

Comments
to the
Federal Housing Finance Administration
in response to its December 28, 2020
Request for Information On Appraisal-Related Policies, Practices, and
Processes

submitted by the
National Consumer Law Center
on behalf of its low income clients,
Americans for Financial Reform Education Fund,
Consumer Action, Mountain State Justice, the National Fair Housing Alliance,
and the National Housing Law Project

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Thank you for the opportunity to comment on Fannie Mae and Freddie Mac’s appraisal-related policies, practices, and processes.¹ The National Consumer Law Center (NCLC) submits the following comments,² on behalf of its low-income clients, with Americans for Financial Reform Education Fund, Consumer Action, Mountain State Justice, the National Fair Housing Alliance, and the National Housing Law Project.

1. Introduction.

The modern real estate finance market would not exist without reliable and standardized appraisals. But Fannie and Freddie are increasingly using appraisal waivers and automated valuation models (AVMs). We believe this is cause for concern—to the safety and soundness of the Enterprises, to consumers, and to the economy in general. The technology underlying the Enterprises’ appraisal policies can have benefits, but only if it is implemented with appropriate safeguards and with appropriate respect for its limitations.

We compliment FHFA on requesting information about the issues highlighted in the RFI. But we also wish to emphasize that FHFA needs to conduct or commission its own research on critical aspects of alternative valuation tools *before* expanding the use of appraisal waivers. Much of the information needed to guide appraisal policy is not yet available or is controlled by competitive interests that will not share it publicly. The Enterprises and other industry participants have vast amounts of data that should be made available to researchers who can reach transparent conclusions about AVMs and related valuation practices.

Because AVMs play such a critical role in any discussion of valuation methods today, we start with a section describing our concerns and recommendations. After that, we explain why appraisals are particularly important to consumers. We then respond to those questions from the RFI that are most relevant to consumers. We have sometimes grouped questions together to reduce repetition

¹ Fed. Hous. Fin. Admin., Request for Information on Appraisal-Related Policies, Practices, and Processes (Dec. 28, 2020), *available at* <https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/RFI-Appraisal-Related-Policies.pdf> (hereinafter “RFI”).

² For questions about these comments, contact Andrew Pizor, Staff Attorney at the National Consumer Law Center, apizor@nclc.org, or Jennifer Wagner, Managing Attorney of Mountain State Justice, jennifer@msjlaw.org.

in our answers. Finally, we make recommendations for how FHFA should proceed, including areas where appraisal waivers may be appropriate.

2. Conduct more research on AVM reliability and develop public standards for accuracy.

Automated valuation models (AVMs), especially Freddie Mac's Loan Collateral Advisor and Fannie Mae's Collateral Underwriter, are at the heart of how the Enterprises use appraisal waivers and FHFA's discussion of appraisal modernization. So any discussion of either automation or waivers must begin with AVMs. In 2010 Congress recognized the importance of AVMs by directing the federal banking agencies and the CFPB to promulgate quality control standards.³ Unfortunately, that mandate has been ignored. That makes FHFA's supervision of Fannie and Freddie even more important.

AVMs are a black box with tremendous influence on the real estate market. They have become systemically critical but are unsupervised. The RFI says the "Enterprises monitor and test their AVMs for model risk." But that is a vague statement that leaves much unanswered. Do the Enterprises test their AVMs for racial bias or disparate impact? What level of accuracy do they consider sufficient? And are the tests audited by impartial outsiders? At the end of these comments, we list other questions that FHFA should address before expanding the use of waivers or alternative valuation methods.

According to a 2011 report by the Government Accountability Office, "AVMs 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."⁴ In the ten years since that report, the first half of the statement has become less true—AVMs *are* becoming the primary source of information on property value for first-lien mortgages. But it is less clear that the second half of the statement has changed as much. As late

³ 12 U.S.C. § 3354(b).

⁴ Government Accountability Office, Report No. GAO-11-653, Residential Appraisals: Opportunities to Enhance Oversight of an Evolving Industry at 16 (July 2011), available at <https://www.gao.gov/products/GAO-11-653>.

as September 2019, Fitch Ratings said “[d]espite improvements in accuracy, use of Automated Valuation Models . . . still requires a guarded view”⁵

AVMs are based on data from traditional appraisals, public records, and private vendors.⁶ Problems with this data make the AVM less accurate. Variations in the availability of data make AVMs less consistent across the country and less reliable in specific areas. We are particularly concerned that increased use of appraisal waivers will reduce the amount of data available from the gold standard—traditional, in-person appraisals. This may further erode the reliability of AVMs.

The FHFA’s own Inspector General wrote not long ago that: “[M]odel-based alternatives to traditional appraisals have certain limitations. For example, AVMs may be less reliable in areas where properties do not share similar characteristics, such as age and size, or where insufficient data exists for a particular area, such as a rural area. Under a system based on a prior appraisal, appraisals can ‘age out’ of the system, requiring new appraisals to refresh the data.”⁷

Fitch and the Inspector General are not the only ones to recognize the limitations of AVMs—including Fannie Mae’s Collateral Underwriter. Moody’s Investors Service downgraded its assessment of JPMorgan Chase’s jumbo-mortgage aggregation unit when it began relying on Fannie Mae’s Collateral Underwriter and automated valuation models before escalating potential valuation issues to a desk review. According to a report about the Moody’s decision, Collateral Underwriter and AVMs introduce new risks due to limitations compared with desk reviews: “Examples of these limitations include using CU which is not calibrated for prime jumbo mortgages and insufficient information to assess the

⁵ Fitch Ratings, Conservatism Still the Best Path for AVMs in U.S. RMBS (Sept. 27, 2019), <https://www.fitchratings.com/research/structured-finance/conservatism-still-best-path-for-avms-in-us-rmbs-27-09-2019>.

⁶ CoreLogic, AVM FAQs (11-avm-faq-va-0804-00), <https://www.corelogic.com/downloadable-docs/avm-faqs.pdf> (2014).

