February 26, 2021

The Honorable Mark A. Calabria
Director
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20019

Dear Director Calabria:

On behalf of U.S. Mortgage Insurers (USMI) and our member companies,[1] we appreciate the opportunity to provide feedback on the Federal Housing Finance Agency's (FHFA) initiatives to modernize appraisal processes and to the specific questions presented in the Request for Information (RFI) on Appraisal-Related Policies, Practices, and Processes.[2] As a general matter, the private mortgage insurance (MI) industry understands and agrees with the FHFA that there are opportunities to modernize appraisal processes and to improve the quality of residential property valuation practices. There have been significant advancements in technology, data aggregation, and analytics throughout the mortgage finance industry that have positively impacted many professions and processes. Collateral risk assessment and real estate valuation can benefit from these same technological advancements if done appropriately. As Fannie Mae and Freddie Mac, collectively the government-sponsored enterprises (GSEs), seek to modernize their appraisal policies and collateral valuation technologies, USMI strongly believes that the FHFA should implement rules designed to ensure that innovations around the appraisal process are done when there is demonstrable benefit to the broader housing finance system, including greater transparency, efficiency, accuracy of property valuations, and lower costs for borrowers and market participants. While we provide specific comments, observations, and recommendations to many of the issues raised and questions posed in the RFI in our responses in Appendix A, our initial comments below focus primarily on the increased use of appraisal waivers through 2020, as well as specific observations related to the above 80 percent loan-to-value (LTV) segment of the market and recommendations to address areas of increased risks.

Balancing Innovation & Prudent Mortgage Lending

USMI and our member companies recognize that there is an opportunity through appraisal modernization to address many of the existing challenges within the appraisal process, including those that stem from the shortage of qualified appraisers in the market and the unique challenges in rural markets of getting appraisers and having comparable properties for valuations. Given the standardization role that the GSEs play within the marketplace, as well as their dominant market presence, there is an opportunity for industry stakeholders and the GSEs to come together to promote appropriate solutions that drive efficiencies and lead to more accurate valuations in a way that appropriately balances risk and operational flexibility.

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[1] USMI represents the nation's leading private mortgage insurance companies and USMI membership comprises: Essent Guaranty, Inc.; Genworth Mortgage Insurance Corporation; Mortgage Guaranty Insurance Corporation; National Mortgage Insurance Corporation; and Radian Guaranty Inc.

[2] Request for Information on Appraisal-Related Policies, Practices, and Processes (December 28, 2020). Available at https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/RFI-Appraisal-Related-Policies.pdf.

At the same time, USMI members continue to appreciate the role of appraisers in the mortgage underwriting process, especially since automated or model-based solutions may not be appropriate for certain properties and transactions. Importantly, for homebuyers, an appraiser's inspection report serves to affirm, when appropriate, the reasonableness of home price discovery via an arms-length negotiation.

USMI members also acknowledge that appraisal technology has the potential to improve the efficiency of the mortgage underwriting process, however it is critical that there be appropriate transparency, monitoring, and governance. Modernization should be accompanied by guardrails to minimize the risk of incorrect collateral valuation outcomes and any adverse effects on mortgage underwriting. Further, model weaknesses and discrepancies, and ways to mitigate for those weaknesses, should also be considered for determining when and how to use these technologies. It is important that FHFA establish policies that ensure collateral valuation, including the use of competing technologies, such as the two GSEs' collateral valuation tools, are not a source of competition between the GSEs. When used inappropriately, these tools have the potential to increase risk beyond their expected benefits to the housing finance system.

Many of the ongoing appraisal modernization efforts by the GSEs have led to general process improvements, however it is very important to recognize that automated valuation models (AVMs) and other alternatives to a full appraisal are not appropriate for every property or transaction. USMI believes they should be used in limited circumstances, and only with appropriate guardrails, particularly for higher LTV mortgages where risk is higher and valuation errors may have greater significance.

Data Democratization

The GSEs' appraisal modernization initiatives have significantly expanded data requirements during the mortgage origination process, with the burden often falling on lenders, mortgage insurers, and other market participants to provide data that informs mortgage underwriting. Industry stakeholders have worked closely with the GSEs since the 2010 launch of the Uniform Mortgage Data Program (UMDP) to implement data collection procedures and technologies to provide data to the GSEs. Despite industry's commitment to the UMDP and increased data integrity of the Uniform Residential Appraisal Report (URAR), market participants currently do not have a great deal of access to this important data repository. Access to this data would improve market participants' operations, ultimately benefitting homebuyers and the strength of the housing finance system.

USMI recommends that the FHFA initiate a process to make collateral valuation data available to the parties that contributed to the analysis and that are part of the underwriting process, including appraisers and appraisal management companies, lenders, private mortgage insurers, title insurance companies, investors, and data analytics providers. Greater insight into the GSEs' collateral valuation technologies and processes will assist with analyses of individual mortgage transactions. Further, the FHFA should implement policies that require the GSEs to share more information about their AVMs, including the tolerances that are incorporated. Data democratization will greatly enhance transparency within the housing finance system and improve risk management practices and strategies across the market.

GSE Appraisal Waiver Policies

One element of the GSEs' appraisal policies, practices, and processes that we believe warrants particular attention is the expanded use of appraisal waivers for high LTV refinance transactions. While both GSEs have had appraisal waiver programs for nearly a decade, specifically with some of the changes made during 2020, there has been a significant expansion of these programs during the mortgage underwriting process. The share of GSE-backed mortgages receiving appraisal waivers has surged, including a dramatic increase in the use of appraisal waivers for higher LTV loans.

