

August 6, 2019

**MEMORANDUM TO:** Board of Directors

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

**SUBJECT:** Final Rule to Increase the Appraisal Threshold for Residential Real Estate Transactions, Implement the Rural Residential Appraisal Exemption, and Require Appropriate Appraisal Review

### **Summary of Recommendation**

Staff recommends that the FDIC's Board of Directors approve the attached Final Rule (FR), entitled *Real Estate Appraisals*, for publication in the *Federal Register*. The FR increases the threshold level at or below which appraisals are not required for residential real estate transactions from \$250,000 to \$400,000. For residential real estate transactions exempted from the appraisal requirement as a result of the revised threshold, regulated institutions must obtain an evaluation of the real property collateral that is consistent with safe and sound banking practices.

The FR makes a conforming change to add to the list of exempt transactions those transactions secured by residential property in rural areas that have been exempted from the agencies' appraisal requirement pursuant to the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), and requires evaluations for these exempt transactions. Finally, the FR amends the agencies' appraisal regulations to require regulated institutions to subject appraisals for federally related transactions to appropriate review for compliance with the Uniform Standards of Professional Appraisal Practice (USPAP). The FR 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) (collectively, the agencies).

### **Background**

Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Title XI) sets forth federal requirements with respect to appraisals. In 1992, Congress amended section 1112 of Title XI by adding subsection (b), which expressly authorizes the agencies to establish a threshold level at or below which an appraisal by a state certified or licensed appraiser is not required in connection with federally related transactions if the agencies determine in writing that the threshold does not represent a threat to the safety and soundness of financial institutions. In 2010, through the Dodd-Frank Act, Congress amended section 1112(b) of Title XI to require concurrence from the Consumer Financial Protection Bureau (the CFPB) that such threshold level provides reasonable protection for consumers who purchase 1-4 unit single-family residences. Transactions at or below the threshold level are exempt from the Title XI appraisal requirements.

During the recent regulatory review process required by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA), which was completed in early 2017, the agencies received comments related to the agencies' appraisal regulations implementing FIRREA (Title XI appraisal regulations), including recommendations to increase the appraisal thresholds, which had been in place since 1994. In April 2018, the agencies finalized a rule to increase the threshold level for commercial real estate transactions from \$250,000 to \$500,000 (CRE rulemaking). The agencies also received comments regarding the residential real estate threshold level in the CRE rulemaking.

In 2018, Congress amended Title XI, through EGRRCPA, to exempt residential transactions in certain rural areas from having to obtain a Title XI appraisal if the financial institution documents that appraisers are not available for the transaction within reasonable time and cost parameters (rural residential appraisal exemption).<sup>1</sup> The statute does not specifically require that evaluations be performed when regulated institutions utilize this exemption.

In the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress amended FIRREA to require financial institutions regulated by the agencies (regulated institutions) to subject appraisals for federally related transactions to appropriate review for compliance with USPAP and required that the agencies issue regulations requiring such review.

### **Summary of Proposed Rule**

In December 2018, the agencies invited comment on a notice of proposed rulemaking (proposal or proposed rule) that would amend the agencies' appraisal regulations promulgated pursuant to Title XI. Specifically, the proposal would increase the monetary threshold at or below which regulated institutions would not be required to obtain appraisals in connection with residential real estate transactions (residential real estate appraisal threshold) from \$250,000 to \$400,000. In addition, the proposal would add to the list of exempt transactions those transactions that qualify for the rural residential appraisal exemption.

The proposal would require regulated institutions to obtain evaluations for transactions exempt from the agencies' appraisal requirements due to the increase in the residential real estate appraisal threshold or the rural residential appraisal exemption. Finally, the proposal would amend the agencies' appraisal regulations to require regulated institutions to subject appraisals for federally related transactions to appropriate review for compliance with the USPAP, as required under the Dodd-Frank Act.

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<sup>1</sup> Under this new exemption, a financial institution need not obtain a Title XI appraisal if the property is located in a rural area; the transaction value is less than \$400,000; the financial institution retains the loan in portfolio, subject to exceptions; and not later than three days after the Closing Disclosure is given to the consumer, the financial institution or its agent has contacted not fewer than three state certified or state licensed appraisers, as applicable, and has documented that no such appraiser was available within five business days beyond customary and reasonable fee and timeliness standards for comparable appraisal assignments. 12 U.S.C. § 3356.