⁷ Fed. Hous. Fin. Admin., Office of Inspector Gen., Overview of Enterprise Appraisal Waivers, OIG WPR-2018-006, <https://www.fhfa.gov/sites/default/files/WPR-2018-006.pdf>.

riskiness of using AVMs Neither product has a track record through a stressed economic cycle.”⁸

3. Consumers depend on accurate valuations.

3.1 Generally.

We compliment FHFA for recognizing that an accurate valuation matters not just to the financing industry but to consumers too. As the RFI says, “[i]naccurate data may lead to an appraisal waiver on an overvalued property leading a borrower to have higher LTVs than anticipated and with less equity in the property.”⁹ Inaccuracies can undervalue properties too. Either problem can have serious, practical consequences for homeowners and buyers:

- A high LTV is associated with an increased risk of foreclosure—which harms both the homeowner and the investor.¹⁰
- Potential buyers may refuse to purchase and lenders may refuse to finance a home if the valuation does not support the home price.¹¹
- If an appraisal undervalues a home so that lenders refuse to finance it, the buyer may be driven to a more expensive and risky land-installment or rent-to-own contract.¹²

⁸ Brandon Ivey, *Inside Mortgage Finance*, Chase’s Jumbo Aggregator Assessment Downgraded by Moody’s (Aug. 24, 2020), <https://www.insidemortgagefinance.com/articles/218986-chases-jumbo-aggregator-assessment-downgraded-by-moodys?v=preview> (quoting Moody’s).

⁹ RFI at 17–18.

¹⁰ Fed. Deposit Ins. Corp., *Interagency Guidance on High LTV Residential Real Estate Lending 2* (Oct. 8, 1999), *available at* <https://www.fdic.gov/news/financial-institution-letters/1999/fil9994.pdf>.

¹¹ See Alexander N. Bogin & Jessica Shui, *Appraisal Accuracy and Automated Valuation Models in Rural Areas*, 60 *J. of Real Estate Fin. & Econ.* 40, 41 (2020) (citing research finding that about a third of negative appraisals result in cancellation of sale).

¹² See National Consumer Law Center, *Toxic Transactions: How Land Installment Contracts Once Again Threaten Communities of Color* (2016), *available at* <https://www.nclc.org/issues/toxic-transactions-threaten-communities-of-color.html>; Sarah Mancini & Margot Saunders, *Land Installment Contracts: The*

- Potential buyers may be discouraged from purchasing a home in the mistaken belief that their down payment is too small to achieve the necessary LTV.
- Loan applicants may be offered a rate that is too high or charged unnecessary PMI because the lender mistakenly believes the loan will have an LTV over 80%.
- Sellers may be led to sell for less than their home is worth.
- Homeowners may be prevented from refinancing, thereby missing-out on lower interest rates or be prevented from making needed repairs.
- Homeowners may become the victim of churning, which would be more difficult without a valuation that incorrectly shows equity in the property.
- Buyers may be tricked by speculators flipping dilapidated properties or developing shoddy new construction for sale at huge markups— leaving them unable to sell or get a loan for repairs.
- A distressed homeowner may be denied a loan modification entirely because an inaccurate AVM leads the servicer to believe that foreclosure is better for the investor. Or the AVM may negatively affect which modification programs the borrower is evaluated for. Notably, the Enterprises have different loan modification rules for loans below 80% LTV. Such loans are not eligible for interest-rate reductions or principal forbearance.
- A homeowner may find herself underwater after purchasing an inaccurately valued home. If the homeowner later wants to sell to avoid foreclosure or take up a new job, doing so will be difficult or— for most people—impossible.
- Entire neighborhoods may be undervalued, preventing entire communities from growing wealth and discouraging outside investment. Or they may be overvalued for property tax purposes, draining wealth from a community.

Newest Wave of Predatory Home Lending Threatening Communities of Color, Fed. Reserve Bank of Boston Communities and Banking (Apr. 2017).

- A lender might make an incorrectly low bid at a foreclosure auction, causing the homeowner to owe a larger deficiency.

As this list illustrates, home buyers, sellers, and owners have just as much interest in getting an accurate valuation as the Enterprises.

One particularly grievous example illustrates a number of problems with the current state of AVMs, how they are being used, and how they can hurt homeowners:

A major servicer foreclosed on an Atlanta, Georgia homeowner and, based on an AVM, bid about \$40,000 for the house—roughly one third less than the loan balance. The homeowner’s attorney was able to get the sale unwound so the homeowner could apply for a modification. But the servicer then denied the modification based on a different valuation showing the house was now worth nearly \$100,000 more than the prior valuation. Further investigation revealed that the servicer was using two different AVMs: one for foreclosures and another for loan modification. The one with the higher value used a broader radius for comparable sales and thereby included a gentrifying neighborhood two miles away that the other AVM did not consider. After negotiations, the servicer agreed to use the lower valuation and gave the consumer a loan modification that saved her home from foreclosure.

In another example, according to the National Community Stabilization Trust (NCST), local developers frequently report that AVMs often overvalue vacant homes that need to be rehabilitated. Other formula-based calculations such as After Rehab/Repair Value provide inaccurately low home valuations for rehabilitated properties in distressed communities. In fact, about a quarter of NCST’s developer partners cited this lack of accuracy as their biggest challenge in reselling rehabilitated homes to prospective homeowners. Neighborhoods with multiple vacant or abandoned properties often have depressed values until repairs have been made. For more examples, we refer you to the testimony of Jennifer Wagner, Director of Mountain State Justice, Inc., before the House Committee on Financial Services, Subcommittee on Housing, Community Development and Insurance, attached as an appendix to these comments.

Whether directly or not, consumers depend on accurate property valuations. On a proportional basis, consumers have far more at risk than the lender, investor, or guarantor. It is important for FHFA to recognize this when authorizing any valuation policy, practice, or process.

3.2 Supposed cost and time savings transfer risk to consumers without a corresponding benefit.

Much has been made of how appraisal waivers, AVMs, and other alternative valuation practices supposedly benefit consumers by saving time and money. We believe, however, that this is a false economy. The Enterprises and lenders are better positioned to handle the risk of an inaccurate valuation because they have substantially more capital and are more diversified than the typical consumer. In most cases the risk-benefit analysis for a consumer will weigh in favor of getting a full appraisal, even if it is more expensive and takes longer than alternatives.