As an industry that is exclusively focused on high LTV mortgage originations, USMI welcomes the opportunity to share our observations concerning the expansion of appraisal waivers in that segment of the market. Appraisal waivers can materially impact LTV ratios and the pricing and risk assessments associated with the GSEs' guarantee fees, MI premiums, and loan-level capital requirements.[3] Importantly, these considerations are more acute for higher LTV loans since the margin of error is slim for these mortgages and could expose the GSEs and the housing finance system to greater credit risk.[4] Inaccurate valuations that result from appraisal waivers could enable delivery of loans with LTVs that arbitrarily – and inappropriately – misprice or eliminate MI credit risk protection. Additionally, automated and index-based valuations rely on broader price trends that can overshadow local or property-specific conditions that would point to higher LTVs. Furthermore, the different approaches to appraisal waivers by the two GSEs create frictions that appear to be incentivizing undesirable lender behaviors and further exacerbating these risks.

Industry Observations – Overall Increase in Appraisal Waivers

While the use of appraisal waivers has increased since the onset of the COVID-19 pandemic, the uptick was most notable when the GSEs expanded appraisal waiver eligibility to mortgages with LTVs up to 90 percent in the spring of 2020. Despite the changes that allowed for the significant increase of appraisal waivers, there was little transparency of data around why these changes were necessary, what outcomes they might have, and what guardrails were in place. In January 2020, approximately 85 percent of 80.01-90 percent LTV, rate/term refinance loans at the GSEs received full appraisals and only 15 percent of loans received appraisal waivers, exclusively through Fannie Mae's program.[5] There was a significant decrease in mortgages with full appraisals throughout 2020 and by October 2020, only about 50 percent of GSE-backed 80.01-90 percent LTV, rate/term refinance mortgages received full appraisals.[6]

Industry Observations – AUS Shopping

As a general matter, USMI believes FHFA and the GSEs should establish clear guidelines to ensure that collateral valuation, including the use of different appraisal methodologies and models, is not a source of competition between the two GSEs. Following an internal study of "repeat address transactions" (i.e.,

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[3] LTV ratio is a primary factor for determining loan-level capital requirements for private MIs under PMIERs and the GSEs under the finalized Enterprise Regulatory Capital Framework (85 Fed. Reg. 82150 (December 17, 2020)).

[4] There is a material difference in getting an appraisal a valuation slightly incorrect on a 60 percent LTV loan (with an equity cushion of 40 percent) than not getting the most precise appraisal valuation for an 80 percent or 90 percent LTV loan.

[5] eMBS data, USMI member data.

[6] eMBS data, USMI member data.

transactions where data on the most recent valuation and a prior valuation are available), USMI member companies have noticed significant – and in some respects concerning – differences in valuations between the two GSEs' respective appraisal waiver programs. FHFA should be mindful of the potential for systemic overvaluations with one of the GSEs' programs when benchmarked to a local housing price index (HPI) and recognize the lack of transparency around the GSEs' valuation technologies. This could manipulate the mortgage market and result in lenders' increased utilization of a specific GSE's automated underwriting and collateral valuation systems to receive favorable property valuations.

USMI members have also observed, and shared our observations with FHFA, that some lenders appear to be "AUS shopping" to optimize loan execution by testing Fannie Mae's Desktop Underwriter (DU) and Freddie Mac's Loan Product Advisor (LPA) for a potential appraisal waiver valuation "advantage." Our industry has seen compelling evidence that lenders are increasingly running loans through both AUSs to determine which one allows the most "advantageous" property valuation. It is important to note that each GSE conducts a validation when it assesses its own model, a process that does not make presumptions about the other GSE's model and where it may fail. Applying the two models to the same loan is inconsistent with how they're validated and effectively undermines the credibility of the GSEs' own validation processes. The GSEs themselves are aware of the "gaming" potential and USMI strongly encourages the GSEs to take actions to address this concern and prevent inappropriate gaming that might occur through the use of the appraisal waiver valuations.

Industry Observations – Compensating Factors for Appraisal Waivers

USMI members have conducted a forensic analysis of loan files with appraisal waivers and found that both GSE appraisal waiver programs consistently missed adverse site conditions that would have been apparent to a trained appraiser. A primary drawback of appraisal waivers is that they miss critical property data during the valuation process that should be collected and analyzed as part of the underwriting process. While property data need not be concurrent with a refinance transaction, recent data is important to industry participants, especially those with a vested interest in mortgage credit risk post-closing.

While the use of appraisal waivers has dramatically increased, there has been minimal transparency concerning whether the GSEs have specific credit policies regarding loan eligibility for their respective appraisal waiver programs. The expanded use of appraisal waivers should be accompanied by a transparent set of compensating factors for determining loan-by-loan waiver decisions. Data from 2020 suggests that at least one of the GSEs takes into account debt-to-income (DTI) ratio, credit score, and whether the borrower has a prior full appraisal on file. USMI believes these types of overlays are appropriate to mitigate the incremental risk of appraisal waivers. While not directly tied to collateral valuation, weaker DTIs and credit scores may correlate to deferred maintenance and property condition issues that go undetected when appraisal waivers are utilized.

