laws requiring the use of appraisals. Title XI created a regulatory framework that includes federal bank regulatory agencies, a federal agency with authority to monitor state activities, a nonprofit appraisal organization, and state agencies that license and certify appraisers. Their roles are summarized below.

Federal Bank Regulatory Agencies

Part 323 of the FDIC Rules and Regulations, as well as uniform regulations implemented by the other banking agencies, specify transactions that require an appraisal, require appraisers to be licensed or certified by state agencies, and mandate that appraisals comply with the USPAP. Examiners enforce compliance with Title XI at federally insured institutions by detailing violations of appraisal regulations in examination reports and referring appraisers to state appraiser agencies. In particularly egregious situations, the FDIC has recommended enforcement actions and made criminal referrals.

Appraisal Subcommittee

The Appraisal Subcommittee (ASC) is an independent agency that is a subcommittee of the Federal Financial Institutions Examination Council. All federal bank regulatory agencies, the National Credit Union Administration, and the U.S. Department of Housing and Urban Development appoint members to the ASC. The ASC conducts on-site reviews of each state appraiser agency once every three years, with more frequent visits to states with weak enforcement programs. The ASC has the authority to disapprove a state appraiser regulatory program. Disapproval disqualifies the appraisers in that state from conducting appraisals for federally insured institutions. Each state certified or licensed appraiser pays $25 each year to support the ASC National Registry. This fee funds the ASC’s operations and provides a grant to the Appraisal Foundation to be used for Title XI-related activities, such as updating the USPAP.

The Appraisal Subcommittee website (www.asc.gov) contains useful information about state appraiser agencies and individual appraisers:
- current status of all appraisers, including any formal sanctions outstanding (National Registry)
- summaries of state appraiser requirements
- listings of state agency contacts and links to state appraiser licensing agency websites
- ASC supervisory letters that describe the findings of ASC state reviews
- current ASC Annual Report, copy of Title XI of FIRREA, and all ASC policies

Appraisal Foundation

The Appraisal Foundation is a private, not-for-profit corporation that sponsors two independent boards: the Appraiser Qualifications Board (AQB) and the Appraisal Standards Board (ASB). The AQB establishes minimum education and experience requirements for appraisers. The ASB issues the USPAP, industry standards for conducting real estate appraisals. The Appraisal Foundation is funded by a grant from the ASC, revenue from the sale of the USPAP, and fees from USPAP courses and other activities.

The Appraisal Foundation website (www.appraisalfoundation.org) provides the following information:
- copy of the USPAP, as well as questions and answers related to the USPAP
- appraiser qualification criteria
- state regulatory update (periodic electronic publication for state regulators) and descriptions of current Foundation initiatives

State Appraiser Agencies

State appraiser agencies license and certify appraisers and establish appraiser education and experience requirements that, at a minimum, must satisfy AQB criteria. State agencies review appraiser referrals and discipline appraisers who do not comply with state law or the USPAP.
instances, the FDIC could prove that the appraiser had not inspected the property, despite having stated so in the appraisal. The FDIC banned the appraisers from the business of banking, and the state appraiser authorities took appropriate disciplinary action.

In 2004, a bank funded a $440,000 loan to a borrower to purchase a 24-unit apartment complex. The borrower failed to make the first payment, and the bank foreclosed on the property. A real estate appraisal performed for the loan showed an “as is” fee simple interest market value of $585,000. A second appraisal performed six months later by another appraiser estimated the market value “as is” at $230,000. Clearly, the two appraisals differed significantly. Conflicting information was provided about the number of buildings on the property, number of stories in each building, landscaping on the property, occupancy rate, the year the property was built, the owner of record of the property, whether the property was boarded up and tagged for back taxes, and whether the property was inhabitable. In this case, the FDIC did not make a criminal referral because the bank had reported the possible criminal activity to the authorities.

A System That Works

Title XI of FIRREA resulted in the development and implementation of a regulatory structure that mandates close supervision of real estate appraisers. The referral process helps ensure the early identification and sanctioning of appraisers who are not complying with applicable regulations. As a result, lenders and borrowers at insured institutions can have greater confidence in the appraisal valuations they are receiving.

Jim Leitner
Examination Specialist