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FOR: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); and Federal Deposit Insurance Corporation (FDIC)

FROM: HouseCanary, Inc., 201 Spear St., San Francisco, CA 94105

DATE: February 4, 2019

SUBJECT: Real Estate Appraisals

HouseCanary appreciates the opportunity to comment on the proposed Real Estate Appraisals rule (Docket No. OCC-2018-0038, 83 FR 63110).

Introduction:

HouseCanary is a real estate technology company that uses data science and machine learning to build residential property valuation tools. HouseCanary's investment in understanding the microdynamics of property valuation has led to innovations in objectively quantifying property condition and determining valuation well within the accuracy ranges of current human-based valuation products. From our experience in data management and valuation modeling, and through rigorous testing, we are highly confident that the proposed Real Estate Appraisals rule is both warranted and safely supported through data-driven evidence.

We offer a variety of products, including market insight reports, automated valuation models, software for valuation analysis, and onsite valuations. Our clients include bank and non-bank mortgage lenders, real estate investors, and mortgage loan servicers. Our leadership team have backgrounds in real estate, finance, consulting, government, and academia.

We believe the proposed Real Estate Appraisals rule would maximize net benefits for consumers. Most notably, the rule would reduce closing and refinancing costs and timelines by empowering consumers to request fast, inexpensive evaluations compared to much slower and materially more expensive appraisals. The rule could also drive down consumers' financing costs by attracting more private lenders and loan-guarantors to the secondary mortgage markets.

The rule is entirely consistent with safe and sound banking practices. Through our testing we have found that Agile Evaluations, one of our main products, are at parity with common valuation approaches in terms of suitability and accuracy for a majority of real-world transactions. By relying more heavily on evaluations, mortgage originators could make more informed lending decisions and reduce default rates.

Agile Evaluation is designed to meet or exceed the Interagency Guidelines' (IAG) criteria of a property evaluation. It uses a combination of human observation and data science to address the property's actual physical condition and characteristics as well as the economic and market conditions that affect the estimate of the property's market value (https://www.fdic.gov/regulations/laws/rules/5000-4800.html).

Analysis:

Question 1. The agencies invite comment on the cost data for evaluations and appraisals detailed above. Should the agencies consider other data and data sources in assessing the costs of appraisals and evaluations to regulated institutions and consumers?

The price of a standard residential appraisal can vary widely. Most appraisals cost between $400 and $600, according to a 2018 *Washington Post* analysis from real estate expert Kenneth Harney. Customary and reasonable fees for appraisals can vary substantially by geography for assignments with near identical scope. Thus, consumers in some geographies may be charged 2x or more the median cost of a residential appraisal simply because of their location.

Each insured depository institution (IDI) is tasked with determining which collateral valuation tools meet the standard of an evaluation for its book of business. The price of evaluations varies significantly, but is much lower than the price of appraisals. HouseCanary's Agile Evaluation is approximately 80 percent less expensive than the lowest-cost appraisal.

Question 2. The agencies invite comment on the time associated with performing and reviewing appraisals versus evaluations. Should the agencies consider other data and data sources in assessing the time associated with performing and reviewing appraisals and evaluations?

Residential appraisal times vary. A 2017 National Association of Realtors study put the average turnaround time between 7 and 9 days. Anecdotal reports of appraisals taking significantly longer are common, especially in highly competitive housing markets. In fact, California sales contracts typically include a 17-day appraisal contingency in anticipation of such delays.

Evaluations take far less time. For instance, we conduct Agile Evaluations and deliver the reports to consumers in as little as two business days, and with a standard turnaround time of five business days, for a fraction of the cost of a traditional appraisal.

Lengthy reviews and associated corrections of traditional appraisals are often driven by requirements to objectively support appraiser judgements. HouseCanary evaluation analytics are driven by verifiable and repeatable data-driven algorithms, ensuring objectivity by design.

Lengthy appraisal times disproportionately impact first-time and middle-class homebuyers, whose offers typically include financing and appraisal contingencies. More experienced, affluent buyers who can afford to forego financing and appraisal contingencies are almost 60 percent more likely to win bidding wars, according to Redfin data.

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By enabling more consumers to use evaluations rather than appraisals, the proposed rule would speed up the financing approval process. That would help first-time and middle-income buyers make more competitive offers.