3.2.1 Speed kills.

Mortgage industry participants argue that waivers and alternative valuations help close loans faster. That benefits the industry because they can use speed as a marketing tactic, and they face less risk of losing business to competitors. On the other hand, while consumers may be attracted to promises of a speedy closing, the real benefits are minimal. In some purchase transactions, speed may help one buyer beat out others (such as a cash buyer or someone willing to waive contingencies in the sale contract). But, like waiving an inspection, this is a high-risk game. In a rushed sale, the lender and seller will certainly walk away with a profit, but the consumer may end up underwater. In a refinance transaction, there is even less reason for speed. Yes, some repairs are considered emergencies, but those situations are better addressed by carefully targeted procedures.

3.2.2 Don't be penny wise, pound foolish.

Industry advocates of waivers and alternative valuations have also touted the savings to consumers. But this benefit is also illusory. The cost of a traditional appraisal ranges from \$300 to \$800 depending on the property and who you ask.¹³ The consumer would still be required to pay the cost of an alternative valuation—usually a few hundred dollars. So the actual savings to the consumer of foregoing a traditional appraisal will be only a tiny fraction of the total cost of

¹³ HomeAdvisor.com, Home Appraisal Costs,, <https://www.homeadvisor.com/cost/inspectors-and-appraisers/hire-a-property-appraiser/> (reporting that a home appraisal costs \$312 to \$407, based on data from 5,315 HomeAdvisor members, but not describing type of appraisal) (last viewed Feb. 16, 2021); Ellen Chang, Bankrate.com, How Much Does a Home Appraisal Cost?, <https://www.bankrate.com/mortgages/how-much-does-an-appraisal-cost/> (Jan. 11, 2021) (describing costs between \$300 to \$450 for typical home and \$500 to \$800 for larger cities with higher cost of living).

a mortgage. In contrast, the risk of buying and mortgaging an inaccurately valued home is likely to be many-fold the amount saved on the appraisal. Lenders routinely require borrowers to pay hundreds of dollars each month for hazard insurance and sometimes PMI too. An \$800 appraisal amortizes to 45¢ per month. If the cost of insurance is considered a reasonable burden, then surely the cost of an appraisal is too.

4. FHFA Questions.

4.1 Response to questions A1.2, A1.4, and B2.5: Anything less than a USPAP-compliant interior and exterior appraisal by a properly licensed or certified appraiser increases the risk of an inaccurate valuation.

Q. 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.

Q. 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?

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

Response: AVMs and other alternatives should only be used where circumstances mitigate the risk. We have particular concerns with using non-appraisers, such as for hybrid appraisals. There is currently no system for screening or training non-appraisers. And there are no standards for how they would perform their jobs. A non-appraiser may be someone who failed appraiser training, or a former appraiser who was fired for misconduct. He or she may also may have a conflict of interest or financial ties to the lender, seller, or buyer. Because non-appraisers are not subject to licensing, there would be little accountability for misconduct and no way for those hiring non-appraisers to know whether a candidate has been in trouble before.

Without standards and training, different non-appraisers might highlight or overlook different conditions. We particularly disagree with using real estate agents because their regular job (selling properties) imposes other pressures that conflict with the duty to provide an impartial and accurate valuation. Real estate

agents depend on sales commissions calculated as a percentage of the sale price, so they have an inherent bias toward overvaluation. We also have concerns about insurance adjusters because their normal employer (insurance companies) has an interest in low valuations. We believe it may be hard for real estate agents and adjusters to “shift gears” from their normal role to that of an impartial party. It may be acceptable to use appraiser trainees. We defer to other groups for a more detailed assessment of that suggestion.

Overall, the most obvious risk of desktop and exterior-only appraisals is that the appraiser will not have current information about the condition of the property. During the February 11, 2021 listening session, one appraiser gave examples of unlevel floors and the odor of sewage that could only be detected by someone inspecting the interior of a home. Homes in disaster areas will be particularly at risk of inaccurate valuation if the appraiser does not see the current condition of the interior and exterior to account for any recent damage.

4.2 Response to questions A1.2, C1.4, and C1.5.

Q. A1.2: Separately, are there opportunities to improve traditional appraisals to mitigate problems and concerns that have been observed to date?

Q. 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 analyses to support your position. Conversely, are there concerns that alternative or automated solutions could have a discriminatory impact?

Q. 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.

4.2.1 It is clear that racial bias is a problem in home valuation.

There have been many news accounts that strongly suggest racial discrimination by individual appraisers.¹⁴ And there is statistical evidence suggesting more

¹⁴ See, e.g., Julian Glover, *abc7news.com*, Black CA Couple Lowballed by \$500K in Home Appraisal, Believe Race Was a Factor, [https://abc7news.com/society/marin-couple-shorter-\\$500k-in-appraisal-say-race-was-a-factor/10331076/](https://abc7news.com/society/marin-couple-shorter-$500k-in-appraisal-say-race-was-a-factor/10331076/) (Feb. 12, 2021); Debra Kamin, *Black Homeowners Face Discrimination in Appraisals*, N.Y. Times, Aug. 25, 2020; T. McMullen, *Pursuing Fairness in Property Valuations*, Wash. Post, Jan. 23, 2021, available at <https://search-proquest-com.dclibrary.idm.oclc.org/newspapers/pursuing-fairness-property-valuations/docview/2479921433/se-2?accountid=46320>.

systemic problems.¹⁵ While a recent American Enterprise Institute study found that bias by human appraisers was uncommon and not systematic,¹⁶ it relied heavily on AVMs without directly addressing the allegation that AVMs themselves can be biased. Concerns about bias in home valuation are not new. According to a 1993 *Washington Post* article, the chairman of the D.C. Board of Appraisers said that underestimates of property values are common in black neighborhoods because banks and thrifts employ mostly white, suburban appraisers who are unfamiliar with those areas. "The inner-city is a very different market," he said. "A given block might have seven homes that have been restored and nine that are shells. With such a mixture it takes a real level of skill to appropriately value the properties. In the suburbs, most of the houses are in pretty comparable condition."¹⁷

The extent of these problems and how to address them are still being debated. We urge FHFA to admit that these problems exist and to make ending them a

