February 5, 2019

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Washington, DC 20219

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: RIN 3064-AE87—Real Estate Appraisals (FDIC)

To the Federal Banking Agencies:

Thank you for the opportunity to comment on the interagency proposed rule increasing the threshold at which residential mortgages require an appraisal from $250,000 to $400,000. The Center for Responsible Lending opposes the proposal. According to the agencies, the proposed rule would exempt 72% of regulated transactions from the appraisal requirement. The proposed threshold amplifies the danger of inflated home values, increasing the likelihood of negative impact on consumers.

I. Quality Appraisals are Essential to Safe Lending

Mortgages without an appraisal that conform with the Uniform Standards of Professional Appraisal Practice (USPAP) heightens risks for the borrower, lender, investors, communities, and the overall economy. Inflated appraisals leave borrowers with unaffordable loans that they cannot refinance because the loan amounts are higher than the true value of their homes. Additionally, when a lender forecloses on a borrower who is underwater, the lender is unable to sell the property for enough to cover the unpaid mortgage balance. This can leave borrowers with hefty deficiency judgments and neighborhoods with unoccupied and unsellable homes.

Appraisal fraud and the lack of adequate regulation in the appraisal market was one of the roots of the subprime mortgage crisis.[1] The intentional inflation of home appraisals is an extremely harmful practice on its own. It proved to be particularly destructive in combination

[1] Financial Crisis Inquiry Report, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States 17-19 (2011). Submitted by The Financial Crisis Inquiry Commission Pursuant to Public Law 111-21.

with predatory and toxic loan products that targeted communities of color.[2] Indeed, in March 2004, the National Association of Realtors stated to a Senate subcommittee that the problem of lender pressure and appraisal fraud was "contributing to the ability of unscrupulous individuals to engage in improper loan practices, including property flipping and predatory lending schemes."[3] Moreover, brokers and loan officers were financially incentivized to make large loans and close them swiftly. One expert testified that appraisal fraud was "the result of collusion among abusive lenders and appraisers" and that "[o]riginator sanctioned appraisal inflation is the dirty little secret of the lending industry."[4] Between 2000 to 2007, a coalition of appraisal organizations produced a petition, signed by 11,000 appraisers that stated lenders were pressuring them to artificially inflate home prices, and would only give business to appraisers that complied.[5] Some of the worst subprime lenders – such as Ameriquest, Countrywide, and Washington Mutual – inflated home values to drive profits, resulting in equity stripping, loss of homeowner wealth, and potentially foreclosure. Attorney General of Illinois, Lisa Madigan, testified to the Financial Crisis Inquiry Commission that a multistate investigation of Ameriquest revealed that the company "engaged in the kinds of fraudulent practices that other predatory lenders subsequently emulated on a wide scale [including] inflating home appraisals."[6] Moreover, another investigation discovered that Washington Mutual loan production staff would "hand-pick appraisers who bring in appraisal values high enough to permit WaMu's loans to close."[7] These predatory practices had a disparate impact on communities of color, depressed housing values, and contributed to the growing racial wealth gap.[8]

In response to these abuses and the enormous economic costs they created, the Dodd-Frank Act strengthened the requirements for appraisals. The statute instituted numerous reforms to ensure the legitimacy, independence, and supervision of the appraisal industry.

[2] *See* David Callahan, Home Insecurity: How Widespread Appraisal Fraud Puts Homeowners at Risk (Mar. 2005), available at www.demos.org/publication/home-insecurity-how-widespread-appraisal-fraud-puts-homeowners-risk.

[3] Statement of the National Association of Realtors Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Housing and Transportation, Regarding the Real Estate Appraisal Industry and Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 at 5 (March 24, 2004).

[4] Testimony of David Berenbaum, National Community Reinvestment Coalition, Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Housing, Transportation and Community Development, Ending Mortgage Abuse: Safeguarding Homebuyers at 10 (June 26, 2007), available at https://www.banking.senate.gov/imo/media/doc/berenbaum.pdf.