## **Summary of Final Rule**

### **Overview of Comments**

The agencies received a range of comments regarding the proposal to increase the residential real estate appraisal threshold, with a total of over 560 unique comments received. Comments from financial institutions, financial institution trade associations, and state banking regulators generally supported an increase. Comments from appraisers, appraiser trade organizations, individuals, and consumer advocate groups, generally opposed the proposal to increase the threshold. The agencies also received a few comments addressing the proposed requirement to obtain evaluations for transactions that qualify for the rural residential appraisal exemption or to subject certain appraisals to appropriate review for compliance with USPAP.

### **Revisions to the Title XI Regulations**

As detailed below, staff believes a residential real estate appraisal threshold of \$400,000 will not threaten the safety and soundness of financial institutions. While the agencies decided against proposing a residential appraisal threshold increase during the EGRPRA process, continued comments have been received from financial institutions and state bank regulatory agencies that increasing the residential appraisal threshold would provide meaningful burden relief, and further analysis has been performed regarding safety and soundness and consumer protection factors related to the proposal. In addition, while Congress recently amended Title XI to provide a narrow, self-effectuating appraisal exemption for rural transactions meeting certain requirements, it is also observed that Congress did not amend the agencies' long-standing authority in Title XI to establish a threshold level at or below which a certified or licensed appraiser is not required to perform an appraisal in connection with federally related transactions.

Staff also recommends finalizing as proposed the requirement to obtain an evaluation for transactions that qualify for the rural residential appraisal exemption and the requirement that appraisals for federally related transactions be subject to appropriate review for compliance with USPAP.

### **Threshold Increase for Residential Real Estate Transactions**

#### **1. Definition of Residential Real Estate Transaction**

The agencies proposed to define a residential real estate transaction as a real estate transaction secured by a single 1-to-4 family residential property and specifically asked commenters whether the proposed definition is appropriate. This definition is consistent with current references to appraisals for residential real estate in the agencies' appraisal regulations and in Title XI, and the definition of commercial real estate transaction that was created in the recent CRE rulemaking. Therefore, staff recommends that the definition of a residential real estate transaction be adopted as proposed.

## 2. Threshold Level

The NPR proposed increasing the residential real estate appraisal threshold from \$250,000 to \$400,000. In determining the level of increase, the agencies considered increases in housing prices and general inflation across the economy since the current threshold was established in 1994. The agencies also considered comments received during the EGRPRA process and in response to questions posed about the residential threshold in the CRE rulemaking. As discussed in the proposal, the agencies analyzed the Standard & Poor's Case-Shiller Home Price Index (Case-Shiller Index) and the FHFA Index to determine changes in house prices since 1994. The agencies also analyzed general measures of inflation by reviewing the Consumer Price Index (CPI).

The agencies adopted a conservative approach and proposed \$400,000 to approximate housing prices based on the low point during the most recent cycle. The proposed threshold level is also consistent with general measures of inflation across the economy reflected in the CPI since 1994.

Commenters supporting a threshold increase asserted that an increase would be appropriate, given the increases in real estate values since the current threshold was established as well as the cost and time savings to lenders and borrowers that the higher threshold would provide. Commenters opposing an increase to the threshold asserted that the proposal would elevate risks to borrowers, financial institutions, the financial system, and taxpayers.

Staff recommends that the residential real estate appraisal threshold be increased to \$400,000 as proposed. Such an increase approximates more recent house prices and provides an inflation adjustment to a threshold that has not been increased since 1994.

## 3. Safety and Soundness Considerations for Raising the Residential Real Estate Threshold

Under Title XI, the agencies may set a threshold at or below which an appraisal is not required if they determine in writing that such a threshold level does not pose a threat to the safety and soundness of financial institutions. Analysis of supervisory experience and available data presented in the proposal indicated that the proposed threshold level of \$400,000 for residential real estate transactions would not pose a threat to the safety and soundness of financial institutions.

### *Coverage of Threshold*

In considering the safety and soundness of the proposed increase in the residential real estate transaction appraisal threshold to \$400,000, the agencies examined 2017 HMDA data to estimate the scope of covered residential real estate transactions under the proposed and existing thresholds.<sup>2</sup>

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<sup>2</sup> 2018 HMDA data are not yet publicly available, so the Agencies continue to rely on 2017 data.

The 2017 HMDA data show that the \$250,000 threshold currently exempts only about 20 percent of the total dollar volume of regulated transactions. Raising the threshold to \$400,000 will exempt an additional 14 percent of the dollar volume, thus increasing the share of the dollar volume of regulated transactions that are exempt to 35 percent.<sup>3</sup> Thus, the threshold increase will have a much smaller impact on the dollar volume of exempt regulated transactions.

Moreover, HMDA data also suggests that the increased threshold will impact a low aggregate dollar volume, but will affect a material number of transactions, suggesting the potential for financial savings and burden relief with limited additional risk.