¹⁵ See generally Katrin B. Anacker, *Still Paying the Race Tax? Analyzing Property Values in Homogeneous and Mixed-Race Suburbs*, 32 *J. of Urban Affairs* 55 (2010); John R. Hipp, & Amrita Singh, *Changing Neighborhood Determinants of Housing Price Trends in Southern California, 1960–2009*, 13 *City & Cmty.* 254 (2014); Junia Howell & Elizabeth Korver-Glenn, *The Increasing Effect of Neighborhood Racial Composition on Housing Values, 1980–2015*, 2020 *Social Problems* 1, available at <https://doi.org/10.1093/socpro/spaa033>; Junia Howell & Elizabeth Korver-Glenn, *Neighborhoods, Race, and the Twenty-First-Century Housing Appraisal Industry*, 2018 *Sociology of Race and Ethnicity* 1, available at <https://doi.org/10.1177/2332649218755>; Richard Moye, *Neighborhood Racial-Ethnic Change and Home Value Appreciation: Evidence from Philadelphia*, 35 *Urban Geography* 236 (2014); Andre Perry, Jonathan Rothwell, & David Harshbarger, Brookings Institution, *The Devaluation of Assets in Black Neighborhoods* (Nov. 2018). But see Michael LaCour-Little & Richard K. Green, *Are Minorities or Minority Neighborhoods More Likely to Get Low Appraisals?*, 16 *J. of Real Estate Fin. & Econ.* 301 (1998).

¹⁶ Edward Pinto & Tobias Peter, Am. Enterprise Inst. Hous. Ctr., *How Common Is Appraiser Racial Bias?* (Jan. 19, 2021), available at <https://www.aei.org/economics/special-briefing-on-appraiser-bias/>.

¹⁷ J.G. Brenner & L. Spayd, L., *Bankers Describe Roots of Bias; Cultural Prejudice and Traditional Home Loan Rules Hurt Blacks*, *Wash. Post*, June 8, 1993, <https://search-proquest-com.dclibrary.idm.oclc.org/newspapers/bankers-describe-roots-bias-cultural-prejudice/docview/307653131>.

high priority. The agency should fund research into whether racial disparities are caused or exacerbated by any aspect of the Uniform Standards of Professional Appraisal Practice (USPAP) or other real estate industry practices. We particularly encourage FHFA to further explore the issues raised in two papers describing research conducted by Junia Howell and Elizabeth Korver-Glenn. According to the authors, their findings “suggest that variation in appraisal methods coupled with appraisers’ racialized perceptions of neighborhoods perpetuates neighborhood racial disparities in home value[;]”¹⁸ and “provide strong evidence that persistent racial inequality is driven in part by perpetual devaluing of communities of color”¹⁹

In the meantime, there are other measures FHFA can implement now:

- The GSEs should only accept valuations from appraisers or others (in the case of hybrids or other methods using non-appraisers) who have completed anti-bias training.
- Any AVMs used or accepted by the GSEs should be subjected to external, independent, anti-bias testing.
- FHFA should mandate that Fannie Mae and Freddie Mac routinely monitor and test all their systems and practices for evidence of disparate treatment.
- FHFA should mandate a new quality control for all valuations: A sample of all valuations (traditional and nontraditional) should be verified by performing a second, traditional appraisal on the same property, at the lender’s expense. The second appraisal should be “blind,” so that the appraiser does not know about the prior valuation.

¹⁸ Junia Howell & Elizabeth Korver-Glenn, *Neighborhoods, Race, and the Twenty-First-Century Housing Appraisal Industry*, 2018 *Sociology of Race and Ethnicity* 1, available at <https://doi.org/10.1177/2332649218755>.

¹⁹ Junia Howell & Elizabeth Korver-Glenn, *The Increasing Effect of Neighborhood Racial Composition on Housing Values, 1980–2015*, 2020 *Social Problems* 1, available at <https://doi.org/10.1093/socpro/spaa033>.

4.2.2 Address the risk of appraisers being influenced by knowledge of the contract price.

There is some evidence that an appraiser's ultimate valuation is influenced by the contract price for the property they are appraising.²⁰ This has been attributed to anchoring bias and confirmation bias.²¹ While the truth of this contention remains controversial, the risk it poses to the Enterprises and buyers is too significant to ignore. Even the appearance of bias will cast doubt on the reliability of appraisals and the integrity of the profession.

Therefore, FHFA should mandate that, for conforming mortgages, the appraiser should not be told the sale price before submitting a final appraisal. If FHFA declines to adopt such a policy, an alternative would be to prohibit informing the appraiser of the sale price until *after* the appraiser has written a first draft of the valuation report.²² Then, if the sale price affects the final valuation, the change can be explained in the report. The Enterprises should then monitor how often the valuation is changed based on the sale price.

4.3 Response to Question B2.6.

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

²⁰ See, e.g., Michael D. Eriksen, Hamilton B. Fout, Mark Palim, et al., *Contract Price Confirmation Bias: Evidence from Repeat Appraisals*, 60 J. of Real Estate Fin. & Econ. 77 (2020), available at <https://doi.org/10.1007/s11146-019-09716-w>; Gregory B. Northcraft & Margaret A. Neale, *Experts, Amateurs, and Real Estate: An Anchoring-and-Adjustment Perspective on Property Pricing Decisions*, 39 Org. Behavior & Human Decision Processes 84 (1987), available at https://web.missouri.edu/segerti/capstone/northcraft_n.

²¹ Michael D. Eriksen, Hamilton B. Fout, Mark Palim, et al., *Contract Price Confirmation Bias: Evidence from Repeat Appraisals*, 60 J. of Real Estate Fin. & Econ. 77 (2020), available at <https://doi.org/10.1007/s11146-019-09716-w>; Gregory B. Northcraft & Margaret A. Neale, *Experts, Amateurs, and Real Estate: An Anchoring-and-Adjustment Perspective on Property Pricing Decisions*, 39 Org. Behavior & Human Decision Processes 84 (1987), available at https://web.missouri.edu/segerti/capstone/northcraft_n.

²² We realize that implementing this proposal will require cooperation from real estate agents. Therefore we encourage FHFA to work with all relevant trade groups for both appraisers and real estate agents.