[5] Financial Crisis Inquiry Commission Report at 18.

[6] *Id.* at 12.

[7] *Id.* at 92.

[8] *See* Center for Responsible Lending, 2013 Update: The Spillover Effects of Foreclosures (Aug. 19, 2013), available at https://www.responsiblelending.org/mortgage-lending/research-analysis/2013-crl-research-update-foreclosure-spillover-effects-final-aug-19-docx.pdf.

II. Portfolio Loans Still Pose Consumer Risks and Should Require an Appraisal

The proposed rule would not change appraisal requirements for Fannie Mae, Freddie Mac, and federal agency loans. Thus, it appears the impact will be on loans held in portfolio. While some lenders will continue to require an appraisal for mortgages up to $400,000, others will likely opt out and permit an evaluation instead. Many contend that lenders who hold the risk on their balance sheets are less likely to engage in unsound or predatory activity. However, the incentive is inadequate to protect borrowers from the risks in not obtaining an appraisal. Quality appraisals are too important to become optional. Indeed, several large banks held unsafe loans in their portfolio in the lead-up the housing crisis.[9] For example, many of the toxic loans, such as negative amortization loans, and adjustable rate mortgages underwritten to initial teaser rates, were held in bank portfolios. Lenders underwrote these loans based upon only an initial, artificially low payment, even though dramatically higher payments commenced after a few years. This product was one of many that devastated the housing market and economy, demonstrating that a loan held in portfolio does not guarantee consumer protections or less risk. We urge you to reject opening the doors to the possibility of inflated appraisals reemerging among portfolio loans and causing harm to borrowers and the market.

III. Evaluations Are Not an Adequate Substitute for an Appraisal

Appraisals must be performed in accordance with uniform standards by individuals whose competency has been demonstrated and whose professional conduct will be subject to effective supervision.[10] The proposed rule purports to replace appraisals with evaluations. But evaluations are not an adequate substitute for an independent appraisal. Although the banking agencies have issued guidelines and an advisory on evaluations,[11] these documents do not set forth enforceable legal requirements. Evaluations are not required to be in a standard form and specific content is not required. Persons performing evaluations are not required to have any professional credentials for valuing real estate. Furthermore, although creditors using evaluations covered by the interim final rule on valuation independence (other than valuations produced solely using an automated model or system) must meet standards for independence that carry civil liability, the evaluator is not necessarily an independent party. As explained in the guidelines and advisory, evaluations may be completed by a bank employee. However, it is

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[9] *See* Eric S. Belsky and Nela Richardson, Understanding the Boom and Bust in Nonprime Mortgage Lending, Joint Center for Housing Studies of Harvard University (Sept. 2010), http://www.jchs.harvard.edu/sites/default/files/ubb10-1.pdf (stating that one of the roots of the crisis included, "the origination of mortgage loans with unprecedented risks through relaxation of mortgage underwriting standards and the layering of risk, especially in the private-label securities market *and in the portfolios of some large banks and thrifts*." (emphasis added)).

[10] 12 U.S.C. § 3331.

[11] *See* Interagency Appraisal and Evaluation Guidelines, 75 Fed. Reg. 77450 (Dec. 10, 2010), available at https://www.fdic.gov/regulations/laws/rules/5000-4800.html; Interagency Advisory on Use of Evaluations in Real Estate-Related Financial Transactions (March 4, 2016), available at https://www.occ.gov/news-issuances/bulletins/2016/bulletin-2016-8a.pdf.

difficult to guarantee independence by bank employees, particularly in a smaller financial institution.

Additionally, there is little recourse for a borrower whose home receives a shoddy evaluation. In addition to setting forth legal requirements for appraisers, the Dodd-Frank Act instituted a national hotline for complaints against state-certified and state-licensed appraisers. States also have the authority to discipline appraisers that violate the USPAP. Evaluations have unenforceable guidelines and lack oversight, creating an untenable situation for borrowers who have been wronged.