#### *Use of Evaluations*

The Title XI appraisal regulations require regulated institutions to obtain evaluations for several categories of real estate-related financial transactions that the agencies have determined do not require a Title XI appraisal, including transactions at or below the current threshold exemptions. Accordingly, the agencies proposed to require that regulated institutions entering into residential real estate transactions at or below the proposed residential real estate appraisal threshold obtain evaluations that are consistent with safe and sound banking practices unless the institution chooses to obtain an appraisal for such transactions.

Although the agencies recognize, as many commenters noted, that evaluations are not subject to the same uniform standards as appraisals in terms of structure and content or the preparer's training and credentialing requirements, evaluations must be consistent with safe and sound banking practices. After considering the comments, staff recommends that the Board adopt this aspect of the proposed rule without change.

#### *Analysis of Loss Rates*

In the proposal, the agencies also considered a loss analysis of aggregate net charge-off rates for residential real estate loans after the prior increase in the appraisal threshold in 1994, which offered no evidence that increasing the appraisal threshold to \$400,000 for residential real estate transactions would materially increase the risk of loss to financial institutions.

Based on the net charge-off data, which suggest that the increase in the appraisal threshold in 1994 did not have a material effect on the loss experience associated with residential real estate loans, staff believes the increase to \$400,000 will not lead to increases in charge-off rates.

#### *Supervisory Experience*

In addition to analyzing net charge-off rates for residential real estate transactions, the agencies also considered their own supervisory experience with appraisals and evaluations, which indicates that increasing the threshold would not increase risk to financial institutions. Staff has

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<sup>3</sup> The additional exempted transactions represent three percent of total HMDA originations in 2017 and 16 percent of regulated transactions.

found that both appraisals and evaluations prepared properly can be credible tools to support real estate lending decisions.

#### *Additional Considerations*

In the proposal, the agencies noted that institutions may elect to obtain appraisals for transactions that fall under the threshold, even though an evaluation would also be permitted and that a financial institutions may choose to obtain appraisals for exempt transactions based on the risks associated with a particular transaction or to preserve the flexibility to sell residential loans in the secondary market.

The agencies requested comment on the question of whether and when institutions use appraisals even if not required to do so by the Title XI appraisal regulations. Staff notes that the FR states that regulated institutions would be expected to continue using a risk-focused approach when considering whether to order an appraisal for transactions that fall below the threshold. Further, the Interagency Appraisal and Evaluation Guidelines (Guidelines) encourage institutions to establish appropriate policies and procedures for determining when to obtain an appraisal in connection with transactions for which an evaluation is permitted. Similarly, the Interagency Advisory on Use of Evaluations in Real Estate-Related Financial Transactions (Evaluations Advisory) suggests it would be prudent to obtain an appraisal rather than an evaluation when an institution's portfolio risk increases or for higher-risk transactions. Data from FR Y-14M reports and schedules as well as comments reviewed by the agencies found that lenders often choose to obtain appraisals, even when evaluations are permitted for transactions at or below the current \$250,000 threshold. Staff notes that each agency has the ability under the appraisal regulations to require an appraisal whenever it is necessary to address safety and soundness concerns.

After considering the comments and analyzing a range of data and information, as discussed above, staff has determined that the threshold level of \$400,000 for residential real estate transactions will not pose a threat to the safety and soundness of financial institutions.

#### 4. Consumer Protection Considerations

The agencies requested comment generally regarding any implications of the proposed rule on consumer protection, for specific information about the potential cost and time savings to consumers that may result from the increased use of evaluations versus appraisals, and whether information in evaluations would be sufficiently clear to enable the consumer to make an informed decision. The agencies also requested comment on the availability of valuation information to consumers through public sources and whether information from those sources help provide consumers with additional protection in residential transactions. Finally, the agencies requested comment on any challenges that financial institutions may have in meeting the requirements and standards for independence for evaluations prepared by internal staff or external third parties.

In general, commenters supportive of the proposed threshold and who commented on consumer protection issues indicated that evaluations provide consumers with sufficient protection in a residential real estate transaction. Many commenters who opposed the increased threshold stated that evaluations are inadequate substitutes for appraisals and therefore an increased threshold would pose a threat to consumer protection.

In adopting the threshold increase for residential mortgage loans as proposed, the agencies appreciate and have considered the consumer protection issues and concerns raised by the commenters. Based on their supervisory experience with evaluations since 1994, staff has found that both appraisals and evaluations can protect consumers by facilitating the informed use of credit and helping to ensure the estimated value of the property supports the purchase price and mortgage amount.