4.3.1 FHFA must commission more research.

We acknowledge that FHFA is asking us for data in this RFI, but it is difficult for outside groups to fully evaluate the GSEs' activities because some data and algorithms are unavailable for competitive and privacy reasons. The GSEs have the resources and data needed to do a comprehensive analysis of bias in the field of collateral valuation. It is up to FHFA to make sure independent researchers have access to the data needed to test for disparate impact. The same problem exists for other industry participants. This limits the ability of impartial researchers to examine the performance of alternative appraisal methods, underwriting software, and compensation practices. FHFA should consider requiring anyone selling loans to the Enterprises to retain outside researchers to examine and affirmatively certify that their software and practices do not have a disparate impact on any part of the lending process, and to use de-biasing techniques, when applicable, to reengineer the models.

4.3.2 More answers are needed before settling on a policy for the use of appraisal waivers and nontraditional valuation methods.

We compliment FHFA for issuing the pending RFI, but there are other important questions that must be answered. In order to make a fully informed decision, FHFA should also investigate the following topics:

- How does the foreclosure rate for loans originated with appraisals compare to loans originated with alternative methods?
- What is the value at risk to guarantors, insurers, and homeowners when using different valuation methods? Are losses greater with a particular method?
- How much do consumers and lenders pay for appraisals and other methods? How does the cost compare to the benefits? Until these questions are answered, cost savings should not be a rationale for increasing the use of waivers or AVMs.
- Similarly, how often do appraisals really delay mortgage closings? Without that data, delay should not be used to justify reduced use of traditional appraisals.
- What is the accuracy of different types of AVMs and other alternative valuation methods compared to traditional appraisals? There is insufficient publicly available data on this subject to make reliable policy.
- It is safe to use AVMs in rural areas given their known limitations?

- What are acceptable metrics for accuracy (e.g., percent predicted value, forecast standard deviation, or confidence score)?²³

5. Waivers may be appropriate in some areas, but FHFA must proceed with caution.

Assuming FHFA conducts the research we recommend above and adopts any changes that are shown necessary, there are a number narrow circumstances where appraisal waivers may be appropriate.

Transactions where the LTV is well below 80%: In this circumstance, all parties involved will have a sufficient equity buffer to mitigate the harm of an inaccurate valuation.

Transactions where there has been a very recent traditional appraisal and no reason to believe the condition of the property has changed in the meantime: This circumstance is self-explanatory.

Streamlined refinancings with no cash-out: With a streamlined refinancing with no cash-out (except perhaps for closing costs), the borrower already owns the property and has a loan. So, as long as an incorrect AVM does not undervalue the property and thereby prevent the borrower from refinancing, there is no risk from an inaccurate valuation.

Small-dollar mortgages: Most lenders are reluctant to make mortgages for less than \$70,000 because such loans have a lower profit margin.²⁴ This has a significant negative impact on communities where small mortgages are needed but unavailable. If appraisal waivers reduce the cost of origination enough to make affordable small-dollar mortgages more common, low-income borrowers and communities of color would benefit.

But FHFA should not assume that this cause-effect relationship exists. Instead, FHFA should conduct a pilot program in which lenders receive appraisal waivers for affordable small mortgages and must report data on those loans,

²³ Fitch Ratings uses these measurements when assessing AVMs. Fitch Ratings, Conservatism Still the Best Path for AVMs in U.S. RMBS (Sept. 27, 2019), <https://www.fitchratings.com/research/structured-finance/conservatism-still-best-path-for-avms-in-us-rmbs-27-09-2019>.

²⁴ The Urban Institute has produced a number of research papers on small-dollar mortgage lending. We refer you to their website, in general, for further information on this type of loan and related research. See www.urban.org.

including cost to originate and cost to the borrower, race, ethnicity, default rate, and zip code disaggregation. If the waivers are shown to increase lending for small mortgages in a way that does not harm borrowers, the program could be expanded.

6. Conclusion

In conclusion, we urge FHFA to be wary of industry assertions that appraisal waivers benefit consumers. While there may be limited circumstances where that is true, consumers generally have more to lose from an inaccurate valuation than do industry participants. We recommend that FHFA take several steps to ensure the safe use of appraisal waivers and AVMs:

1. Conduct more research to determine when and where alternative valuation methods may be safely used.
2. After completing that research, require sellers and servicers to meet public standards for accuracy and transparency when using alternative valuation methods.
3. Research the issue of racial bias in home valuation and take aggressive measures to eliminate it.

Appendix of Signatories

Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services; and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitative practices, help financially stressed families build and retain wealth, and advance economic fairness.

Americans for Financial Reform Education Fund: The [Americans for Financial Reform Education Fund \(AFREF\)](#) is a coalition of more than 200 consumer, investor, labor, civil rights, business, faith-based, and community groups that works through policy analysis, education, advocacy, and outreach to lay the foundation for a strong, stable, and ethical financial system. Formed in the wake of the 2008 financial crisis, AFREF works to protect and strengthen consumer protections for all people, including advocacy for greater protections against predatory lending, increased access to affordable and sustainable credit, and fairness and transparency in all financial transactions.

Consumer Action has been a champion of underrepresented consumers nationwide since 1971. A nonprofit 501(c)3 organization, Consumer Action focuses on financial education that empowers low to moderate income and limited-English-speaking consumers to financially prosper. It also advocates for consumers in the media and before lawmakers to advance consumer rights and promote industry-wide change. By providing financial education materials in multiple languages, a free national hotline and regular financial product surveys, Consumer Action helps consumers assert their rights in the marketplace and make financially savvy choices. More than 8,000 community and grassroots organizations benefit annually from its extensive outreach programs, training materials, and support.

Mountain State Justice (MSJ) is a non-profit legal services organization dedicated to redressing systemic social, political, and economic imbalances of power for underserved West Virginians. MSJ has provided legal representation to thousands of homeowners combatting predatory mortgage lending practices, including fraudulent appraisals, which threatened them with the loss of their homes.

The [National Fair Housing Alliance \(NFHA\)](#) is the voice of fair housing. NFHA works to eliminate housing discrimination and to ensure equal housing

opportunity for all people through leadership, education, outreach, membership services, public policy initiatives, community development, advocacy, and enforcement.

The National Housing Law Project (NHLP) is a non-profit law and advocacy center established in 1968 and based in San Francisco, California. NHLP is dedicated to advancing housing justice by using the power of the law to increase and preserve the supply of decent affordable housing, improve existing housing conditions, expand and enforce low-income tenants' and homeowners' rights, and increase opportunities for racial and ethnic minorities.