Property data collection is a particularly important part of the valuation and underwriting processes. One appropriate guardrail for mortgages that receive appraisal waivers or other flexibilities would be to require a property inspection followed by a Desktop Review. One of the biggest challenges with the appraisal waiver programs is that property data collection is missed, and this policy would help mitigate the risk associated with underwriting a mortgage without a full appraisal.

Recommendations

Many of the appraisal modernization efforts of the GSEs over the years have led to general process improvements, however it is very important to recognize that AVMs and other alternatives to a full appraisal are not appropriate for every situation. For the reasons outlined above, USMI believes appraisal alternatives should be used in limited circumstances, and only with appropriate guardrails. To better tailor the use of appraisal waivers, it is critical that the GSEs' programs be subject to robust oversight by FHFA and that strong governance policies be in place to promote transparency and facilitate data sharing with market mortgage market participants. It is especially important that the FHFA implement policies that recognize and speak to the unique risks associated with the use of waiver appraisals in the high LTV segment of the market. As the equity position on a mortgage decreases, the risk of loss severity can increase, and these mortgages cannot merely rely on amortization or home price appreciation (HPA) to guard against risk stemming from incorrect AVM valuations. FHFA and the GSEs should implement policies to address the potential for "gaming" to test and shop appraisal waiver programs to reduce LTVs and/or reduce or eliminate MI coverage requirements. Particular attention should be given to the 80 percent LTV threshold, which is a segment of the market that has historically been the largest contributor of GSE losses. The usage of appraisal waivers to "game" the 80 percent LTV segment to reduce or eliminate MI coverage shifts a greater burden of losses toward taxpayers and away from private capital. Further, while LTV is – to some degree – correlated to loan performance, guardrails such as the presence of compensating factors should be considered to inform policies that pertain to this specific segment of the market.

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USMI appreciates the opportunity to share its views on these important issues with the FHFA. We welcome any questions you may have, as well as requests for data to supplement our observations and recommendations. USMI welcomes efforts by FHFA to properly balance innovation in the housing finance system with the need for transparent standards and appropriate protections.

Questions or requests for additional information may be directed to Lindsey Johnson, President of USMI, at ljohnson@usmi.org or 202-280-1820.

Sincerely,

Lindsey D. Johnson
President

APPENDIX A

General Questions on Appraisal Policy and Process Improvements

A1.1: Is there a need to provide new valuation solutions that address industry identified issues of appraiser capacity, turn-times, training, and rural and high-volume market coverage? What are those potential solutions? What are the risks of these policies and the challenges in implementing them?

Appraiser capacity, turn-times, lack of training, and rural and high-volume market coverages are all well-documented issues and concerns within the housing finance industry. USMI and our member companies recognize that there is an opportunity through appraisal modernization to enhance the appraisal process and to address many of the existing challenges, including those that stem from the shortage of qualified appraisers in the market and the unique challenges in rural markets of getting appraisers and having comparable properties for valuations. There is also an opportunity to generally improve the collateral risk assessment and valuation processes. The significant advancements in technology, data aggregation, and analytics throughout the mortgage finance industry have positively impacted many professions and processes. Collateral risk assessment and real estate valuation can benefit from these same technological advancements if done appropriately.

In addition, FHFA and the GSEs should consideration the application of alternative valuation solutions for all origination, risk management, and servicing functions that require a valuation, including quality control and default servicing. For example, lenders and mortgage insurers are required to obtain field reviews for a subset of properties associated with a random sample of loans. This creates a significant expense and often creates delays in the quality control cycle. By applying a risk-based framework for the various valuation needs, the mortgage industry could optimize its use of appraisers for the tasks where their skill and experience are most needed and promote efficiency and cost reduction for low-risk valuation activities.

It is important, however, to recognize the risks of relying on inspection-only or third-party data collection for purposes of property valuation. These options pose a risk to the reliability of information used in the collateral valuation and collateral risk assessment since they utilize persons who may be unlicensed, unregulated, or whose contribution to the data collection (e.g., property data, interior pictures, etc.) and/or valuation process lack standards and enforcement mechanisms. Further, of particular concern is data from persons who have a vested interest in the outcome of the transaction, such as homeowners, sellers, borrowers, and real estate agents.

When considering potential improvements to collateral risk assessment and valuation processes, the objective should be the pursuit of a realistic and reliable understanding of collateral risk and property value. This objective obligates ideas to be tested against vulnerabilities in assumptions, data accuracy, and reliability. To encourage buy-in from counterparties, opaque analytics should be offset by robust data sharing, audit result sharing, collaborative communications, and transparency into key tolerances. Further, it is imperative to use this opportunity to reinforce the importance of continuously engaging and requesting and receiving input, as well as sharing data with other key stakeholders to mortgage transactions, including lenders and mortgage insurers who stand in a first-loss position. USMI and our member companies support innovation and process improvement but firmly believe that modernization efforts must include appropriate guardrails, transparency, and data sharing with mortgage market participants to best address potential increased risk associated with new valuation solutions.

A1.2: Are there opportunities for process improvements that allow non-traditional valuation services (inspection-only, desktop, exterior-only) to augment traditional appraisals? Please elaborate on the risks, challenges, and benefits. Separately, are there opportunities to improve traditional appraisals to mitigate problems and concerns that have been observed to date?

As previously stated, there are opportunities to improve the collateral risk assessment and valuation processes to address existing challenges and to take advantage of the advancements that technology and enhanced data analytics and aggregation can provide to the valuation process. If done appropriately these improvements will address current market challenges and achieve a more accurate and reliable understanding of collateral risk and value.