Question 3. What valuation information, if any, would consumers lose in practice if more evaluations are performed rather than appraisals? What additional comments, if any, are there relative to the presentation or content of evaluations for residential real estate transactions in practice? Please provide data or other evidence to support any comments.

As long as insured depository institutions choose a comprehensive, high-quality evaluation suited to their book of business, any information lost in some areas will be largely offset by increased data provided elsewhere within the evaluations. In fact, evaluations may provide consumers with deeper quantitative, objective, and relevant information than many appraisals.

Traditional appraisals are a frequented resource for assessing or verifying property gross living area (GLA) by way of including property sketches. Most evaluations do not require or include a property sketch. As such, consumers stand to lose some property sketch data (i.e. GLA verification) with the reduction of traditional appraisals in favor of evaluations.

Offsetting this change, however, are powerful advancements in data science and machine learning that can supply powerful, relevant information very rarely included in traditional appraisals. Image recognition technology, for example, employed in HouseCanary's Agile Evaluation, automates the identification of positive and negative value-influencing property characteristics. HouseCanary evaluations can supply consumers with deep support for comparable selection, analysis, and overall condition and quality characteristics of their property as well as neighboring/comparable properties in ways traditional appraisals currently cannot.

HouseCanary's algorithms crunch four decades of sales data, collected from roughly 3,000 U.S. counties. Our evaluations also incorporate local economic and pricing trends, consumer demand and buying behavior, and many other factors -- even the slope of the land and how close the dwelling is to other residences. Such deep data analysis and associated algorithms are difficult to incorporate into the traditional appraisal approach, further offsetting any risk of a reduction in data supplied to consumers.

Question 4. To what extent do appraisals or evaluations provide benefits or protections for consumers that are purchasing 1-to-4 unit single-family residences? What are the nature and magnitude of the differences, if any, in consumer protection, including any differences in credibility, arising from the use of evaluations rather than appraisals, especially with respect to residential real estate transactions of $400,000 or less? For example, are there any differences with respect to negotiating the price of a home or canceling a transaction when an evaluation rather than an appraisal is obtained? Please provide data or other evidence to support any comments.

While USPAP governs appraiser practice and requires objectivity and non-bias, appraisers are required to analyze sale contracts for any purchase appraisal. Studies reveal that knowledge of the contract price often predisposes appraisers to “snap to” the contract price. Foreknowledge of the sales price unquestionably biases appraisers and diminishes the level of protection that consumers derive from appraisals.

Consider a working paper from the Federal Reserve Bank of Philadelphia that analyzes 3.6 million mortgage applications made from 2013 to 2015. In one-third of appraisals, the appraised value exactly equaled the contract price -- an unmistakable sign of “snap-to-contract” bias, in which appraisers inflate their valuation estimates to ensure the transactions can proceed.

Or consider a Fannie Mae study which examined a:

> *unique database of residential properties that were appraised twice within 6 months between 2012 and 2015, where one of the appraisers was uninformed of the contract price. Significant differences were found between the two appraisals, where the appraiser aware of the contract price used a different set of comparable transactions, price adjustments, and weights of adjusted values of comparable transactions to justify appraised values which confirmed contract price.*

The study’s authors found the appraiser who knew the contract price:

> *was more likely than the precontract appraiser to select comparables with average values at or above known contract, to then adjust so that average adjusted values were even more likely to be at or above contract, and finally to reconcile (weight adjusted sales values) so that the final appraisal was far more likely to be at or above contract than if the contract were not already available to him. We also find a remarkable difference in either direction of the two appraisers' assessment of condition and quality, even though the home is unchanged between the two visits, separated by a median period of 81 days.*

In other words, traditional appraisals can provide a false sense of protection to consumers and lenders, who incorrectly assume they'll be able to sell the property for the appraised value if the mortgagee encounters financial difficulties.

Well-designed, technology-driven evaluations are generally less subjective than appraisals. They don't consider the contract price. And they rely heavily on objective data.

Agile Evaluation’s algorithm, for instance, incorporates hundreds of objective factors -- including decades of property price history, mortgage records, capital markets data, local housing inventory, local economic and employment trends, consumer demand and buying patterns -- into its valuation estimate. A trained inspector also visits the property to take time-stamped, geocoded photos, which help quantify the property's condition and further enhance the accuracy of the evaluation.