As stated in the proposal, evaluations have long been required for below-threshold transactions; must be consistent with safe and sound banking practices; and should contain sufficient information and analysis to support the decision to engage in the transaction, although it may be less structured than an appraisal. In addition, the Guidelines and the Evaluations Advisory provide that individuals preparing evaluations should be qualified, competent, and independent of the transaction and the loan production function of the institution.

The agencies consulted with the CFPB throughout the development of the proposal and final rule and have received, as required by the Dodd-Frank Act, concurrence from the CFPB that the residential real estate appraisal threshold being adopted provides reasonable protection for consumers who purchase 1-4 unit single-family residences.

#### 5. Reducing Burden Associated with Appraisals

In proposing the increase in the residential appraisal threshold, the agencies considered that the increased use of evaluations would likely reduce the time and costs associated with certain residential real estate transactions, which in turn would reduce burden for financial institutions and consumers.

Available data and analysis indicate that raising the residential threshold, and the corresponding increased use of evaluations, will lead to cost savings for consumers and institutions. Staff also conclude that raising the threshold is likely to reduce the time needed to find appropriate personnel to perform the valuation, particularly in areas experiencing shortages of certified or licensed appraisers, as well as the time needed to review the evaluation.

As discussed above, the agencies' analysis of 2017 HMDA data suggests that increasing the residential threshold from \$250,000 to \$400,000 would exempt an additional 214,000 residential real estate originations at regulated institutions from the agencies' appraisal requirement, representing 16 percent of all regulated transactions. While the supervisory data suggests that use of evaluations is lower than it could be, staff expect that raising the residential appraisal threshold will still provide burden relief because it will provide flexibility in those situations where obtaining an appraisal would significantly delay the transaction and the financial institution determines that an evaluation would be sufficient for the safety and soundness of the particular transaction. Staff also believes that the increase in the threshold would provide meaningful burden relief for regulated institutions in rural areas by extending the option to obtain an evaluation to a wider range of transactions, without sacrificing sound risk management principles.

## **Incorporation of the Rural Residential Appraisal Exemption under Section 103 of the EGRRCPA**

After considering the comments received, staff recommends that the Board add the rural residential appraisal exemption to the list of transactions that are exempt from the agencies' appraisal requirement and implement the requirement for regulated institutions to obtain evaluations when the rural residential appraisal exemption is used. Under the FR, creditors operating in rural areas could opt to rely on the more broadly applicable exemption for transactions of \$400,000 or less in lieu of the rural residential appraisal exemption and would not need to meet the additional criteria required under the rural residential appraisal exemption. This is because the broader exemption for transactions of \$400,000 or less adopted in the FR encompasses the more narrow exemption under EGRRCPA. An evaluation is required regardless of which of these exemptions are relied upon.

## **Addition of the Appraisal Review Requirement**

Section 1473(e) of the Dodd-Frank Act amended Title XI to require the agencies' appraisal regulations to include a requirement that Title XI appraisals be subject to appropriate review for compliance with USPAP.

After considering the comments received, staff recommends that the Board adopt the requirement that financial institutions review appraisals for federally related transactions for compliance with USPAP. The FR states that the agencies encourage regulated institutions to review their existing appraisal review policies and incorporate additional procedures for subjecting appraisals for federally related transactions to appropriate review for compliance with USPAP, as needed. Financial institutions may refer to the Appraisal Guidelines for more information to assist them in the appropriate review of appraisals and evaluations.

## **Conforming and Technical Amendments**

The agencies' appraisal regulations require that all complex 1-to-4 family residential property appraisals rendered in connection with federally related transactions shall have a state certified appraiser if the transaction value is \$250,000 or more. In order to make this paragraph consistent with the other proposed changes to the agencies' appraisal regulations, the agencies proposed changes to its wording to incorporate the proposed definition of "residential real estate transaction," to introduce the \$400,000 threshold, and to make other technical and conforming changes. The agencies also proposed to amend the definitional term "complex 1-to-4 family residential property appraisal" to "complex appraisal for a residential real estate transaction" to conform to the definition of residential real estate transaction. The proposed amendments to these provisions would have been conforming changes that would not alter any substantive requirements, and staff recommends adopting them as final.

## **Effective Date**

Staff recommends finalizing the effective date as proposed. All provisions of the rule, other than the evaluation requirement for transactions exempted by the rural residential appraisal exemption and the appraisal review provision, would be effective the first day after publication of the final

rule in the *Federal Register*. The evaluation requirement for transactions exempted by the rural residential appraisal exemption and the appraisal review requirement would have a 30-day delayed effective date.

**Recommendation**

Staff recommends that the Board approve the attached Resolution to authorize publication of the FR entitled *Real Estate Appraisals* in the *Federal Register* of the attached FR.

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