Risks of using inspection-only or third parties for data collection include that the utilization of these persons who may be unlicensed, unregulated, or persons whose contribution to the data collection (e.g., property data, interior pictures, etc.) and/or valuation process lack standards and enforcement mechanism, poses a risk to the reliability of information used in the collateral valuation and collateral risk assessment. Further, of particular concern is data from persons who have a vested interest in the outcome of the loan/transaction, such as homeowners, sellers, borrowers, and real estate agents.

One of the risks posed by expanding desktop valuations is the risk of appraisers becoming licensed in many states or accepting assignments over an entire state so they can generate enough volume to focus exclusively on desktop appraisals. Local market knowledge is significantly influential in buyer/seller decisions and fundamental to credible market value appraisals. There are few states, however, where an appraiser could credibly claim local market knowledge for a single state and limited areas (such as the Washington, DC or Philadelphia metro areas) where an appraiser could plausibly claim local market knowledge across state lines. As such, the risk is that desktop appraisals are completed by appraisers who lack sufficient familiarity with the local real estate market to render a credible appraisal. Given the risks noted above, any expansion or continuation of the use of desktop appraisals should be accompanied by explicit requirements for the GSEs and lenders to develop effective processes for ensuring that appraisers being considered for a desktop appraisal assignment are sufficiently proximate and/or experienced in the local market so as to credibly assert local market knowledge and competency.

Another area of concern with desktop appraisals is the apparent ease by which licensed appraisers could utilize non-licensed individuals to complete the desktop appraisals with the licensed appraiser signing the appraisal and misrepresenting themselves as the person who completed the desktop appraisal. Although the fraudulent use of unlicensed appraisers to conduct inspections and prepare appraisals has occurred in traditional appraisal assignments, the assignment at least involved an inspection where the unlicensed appraiser could be identified and discovered. This would be significantly more difficult to discover in a similar scheme involving desktop appraisals. The economics of desktop appraisals would favor the least expensive appraiser, which would encourage the use of domestic or international unlicensed people in the fraud scheme.

To minimize risk of incorrect valuation, guardrails should accompany modernization. For example, non-credit factors such as the availability of data from a recent appraisal, the age of the home, the complexity of the property, and the micro-market trends may be important factors to consider when assessing the use of non-traditional valuation services.

A1.3: Do waivers appraisals have a place in Enterprise appraisal policy and process, and if so, for what segment of loans? What are the current risks to Enterprise safety and soundness in how appraisal waivers are offered? Would caps or other limits on their usage be appropriate.

Appraisal waivers have a place in the GSEs' appraisal policies and processes, provided they are utilized on properties for which data critical to assessing property value and eligibility is sufficiently comprehensive, current, and reliable and appropriate limits are placed on their use/applicability, particularly in declining markets, on complex properties, and higher risk properties.

However, there are several risks that are posed by appraisal waivers that should be considered as FHFA reviews and considers making certain allowances temporary or permanent. Appraisal waivers can have a material impact on risk in the housing finance system as the underlying valuations affect LTV ratios and the appropriateness of pricing and risk assessments for the GSEs' guarantee fees, mortgage insurance premiums, and prudential measures such as FHFA's finalized Enterprise Regulatory Capital Framework.[7] Importantly, these considerations are more acute for higher LTV loans and it is important for the FHFA and GSEs to acknowledge and address the unique risks associated with the use of waivers in the high LTV segment of the market. The risk of loss severity on these mortgages is elevated since the equity positions are thinner and homebuyers/market participants cannot merely rely on amortization or home price appreciation (HPA) to guard against risk stemming from incorrect AVM valuations.[8] Inaccurate valuations permitted by appraisal waivers could enable delivery of loans with LTVs that arbitrarily – and inappropriately – misprice MI credit risk protection. Guardrails such as the presence of compensating factors should be considered when implementing policies that pertain to this specific segment of the market. Credit profile overlays, including but not limited to DTI ratio, credit score, and a prior full appraisal on file, are appropriate mitigants for the increased use of appraisal waivers on high LTV mortgages.

USMI specifically urges the FHFA to consider the following policies to ensure robust oversight of the GSEs' appraisal waiver programs:

- There should be a prudent LTV maximum for appraisal waiver decisioning to protect against the underpricing of mortgage credit risk and increased risk to the American taxpayer.
- There should be a risk-based framework to determine the appropriateness of appraisal waivers on a loan-by-loan basis and prevent inappropriate competition between the GSEs, especially as it relates to the 80 percent LTV threshold, where private MI protection is not on, which is a segment of the market that has historically been the largest contributor of GSEs losses through stressed economic scenarios. The framework should include increased transparency around the use of compensating factors during the waiver decision process.
- Require that properties receiving appraisal waiver have a prior full appraisal on file that was completed within a certain timeframe. USMI recommends a maximum timeframe of five years and encourages the GSEs to study their own data to determine an appropriate time period.
- Require greater transparency and data sharing among private MIs and other market participants around the GSEs' AVMs and derived property valuations.

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[7] 85 Fed. Reg. 82150 (December 17, 2020).

[8] There is a material difference in getting an appraisal a valuation slightly incorrect on a 60 percent LTV loan (with an equity cushion of 40 percent) than not getting the most precise appraisal valuation for an 80 percent or 90 percent LTV loan.