Moreover, according to the guidelines, evaluations may permit automated valuation models (AVMs) to be used if the evaluator also visits the property.[12] An AVM is a computerized model that estimates property values using public record data, multiple listing services, and other real estate records. These models use statistical techniques to produce a market value. AVMs are unregulated and viewed as less reliable than an appraisal.[13] They are "generally not used as the primary source of information on property value for first-lien mortgage originations, due in part to potential limitations with the quality and completeness of the data AVMs use."[14] The data AVMs draw from includes information that is not always current, consistent, or complete, as well as information that is itself often generated from statistical models.[15] The Dodd-Frank Act required that the banking agencies, National Credit Union Administration, Federal Housing Finance Agency, and Consumer Financial Protection Bureau issue regulations to implement quality control standards for AVMs, but this has not yet occurred.[16] As AVMs play a large role in evaluations, the agencies should not expand the use of evaluations and AVMs prior to assessing reliability and issuing regulations to ensure quality control.

Furthermore, it is unclear whether evaluations result in cost savings. The agencies acknowledge that there is "limited information available on the cost of evaluations and appraisals" and request information about costs. We support this request for further information and urge the agencies to obtain reliable and independent data to support any cited cost savings. However, even if evaluations result in some cost savings, it is not worth the tradeoff in reliability, independence, and oversight.

IV. The Proposed Rule is Premature

Additionally, we believe it is premature for the banking agencies to make this change. Congress recently addressed modifications to the existing appraisal rules. Public Law 115-174 waives the general requirement for independent home appraisals for transactions in rural areas under

[12] Interagency Appraisal and Evaluation Guidelines, 75 Fed. Reg. at 77,468.
[13] GAO, Residential Appraisals: Opportunities to Enhance Oversight of an Evolving Industry at 15 (GAO-11-653, July 2011), available at https://www.gao.gov/products/GAO-11-653.
[14] *Id.* at 17.
[15] *Id.*
[16] 12 U.S.C. § 3354.

certain circumstances.[17] First, the lender must contact three state-licensed or state-certified appraisers and determine that none of them could complete an appraisal in a reasonable amount of time. The banking agencies should determine the impact of implementing this provision before creating an even larger exemption.

V. The Banking Agencies Should Provide Further Data on the Impacts of the Proposal

Lastly, we believe the banking agencies should conduct an analysis regarding the borrowers and geographies that will be most affected by an increase in the appraisal threshold. Will there be more of an impact on certain areas of the country, such as urban or rural areas? Are particular borrowers more likely to be affected? Borrowers of color are more likely to purchase homes in a lower price range due to lower wealth status. Thus, they will bear the brunt of any negative impact, as they have historically. The banking agencies should carefully examine whether this change will have a disparate impact on communities of color. It is crucial to analyze these questions to ensure that no borrower group or geography will be disproportionately impacted by the risks in not obtaining an appraisal.

VI. Conclusion

The risks inherent in a home overvaluation are significant and fall most harshly on the borrower/homeowner. An independent and legitimate appraisal is a crucial component to a safe loan. CRL believes that the agencies arrived at the correct conclusion in 2017 when they decided against increasing the appraisal threshold.[18] We urge the banking agencies to maintain strong appraisal standards for as many loans as possible and not permit inflated valuations to potentially overtake a subset of the market. Thank you for considering our comments.

Sincerely,

Center for Responsible Lending

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[17] Public Law No: 115-174 § 103 (May 24, 2018), *codified as* 12 U.S.C. § 3356.
[18] Joint Report to Congress, Economic Growth and Regulatory Paperwork Reduction Act (March 2017), available at https://www.ffiec.gov/pdf/2017_FFIEC_EGRPRA_Joint-Report_to_Congress.pdf.