By minimizing bias and subjectivity, evaluations generally offer better protection to consumers and lenders. Automated valuation models -- the foundation for many Interagency Guidelines-compliant evaluations -- are more predictive of default risk than appraisals, according to the Federal Reserve Bank of Philadelphia paper.

In addition to better protecting consumers and lenders, the proposed rule would likely benefit consumers by attracting more private capital to the secondary mortgage markets, ultimately resulting in cheaper financing costs. Here's how.

Current regulations largely forbid private mortgage guarantors from financing 1- to 4-unit residential transactions above $250,000 unless an appraisal has been completed. Similarly, insured depository institutions refrain from financing, securitizing, or otherwise supporting transactions above the $250,000 threshold unless an appraisal has been completed, meaning that non-bank lenders are also bound by the same guidelines.

However, government-sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac can exempt themselves from this requirement with an appraisal waiver. These waivers do not meet the threshold for an evaluation -- they allow the lender to skip the appraisal/valuation process completely.

The GSEs often exercise this option when they agree to purchase loans above the threshold. In 2017, for example, Fannie Mae acquired about 60,000 no-appraisal mortgages, according to an analysis published in the *Washington Post*. That accounted for about 5 percent of its total home-loan acquisitions. In March 2018, Fannie Mae "offered appraisal waivers on approximately 10% of the mortgages submitted for purchase during that month," according to a report from the Federal Housing Finance Agency.

These waivers reduce costs for mortgage originators who choose to sell loans to GSEs. That gives the GSEs an unfair competitive advantage over private mortgage guarantors and other private sources of capital.

The proposed rule would help level the playing field between GSEs and insured depository institutions and eliminate operational friction from the considerable portion of the financial system related to residential real estate. This competition, in theory, should result in lower costs of capital for consumers.

Question 5. To what extent is useful property valuation information readily available to consumers through public sources?

Free real estate sites like Zillow and Redfin offer valuation estimates and recent price histories for many residential properties. These sites can offer consumers a helpful ballpark estimate of a property's value.

However, these estimates often deviate considerably from real-world transaction prices. For instance, one in seven Zillow estimates, or "Zestimates," is more than 20 percent higher or lower than the eventual sale price.

Real-estate transaction data is generally recorded at the county level. As a result, the reliability, accessibility, and timeliness of transaction data varies widely between America's 3,000+ counties.

Question 6.

N/A.

Question 7.

N/A.

Question 8. Is the proposed level of $400,000 for the threshold at or below which regulated institutions would not be required to obtain appraisals for residential real estate transactions appropriate?

The proposed threshold increase is a welcome reform that would undoubtedly benefit both consumers and lenders. However, $400,000, like the original $250,000 figure, is a relatively arbitrary, static figure that does not take local market conditions or inflation into account. According to HouseCanary's national house price index (HPI), a $250,000 property valuation in 1994 would be worth $653,000 in today's dollars. Case-Shiller's national HPI found a similar valuation, with a $250,000 property valuation in January 1994 worth $658,000 today.

While a $400,000 threshold would exempt the vast majority of residential transactions from the appraisal requirement in many rural and suburban areas of the country, it would not necessarily alleviate consumers' burdens in high-cost housing markets like New York City, Washington, D.C., San Francisco, and other major cities, where entry-level homes and condos often sell for more than $400,000.

A more tailored solution would be to index the threshold to the cost of housing in a geographic area.

Alternately, the finalized rule could set the threshold at the conforming loan limit, which would relieve consumers in high-cost markets and encourage more competition between GSEs and private lenders. Setting the threshold at the conforming loan limit would also eliminate the need to adjust the threshold in response to inflation or deflation.

Question 9.

N/A.

Question 10.

N/A

Conclusion:

HouseCanary strongly supports the proposed rule. Evaluations can be cheaper, quicker, and more objective than appraisals. The rule would offer significant new protections to consumers and lenders and maximize net benefits to consumers.

However, the rule could be further improved if the $400,000 threshold was indexed to either local housing costs or the conforming loan limit.

Thank you for your time and consideration.

Sincerely,

[redacted]

Jeremy Sicklick, CEO
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