In addition, automated and index-based valuations rely on broader price trends that can overshadow local or property-specific conditions that would point to higher LTVs. Furthermore, the different approaches to appraisal waivers by the two GSEs create frictions that appear to be incentivizing undesirable lender behaviors and further exacerbating these risks. Another issue is the difficulty for alternative appraisal methods to detect adverse site conditions. USMI notes that a forensic analysis of recent loan files with appraisal waivers found that both of the GSEs' programs consistently missed such conditions that would have been apparent to a trained appraiser.

Given the lack of standards, enforcement, accountability, and oversight of automated valuations and automated valuation providers – coupled with the risk of automated valuation value shopping – the GSEs should not entertain acceptance of non-GSE automated valuations procured by a lender.

Of additional note, the benefits of waivers are enjoyed primarily by those that do not hold the mortgage risk or whose exposure to the risk is often short-term. As such, the GSEs should maintain a high degree of transparency and collaboration with counterparties who maintain long-term risk associated with loan repayment and foreclosure.

A1.4: Would utilizing alternative inspection workforces, such as insurance adjusters, real estate agents, and appraisal trainees assist with addressing appraiser capacity concerns? Are there risks of using third-party non-appraisers? If yes, how?

The utilization of alternative inspection workforces in the property data collection process appears reasonable and viable – particularly the use of appraisal trainees.

However, caution should be exercised in the use of persons who lack formal governmental oversight, industry vetted standards of practice, mechanism for enforcement of standards, and accountability for adherence to standards. It is critical that parties collecting critical information about the property are required to be objective, independent, and impartial. There must be formal oversight to ensure enforcement of these requirements. Otherwise, there is potentially unmitigated risk that minimally qualified persons, operating with minimal oversight and accountability, may participate in practices that compromise the reliability and accuracy of key data supplied in the property data collection process.

The utilization of persons who are unlicensed, unregulated, or persons whose contribution to the data collection (e.g., property data, interior pictures, etc.) and/or valuation process lack standards and enforcement mechanism, poses a risk to the reliability of information used in the collateral valuation and collateral risk assessment. Of particular concern are persons who have a vested interest in the outcome of the loan/transaction, such as homeowners, sellers, borrowers, and real estate agents. Such practices increased the risk of the exposure of the GSEs prior to the 2008 financial crisis. The collateral associated with home loans needs to be understood by all counterparties for risk to be minimized.

Standardization of alternative inspection workforces, including transparency into the use of the data they collect as part of the appraisal process, should be developed by FHFA before their utilization is permitted. Additionally, the GSEs should consider establishing a transparent system to ensure that property inspections are regularly, transparently, and effectively audited.

A1.5: Is there a need for additional policies and controls to balance potential risks with efficiency benefit from appraisal modernization? If yes, please provide your recommendations.

It is appropriate to consider addressing the challenges and issues that exist within the collateral risk assessment and valuation processes, as the GSEs seek to modernize their appraisal policies and collateral valuation technologies. USMI strongly believes that the FHFA should implement policies to ensure that innovations around the appraisal process are done when there is demonstrable benefit to the broader housing finance system, including greater transparency, efficiency, accuracy of property valuations, and lower costs for borrowers and market participants. When considering potential improvements to collateral risk assessment and valuation processes, the objective should be the pursuit of a realistic and reliable understanding of collateral risk and value. This objective obligates ideas to be tested against vulnerabilities in assumptions, data accuracy, and reliability. Further, modernization should be accompanied by guardrails to minimize the risk of incorrect collateral valuation outcomes and any adverse effects on mortgage underwriting.

With respect to using a workforce to conduct important property level data gathering that are not licensed appraisers, it is important that protections against improper bias, fraud, and negligence be added to the system. Caution should be exercised in the use of persons who lack formal governmental oversight, industry vetted standards of practice, mechanism for enforcement of standards, and accountability for adherence to standards. It is critical that parties collecting critical information about the property are required to be objective, independent, and impartial. As the RFI notes, there is a lack of a uniform regulatory framework for non-appraiser accountability, and therefore FHFA should develop such a framework with industry stakeholder input to mitigate the risks associated with lessening reliance on trained appraisers in the property valuation process. This should include training requirements for alternative inspection workforces and guidelines for the types of data gathered by non-appraisers that are acceptable for use in appraisal reports. There should also be formal oversight to ensure enforcement of these requirements. Otherwise, there is potentially unmitigated risk that minimally qualified persons, operating with minimal oversight and accountability, may participate in practices that compromise the reliability and accuracy of key data supplied in the property data collection process.

Given the lack of standards, enforcement, accountability, and oversight of automated valuations and automated valuation providers – coupled with the risk of automated valuation value shopping – the GSEs should not entertain acceptance of non-GSE automated valuations procured by a lender. Further, model weaknesses and discrepancies, and ways to mitigate for those weaknesses, should also be considered for determining when and how to use these technologies.

Automated valuations used by a GSE as a source of value estimation for a property securing a loan should be independently tested for accuracy and reliability, and such test results should be shared with counterparties who are reliant on the accuracy and reliability of such automated valuations. Such information sharing and independent testing supports transparency, collaboration, and credibility.

The recommendations above, including introducing minimum training and data requirements for non-appraisers, along with provisions for audits of appraisal processes and testing of automated valuation systems would lessen the risk that these provide incorrect valuations as well as serve as a check against bias in appraisals.