Statement Submitted for the Record to the
United States House of Representatives
Committee on Financial Services
Subcommittee on Housing, Community Development and Insurance
Hearing on
“What’s Your Home Worth? A Review of the Appraisal Industry”

June 20, 2019

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Also on behalf of:
National Consumer Law Center (on behalf of its low-income clients)

On behalf of Mountain State Justice and the National Consumer Law Center, thank you for the opportunity to submit this statement regarding the appraisal industry.¹ I am the Co-Director of Mountain State Justice, a non-profit legal services provider in West Virginia that represents low-income people at no cost. Since the early 2000s, we have served thousands of homeowners in danger of losing their homes as the direct result of appraisal fraud and other predatory lending practices.

With this statement I wish to express appreciation to Congress for imposing stricter standards for appraisals under the Dodd-Frank Act, and to warn against the apparent loosening of standards that will likely lead to another housing crisis—with low-income homeowners and communities of color bearing the brunt of the cost.

It is common knowledge that lax regulation of the mortgage and appraisal market led directly to the financial collapse of 2008.² Prior to that collapse, unscrupulous mortgage brokers and lenders joined forces with a handful of appraisers to fraudulently inflate home values to enable property flipping schemes and other home-secured lending of increasingly large amounts. Many of these loans contained adjustable rate or interest only features that would cause payments to skyrocket after a teaser period. Even before the market collapse in 2008, consumers and their advocates began to see this house of cards topple, as homeowners trapped in these underwater loans were unable to refinance when their adjustable rates spiked.³ Thousands—and soon millions—of homeowners faced foreclosure.⁴ Mountain State Justice, and I personally, have continued to see the ongoing fallout of these predatory mortgages to this day.

¹ Mountain State Justice is a non-profit legal services firm dedicated to redressing entrenched and emerging systemic social, political, and economic imbalances of power for underserved West Virginians, through legal advocacy and community empowerment. More information about Mountain State Justice can be found at www.mountainstatejustice.org.

The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

² See, e.g., The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, available at <https://www.gpo.gov/fdsys/pkg/GPO-FCIC/content-detail.html>.

³ Mountain State Justice's Executive Director testified before this Subcommittee in 2005 about these very practices. See Daniel F. Hedges, *Testimony before the Subcommittee on Housing and Community Development*, Committee on Financial Services, U.S. House of Representatives (Sept. 29, 2005), available at <http://archives.financialservices.house.gov/media/pdf/092905dh.pdf>.

⁴ The Financial Crisis Inquiry Report: *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* 402, available at <https://www.gpo.gov/fdsys/pkg/GPO-FCIC/content-detail.html>.

This bubble in housing prices was not just created by a spike in consumer demand. Rather, in many cases throughout the country, it was created as the direct result of intentional fraud and lack of oversight. West Virginia—which saw little increased demand—is a prime example. At my organization alone, over the past decade we have seen hundreds of families facing foreclosure resulting in large part from these fraudulent appraisals.

The Dodd-Frank Act required essential increased regulation of appraisals, building on necessary safety and soundness requirements passed after the savings and loan crisis. These changes have been instrumental in steadying the housing market and tamping down fraudulent over-valuations of homes in the lending market, primarily by requiring appraisal independence while still recognizing the centrality and importance of appraisals as the most accurate methodology of obtaining a home value. Appraisal independence ensures that lenders and brokers cannot intentionally choose appraisers who will deliver implicitly (and sometimes explicitly) requested inflated appraisals. Reforms requiring true, in-person appraisals by qualified appraisers similarly have ensured not only a healthy appraisal industry, but also that lenders and investors can be certain that they have sufficient collateral to protect their risk. These reforms have been an unqualified success. They have worked.

Because the reforms did exactly what they were intended—they stopped appraisal fraud—we urge you to leave these requirements in place, to resist weakening appraisal requirements, and to create a more robust system of oversight and standards for the use of technology. Appraisal requirements and valuation oversight do not just help consumers, they also support honest appraisers and lending institutions, and protect investors and the economy as a whole.

Background

Appraisal Standards

Home appraisals are required to safeguard homeowners, home mortgage investors, and government insurance programs alike. Appraisals protect homeowners who are making the largest investment—and taking on the largest debt—of their lives, by enabling them to make wise and well-informed financial decisions. Appraisals are necessary to ensure that loans do not exceed the values of homes that serve as their collateral. This collateral protects investors and insurers, such as the Federal Housing Administration and the Government Sponsored Entities, against the risk of long-term home lending. Provision of sufficient collateral thus enables and supports lending, which in turn creates a healthy housing market.

Home appraisals—if done according to regulatory standards—are conducted by highly trained and skilled professionals with knowledge of the local area. Appraisals, under current standards, require the appraiser to personally view both the interior and exterior of the home, the surrounding area, and comparable homes that have recently sold on the open market, in order to ensure an accurate opinion of value. Appraisers are educated in a classroom and serve as apprentices under the supervision of an experienced appraiser before they obtain their final certification. They maintain their licensure under oversight by state appraisal boards and with requirements for continuing education and compliance with the Uniform Standards of Professional Appraisal Practice (USPAP). All of these requirements ensure that appraisers are qualified and

competent to complete their essential work. They further protect homeowners and lenders from increased risk associated with high loan to value ratios and overvalued collateral.

Widespread Appraisal Fraud⁵

Without independent and qualified appraisals, home secured lending poses significant risks to consumers and investors, as well as the entire economy. Indeed, appraisal fraud played a vital role in the market collapse in the 2000s.

Incentives for Appraisal Fraud

Without the strict requirements imposed by the Dodd-Frank Act and other federal regulation, the financial incentives of those involved in the mortgage loan process work against honest appraisals.⁶ Origination fees for lenders and loan brokers are commonly based on the amount of the mortgage loan.⁷ This can make lenders and brokers complicit in, or simply indifferent to, appraisal fraud because higher loan volume and higher loan amounts lead to greater profits.⁸ Some lenders may deliberately seek inflated appraisals in order to trap borrowers in abusive loans and prevent them from refinancing.⁹ Lenders' indifference to appraisal fraud may be traceable, at least in part, to securitization, which allows them to pass on the risk of loss while retaining minimal liability in the event of default by the borrower.¹⁰ Lenders also rely on mortgage

⁵Significant portions of the following text, especially background on appraisal fraud, the mortgage market, and regulatory overviews are drawn from the National Consumer Law Center's book on mortgage lending, National Consumer Law Center, *Mortgage Lending* (2d ed. 2014).