A1.6: Do the objectives as outlined for the UAD update and forms redesign meet the current and future needs of the mortgage industry? Are there opportunities for refinements or additions?

The objectives as outlined for the Uniform Appraisal Dataset (UAD) update and forms redesign appear to meet the over-arching current and future needs of the mortgage industry. However, the GSEs should consider limiting property data collection to those characteristics and attributes that are essential to assessing collateral risk.

Gathering non-essential data risks increased expense to the consumer, excessive inspection time, and increases risks of limited workforce participation. Moreover, unnecessarily invasive property inspections, particularly on refinance transactions, risk rejection by borrowers.

When considering updates to the UAD, the GSEs should develop and publish an analysis of the tangible and quantifiable benefits to the mortgage transaction, along with an analysis of the costs that will be borne by the mortgage industry to implement updates. Given the significant role that the GSEs serve in the mortgage system and the significant impact their actions have on the mortgage market, the incorporation of market/industry cost impact analysis would be prudent, helpful, and consistent with the rigor often required of government entities when considering new rulemaking or legislation.

Questions on Risk Management

B2.1: How could the Enterprises make additional data available to appraisers while promoting appraisal independence without crowding out other data providers? What additional challenges arise if the Enterprises provide data to appraisers?

Although there is some foreseeable benefit to appraisers receiving GSE data about subject properties and comparable sales during their data research and analysis, the risks of sharing such data include privacy concerns, concerns about competition with private data providers, and concerns that GSE data becomes an echo chamber.

B2.2: How can the Enterprises improve their collateral tools currently available to lenders?

USMI strongly supports greater transparency and sharing of data around the GSEs' collateral tools. This should apply to interactions between the GSEs and lenders, private mortgage insurers, and other market entities that play a role in the mortgage underwriting process. Increased data sharing and greater insight into the GSEs' collateral tools will assist market participants' analyses of individual mortgage transactions, especially entities such as private mortgage insurers who manage credit risk long after the closing table. Further, as the GSEs seek to modernize their appraisal policies and collateral tools, it is critical that there be a balance between innovation at the GSEs and the need for transparent standards and appropriate protections from undue risk in the housing finance system. FHFA policies should be mindful that competing technologies, such as the two GSEs' collateral valuation tools, have the potential to increase risk beyond their expected benefits to the housing finance system.

B2.3: How do Enterprise appraisal waiver offers differ between Freddie Mac and Fannie Mae? Are both Enterprises equally likely to offer a waiver on a given property? Please elaborate.

The GSEs have offered appraisal waivers on eligible refinance transactions since the late 1990s (and on certain purchase transactions since 2017), but their use has significantly increased during 2020.[9]

[9] Expansion of appraisal waivers were implemented via Fannie Mae LL-2020-04 and Freddie Mac Bulletin 2020-5 (both issued March 23, 2020 and subsequently modified/extended multiple times).

Unfortunately, the dramatic increase in the use of appraisal waivers by the GSEs was not coupled with additional data sharing with mortgage market participants, including private MIs that underwrite and insure single family mortgage credit risk, to understand appraisal waiver decisioning at the loan level.

The GSEs should require that property data from a prior appraisal be present in the UAD as a condition of waiver eligibility. The absence of property data from a prior inspection offers increased risk to an appraisal waiver, due in part to issues with data reliability, sufficiency, and completeness. When a GSE requires prior appraisal/property inspection information, the GSE can consistently apply property condition, property type, and other relevant screens to verified property data when determining waiver eligibility.

USMI analysis of “repeat address transactions” (transactions where data on the most recent valuation and a prior valuation are available) revealed stark differences between the two GSEs’ appraisal waiver programs. While market participants do not have visibility into the GSEs’ specific credit policies for determining loan eligibility for appraisal waivers, the loan characteristics for the two GSEs are substantially different. For example, data for 2020 refinances suggests that the GSEs differ in the application of “overlays” that are considered, including DTI ratios and credit scores. While higher DTIs and lower credit scores are not directly connected to collateral valuation, they may correlate to deferred maintenance and property condition issues that go undetected when appraisal waivers are utilized.

B2.4: How can lenders manipulate automated underwriting systems when seeking an appraisal waiver? For example, lenders changing the loan amount, submitting data changes multiple times, or submitting to both Enterprises and delivering to the one who offers the waiver? How do the Enterprises minimize this manipulation?

If a GSE makes an appraisal waiver offer based on reliable and sufficient property information, coupled with a reliable and accurate automated valuation, then lenders submitting multiple changes to the estimated property value to obtain an appraisal waiver would not appear concerning. Presumably, if a loan did not initially receive a waiver offer, but eventually achieved a waiver offer via multiple changes to the inputted value, the waiver offer would have been based on reductions to the lender’s estimated value – which is not a particular concern. Alternatively, achieving a waiver offer by leveraging property information asymmetry between the GSEs or by improperly manipulating other influential variables to a waiver offer (property type, occupancy, etc.), would represent a concern.

Evidence through 2020 indicates that frequency and probability of appraisal waiver offers are not consistent between the GSEs, which may partially be explained by their differing property data, eligibility standards, and approaches to independently estimating the current property value.

As evidenced by the data and observations in our response to Question B2.3, the different approaches to appraisal waivers by the GSEs appears to incentivize undesirable lender behaviors. USMI members have observed some lenders optimizing refinance mortgage execution by testing both GSEs’ AUSs to determine which one allows for the most “advantageous” property valuation. The GSEs themselves are aware of this trend in the market and USMI strongly encourages the GSEs to take actions to address this concern and prevent inappropriate competition between the two GSEs.

The GSEs may reduce potentially inappropriate lender behavior by utilizing advanced analysis to identify normal lender interaction with the automated underwriting system and flagging atypical behaviors for additional scrutiny/review. Also, requiring both GSEs to have recent inspection information about the subject property would reduce the property information asymmetry that may contribute to adverse selection for gaming.

B2.5: What are the challenges associated with quality of services, enforcement, and consumer protections related to non-appraiser entities providing property inspection data?

With respect to using non-appraiser entities to conduct critical property level data gathering, it is important that protections against improper bias, fraud, and negligence be added to the system. Caution should be exercised in the use of persons who lack formal governmental oversight, industry vetted standards of practice, mechanism for enforcement of standards, and accountability for adherence to standards. It is critical that non-appraiser entities who are engaged to collect critical information about the property are required to be objective, independent, and impartial. There must be formal oversight to ensure enforcement of these requirements. Otherwise, there is potentially unmitigated risk that minimally qualified persons, operating with minimal oversight and accountability, may participate in practices that compromise the reliability and accuracy of key data supplied in the property data collection process.

Additionally, the GSEs should consider establishing a transparent system to ensure that property inspections are regularly, transparently, and effectively audited.

B2.6: Is there any data or evidence you could share regarding the performance of alternative appraisal solutions versus traditional appraisals?

As previously noted, USMI members are cognizant of the potential for increased risk in the housing finance system due to systemic overvaluations for mortgage underwriting that utilizes the GSEs' proprietary AUSs and collateral tools/technologies rather than full appraisals. Index-based technologies that rely on broader HPI trends that can ignore or downplay local or property-specific conditions that would produce more accurate, often slightly higher, LTVs. Systemic overvaluations of properties associated with refinance transactions have the potential to manipulate the pricing and amount of mortgage credit risk in the housing finance system. This is most acute for high LTV loans which have smaller equity cushions to absorb inflated/inaccurate valuations.[10] The continued use or expansion of alternative appraisal solutions should only be permitted so long as their accuracy and efficacy are on par with full appraisals, both of which should not be compromised in the name of "innovation" or "efficiency." Ideally, the FHFA should consider utilizing an effective bifurcated process, in lieu of appraisal waivers, that retains an inspection of properties collateralizing mortgage loans.

B2.7: Should Enterprise type COVID-19 appraisal flexibilities be part of an updated appraisal process to address disasters and other events to less market impacts?

COVID-19 appraisal flexibilities (except for unvalidated borrower supplied property information) should remain a part of the GSE appraisal modernization efforts and would be useful in disaster situations to lessen market impacts.

The use of unvalidated/corroborated property information by the borrower or seller poses a risk to the reliability of such information when used by an automated valuation system, exterior-only appraisal, or

[10] There is a material difference between a slightly incorrect valuation on a 60% LTV mortgage and an incorrect valuation on a 90% LTV mortgage due to the significant disparity in homeowner equity.

desktop appraisal in collateral valuation. Property condition, quality and features are prominent components of property value and thus should be obtained from sources who are reasonably considered to be objective and impartial. A borrower or seller has a vested interest in the outcome of the loan/transaction, is thusly not impartial, and benefits from information asymmetry about the property. For these reasons, utilizing borrowers or sellers to provide unverified information about the current property condition, quality, and features, provides opportunity and incentive to misrepresent such key information.

To better achieve these goals, FHFA should consider utilizing an effective bifurcated process of property level data gathering from the analysis of the collateral for the purpose of the value estimation and property eligibility. Further, process improvements that aggregate non-traditional appraisal estimates and valuations from licensed appraisers would allow for greater efficiency, accuracy and transparency in many cases than relying solely on traditional appraisals. Automated property valuation tools provide an actionable baseline for home value based on comparable sales. Potential challenges associated with automated evaluations include procyclical influences and skewed underlying data. A licensed appraiser may need to adjust for these in some cases.

<u>Operational Questions on Appraisal Process Improvement</u>

C1.1: What do you envision the impact of appraisal process improvement as described in this RFI to be on the appraisal industry? What impact, if any, has increasing use by the Enterprises of alterative appraisal solutions had on the availability and/or quality of traditional appraisals?

A potential outcome of reducing the role of licensed appraisers (either by products that eliminate their participation or that lessen their involvement) is a reduction in the number of licensed appraisers. Peak demand periods impact the service levels of many functions of the mortgage system (e.g., underwriters, surveyors, title companies, county recorders, real estate agents, appraisers, processors, lenders, etc.). During these peak periods, service levels typically elongate and closing times increase. Naturally, appraisal turn times typically elongate during periods of heavy demand, such as the demand the market experienced in 2020, and would be considerably worse if appraisal waivers were not being used.

However, the record levels of mortgage volume are likely to regress to normalcy. If appraisal waivers remain a large part of the volume at that time, the result will be a consequential loss of licensed appraisers. And, since the barrier to entry for appraisal licensure is necessarily time consuming, resulting in inelasticity of supply, it is unlikely that a sufficient volume of new appraisers can be fielded when volume levels increase. Thus, future peak demand periods may experience yet another appraiser shortage, but this time in the form of a shortage of appraisers to participate in the non-traditional valuations.