⁶ See *Wallace v. Midwest Fin. & Mortg. Services, Inc.*, 714 F.3d 414, 422 (6th Cir. 2013) (reversing summary judgment in favor of creditor on civil racketeering claim; noting that lender not dissuaded by facially unreasonable appraisal); *Fed. Hous. Fin. Auth. v. JPMorgan Chase & Co.*, 902 F. Supp. 2d 476 (S.D.N.Y. 2012) (quoting amended complaint, "WaMu falsely overstated appraisals in order to secure low LTV ratios for mortgages, thereby making the loans more attractive to prospective purchasers of certificates"); David Callahan, Home Insecurity: How Widespread Appraisal Fraud Puts Homeowners at Risk (Mar. 2005), available at www.demos.org.

⁷ Cf. 15 U.S.C. § 1639b(c)(1) (explicitly permitting compensation for loan originators to be based on loan amount).

⁸ See *Fed. Hous. Fin. Auth. v. JPMorgan Chase & Co.*, 902 F. Supp. 2d 476 (S.D.N.Y. 2012) (quoting amended complaint, "WaMu falsely overstated appraisals in order to secure low LTV ratios for mortgages, thereby making the loans more attractive to prospective purchasers of certificates"); *In re Bear Stearns Mortg. Pass-Through Certificates Litig.*, 851 F. Supp. 2d 746 (S.D.N.Y. 2012) ("[L]oan officers applied 'intense' pressure on underwriters to approve risky loans and rewarded 'high producers.'"); *Cedeno v. IndyMac Bancorp, Inc.*, 2008 WL 3992304 (S.D.N.Y. Aug. 26, 2008) (alleging that lender selected appraisers, who provided inflated appraisals, in order to complete more transactions and earn greater profits; granting lender's motion to dismiss RESPA and TILA claims). Cf. *United States v. Grintjes*, 237 F.3d 876 (7th Cir. 2001) (discussing evidence that tended to show that mortgage broker had knowledge of clients' property flipping scheme); *Am. Mortg. Network v. Shelton*, 2006 WL 909415 (W.D.N.C. Apr. 6, 2006) (discussing how a buyer arranged for and helped prepare a fraudulent appraisal), *aff'd*, 486 F.3d 815 (4th Cir. 2007).

⁹ See, e.g., *Tocco v. Argent Mortg. Co.*, 2007 WL 170855 (E.D. Mich. Jan. 18, 2007) (describing a borrower's inability to refinance an Argent loan when the appraisal for the refinancing came in \$300,000 lower than the appraisal, performed less than a year previously, on which the original loan had been based); Office of the New York State Att'y Gen., Press Release, N.Y. Attorney General Sues First American and Its Subsidiary for Conspiring with Washington Mutual to Inflate Real Estate Appraisals (Nov. 1, 2007), available at www.ag.ny.gov (alleging that large national lender demanded that appraisers inflate property values).

¹⁰ See, e.g., *Wallace v. Midwest Fin. & Mortg. Services, Inc.*, 714 F.3d 414, 422 (6th Cir. 2013); *Homeward Residential, Inc. v. Sand Canyon Corp.*, 2014 WL 2510809, at *9–10 (S.D.N.Y. May 28, 2014) (refusing to dismiss trust's breach of warranty claims against Option One based upon appraisal fraud); *Prudential Ins. Co. v. Credit Suisse Sec. (USA) L.L.C.*, 2013 WL 5467093 (D.N.J. Sept. 30, 2013) (investor suit against parties to a securitization of New Century and Option One loans; fraud claim based on pattern of false appraisals survived motion to dismiss); *Fed.*

insurance to insulate them either partially (or fully, in the case of the government-backed FHA insurance), from the risk of loss after foreclosure. Secondary market participants, those who buy loans from lax lenders, can also purchase their own insurance against failure and so have reduced incentives to police the pool,¹¹ even if the disclosures are enough to put them on notice of the inflated appraisals.¹²

In some cases, appraisers received direct benefits for their participation in the fraud, through the promise of repeat business or more overt kickbacks or payment schemes.¹³ Other times, lenders and brokers pressure appraisers to hit or exceed a predetermined value.¹⁴ Failure to do so could lead the lender or broker to withhold business from the appraiser, to refuse to pay the appraiser, or to blacklist the appraiser.¹⁵

Hous. Fin. Auth. v. JPMorgan Chase & Co., 902 F. Supp. 2d 476 (S.D.N.Y. 2012); Fed. Hous. Fin. Agency v. UBS Americas, Inc., 858 F. Supp. 2d 306, 320 (S.D.N.Y. 2012), *aff'd*, 712 F.3d 136 (2d Cir. 2013); HSH Nordbank AG v. Barclays Bank PLC, 986 N.Y.S.2d 866, 2014 WL 841289, at *15, 18 (Sup. Ct. 2014) (table) (refusing to dismiss investor claims of fraud against seller and depositor in deal involving Fremont Inv. & Loan and New Century Mortg. Co. loans based on appraisal fraud; data showed approximately 24.5%–51.6% of the loans had combined loan-to-value ratios of over 100%, which contradicted the offering documents). *See also* Settlement Agreement, Annex 1, Statement of Facts at 4–5, U.S. Dep't of Justice & JPMorgan Chase & Co. (Nov. 19, 2013), available at www.justice.gov (describing JPMorgan's purchase and pooling into securities of loans it knew were missing appraisals, its tolerance for appraisals of 15% below loan amount, even when the loan-to-value ratio was 100%, and its inclusion in securitizations of loans that exceeded even that tolerance).

Secondary market purchasers may not be vigilant in policing lenders because they underestimate the risk of inflated appraisals or because they may be insured against this kind of fraud. *See, e.g.,* Mass. Mut. Life Ins. Co. v. Residential Funding Co., 843 F. Supp. 2d 191 (D. Mass. 2012) (securities disclosures insufficient to put secondary market purchaser on notice that appraisers were systematically abandoning the represented appraisal procedures). In these cases, the insurer bears the risk of loss instead of the trust or other secondary market purchaser.