Although there is a risk of perpetuating a shortage of real estate appraisers via modernization efforts and the use of appraisal waivers, that risk should not impede appraisal modernization or the development of non-traditional collateral risk assessment tools/processes but should be considered in the analysis of risk/reward.

C1.2: What would be the impact of appraisal policy and process improvements to the mid or late career appraiser? Do you believe late career appraisers would delay retirement if they could focus on specific valuation services like desktop appraisals? Or alternatively, would late career appraisers cease operations due to technology adoption challenges?

Mid and late career appraisers may delay retirement if there is sufficient volume to enable a full transition to desktop appraisals. Technology challenges may result in some loss, but it is unlikely that such loss would be significant in number. Alternatively, non-appraisers of any career stage may be attracted to appraisal for the opportunity to focus primarily or exclusively on desktop valuations.

One of the risks posed by expanding desktop valuations is the risk of appraisers becoming licensed in many states or accepting assignments over an entire state so they can generate enough volume to focus exclusively on desktop appraisals. Local market knowledge is significantly influential in buyer/seller decisions and fundamental to credible market value appraisals. There are few states, however, where an appraiser could credibly claim local market knowledge for a single state and limited areas (such as the Washington, DC or Philadelphia metro areas) where an appraiser could plausibly claim local market knowledge across state lines. As such, the risk is that desktop appraisals are completed by appraisers who lack sufficient familiarity with the local real estate market to render a credible appraisal. Given the risks noted above, any expansion or continuation of the use desktop appraisals should be accompanied by explicit requirements for the GSEs and lenders to develop effective processes for ensuring that appraisers being considered for a desktop appraisal assignment are sufficiently proximate and/or experienced in the local market so as to credibly assert local market knowledge and competency.

Another area of concern with desktop appraisals is the apparent ease by which licensed appraisers could utilize non-licensed individuals to complete the desktop appraisals with the licensed appraiser signing the appraisal and misrepresenting themselves as the person who completed the desktop appraisal. Although the fraudulent use of unlicensed appraisers to conduct inspections and prepare appraisals has occurred in traditional appraisal assignments, the assignment at least involved an inspection where the unlicensed appraiser could be identified and discovered. This would be significantly more difficult to discover in a similar scheme involving desktop appraisals. The economics of desktop appraisals would favor the least expensive appraiser, which would encourage the use of domestic or international unlicensed people in the scheme of deception and misrepresentation.

C1.3: Do you believe appraisal policy and process improvements would have a positive impact on access to credit, including for rural and underserved markets by providing additional valuation services that serve the needs of these markets?

When considering potential adjustments to appraisal policy and process improvements pertaining to collateral risk assessment and valuation, the objective should be the pursuit of a realistic and reliable understanding of collateral risk and value. While we support the exploration of less costly alternatives, including the responsible deployment of alternative valuation services, these changes must include guardrails. This objective obligates ideas to be tested against vulnerabilities in assumptions, data accuracy, and reliability. Broadly speaking, less costly valuation options will most benefit lower wealth borrowers.

Rural markets and rural housing commonly offer complexities, such as paucity of sales and listings, limited data access, and significant diversity in housing characteristics, acreage, outbuildings, and land use. These complexities may impact the opportunity for responsible widespread use of non-traditional valuation products. As such, it is not clear whether the use of non-traditional products will have a meaningful positive effect on access to credit for rural markets. And, since rural borrowers face similar financial stresses and adverse events as non-rural borrowers, less rigorous property eligibility or credit requirements may result in long-term negative outcomes to rural borrowers and housing. The same concerns can be true for non-rural borrowers.

C1.4: Is there discrimination in current collateral valuation practices? If you believe there is discrimination, describe the impact. Please provide any relevant data or analysis to support your position. Conversely, are there concerns that alternative or automated solutions could have a discriminatory impact?

Please see response to Question C1.5.

C1.5: What are the fair housing impacts of current FHFA and Enterprise policies and procedures on appraisals and valuations, and how can these policies change to further fair housing? Please provide any relevant data or analyses.

Some industry stakeholders have long asserted that AVMs would reduce costs and increase the accuracy of property valuations during the mortgage underwriting process. Consumer advocates, however, will point out that artificial intelligence (AI) systems and algorithmic valuation models do not remove biases from the underwriting process and, in some cases, can even amplify them to the detriment of minority borrowers. AVM technologies rely on historical data to arrive at valuation determinations and this data may include discriminatory information that could yield lower property values in formerly redlined areas. Artificially low appraisals due to the use of AVMs have the potential for transactions to fall through or penalize Black borrowers with higher LTV ratios and higher interest rates. These issues essentially reduce wealth accumulation for minority borrowers, thereby exacerbating the existing racial homeownership and wealth gaps.

While lenders do not intend to engage in discriminatory mortgage lending practices, appraisal policies must be cognizant of potential unintended consequences associated with broad AVM utilization on minority borrowers. To best mitigate fair housing risks, FHFA should consider collaborating with lenders and real estate companies, such as Zillow and Redfin, that have developed valuation models to identify best practices and craft appropriate appraisal standards.

USMI fully supports collaboration between FHFA, the GSEs, market participants, and consumer advocates to further study discrimination and fair housing concerns related to policies governing appraisals and valuations. It is important that stakeholders conduct a data-driven analysis to determine any existence of systemic discrimination in the appraisal process and ensure that policies at the GSEs and FHFA fully support access to affordable conventional mortgages for all consumers.