Some of the notorious FAMCO loan trusts were insured by mortgage guaranty policies issued by MBIA Insurance Corp. Stipulation of Settlement, Fed. Trade Comm'n v. First Alliance Mortg. Co. (In re First Alliance Mortg. Co.), No. SA CV 00-964 (C.D. Cal. Feb. 25, 2002), available at www.ftc.gov.

¹¹ *See, e.g.,* Stipulation of Settlement, Fed. Trade Comm'n v. First Alliance Mortg. Co. (In re First Alliance Mortg. Co.), No. SA CV 00-964 (C.D. Cal. Feb. 25, 2002), available at www.ftc.gov (noting insurance of some of the notorious FAMCO loan trusts by mortgage guaranty policies issued by MBIA Insurance Corp.).

¹² *See, e.g.,* Mass. Mut. Life Ins. Co. v. Residential Funding Co., 843 F. Supp. 2d 191 (D. Mass. 2012) (securities disclosures insufficient to put secondary market purchaser on notice that appraisers were systematically abandoning the represented appraisal procedures).

¹³ *See* First Magnus Fin. Corp. v. Star Equity Funding, L.L.C., 2007 WL 414272 (D. Kan. Feb. 2, 2007) (discussing scheme between mortgage brokers and appraisers).

¹⁴ *See, e.g.,* Wallace v. Midwest Fin. & Mortg. Services, Inc., 714 F.3d 414, 417 (6th Cir. 2013) (describing scheme whereby broker requested appraisal value needed from the appraiser); Davis v. Wells Fargo Bank, 976 F. Supp. 2d 870, 876 (S.D. Tex. 2013) (describing pressure brought to bear on appraisers to produce low values at foreclosure sales of property, allegedly in order to maximize paper losses for tax purposes), dismissed on other grounds, 2014 WL 585403 (S.D. Tex. Feb. 14, 2014); Office of the New York State Att'y Gen., Press Release, N.Y. Attorney General Sues First American and Its Subsidiary for Conspiring with Washington Mutual to Inflate Real Estate Appraisals (Nov. 1, 2007), available at www.ag.ny.gov (detailing scheme in which a large national lender demanded that appraisers inflate property values).

¹⁵ *See* Davis v. Wells Fargo Bank, 976 F. Supp. 2d 870, 876 (S.D. Tex. 2013) (appraiser who did not meet target values was blacklisted), dismissed on other grounds, 2014 WL 585403 (S.D. Tex. Feb. 14, 2014); Fed. Hous. Fin. Auth. v. JPMorgan Chase & Co., 902 F. Supp. 2d 476 (S.D.N.Y. 2012) (quoting amended complaint; “WaMu selected individual appraisers who were willing to produce false, inflated appraisals and refused to hire appraisers who maintained their independence.”); Gaudie v. Potestivo Appraisal Services, 837 F. Supp. 2d 799 (N.D. Ill. 2011)

Appraisers themselves advocated for tighter regulation to protect their industry. In 2007, a petition with 11,000 appraiser signatures was delivered to Washington explaining that “Lenders . . . as a normal course of business, apply pressure on appraisers to hit or exceed a predetermined value. . . . We believe that this practice has adverse effects on our local and national economies and that the potential for great financial loss exists. We also believe that many individuals have been adversely affected by the purchase of homes which have been over-valued.”¹⁶ The appraisers went on to request that the government appropriately regulate the market to protect appraisers from “pressur[e] . . . to do dishonest appraisals.”¹⁷ Given the potential incentives for lenders and appraisers to inflate appraisal amounts, the need for focused oversight and effective supervision of both appraisers and appraisal practices has long been recognized.¹⁸

Impacts on Lending and Fraud

Due to the incentives for appraisal fraud, it is not surprising that inflated appraisals are key to predatory mortgage lending that directly led to the 2008 market collapse.¹⁹ For instance, loan churning, which involves repeated refinancing with additional fees and costs rolled into the new principal balance, often depends on inflated appraisals to justify higher loan amounts.²⁰ Without the inflated appraisal, these loans would be denied for insufficient equity.²¹ Similarly, property flipping scams involve speculators who buy dilapidated residential properties or develop shoddy new construction at low prices and resell them to unsophisticated first time home buyers at huge

(discussing appraiser’s possible motivation in inflating appraisal, noting that the appraiser was dependent on lender for employment and “had to give [it] the the appraised values [it] desired if [he] wanted to work in that field”); Office of Pol’y Dev. & Research, U.S. Dep’t of Hous. & Urb. Dev., Report to Congress on the Root Causes of the Foreclosure Crisis 40–41 (2010), available at www.huduser.org (arguing that appraisal fraud depends on lack of underwriting control of the broker and appraiser). See also *People v. First Am. Corp.*, 878 N.Y.S.2d 860 (Sup. Ct. 2009) (recounting complaint’s allegations of lender control of appraisers, in violation of state law and Uniform Standards of Professional Appraisal Practice), *aff’d*, 902 N.Y.S.2d 521 (App. Div. 2010).

¹⁶ Appraisers Petition, available at <http://appraiserspetition.com>.

¹⁷ *Id.*

¹⁸ Office of Pol’y Dev. & Research, U.S. Dep’t of Hous. & Urb. Dev., Report to Congress on the Root Causes of the Foreclosure Crisis 40–41 (2010), available at www.huduser.org (arguing that appraisal fraud depends on lack of underwriting control of the broker and appraiser). See, e.g., Fed. Reserve Bank of Atlanta, Appraisal Reviews Are Important to Safe Banking, Fin. Update, 4th Quarter, 2004, available at www.frbatlanta.org.

¹⁹ *Cf. Wallace v. Midwest Fin. & Mortg. Services, Inc.*, 714 F.3d 414, 422 (6th Cir. 2013) (reversing summary judgment for broker and lender on civil racketeering claims based on an inflated appraisal of borrower’s home; noting, “Though the decision to obtain a mortgage is no doubt complicated, the appraisal of the home used to secure it is a fundamental part of the calculus.”).

²⁰ See, e.g., *Hill v. Meritech Mortg. Services, Inc. (In re Hill)*, 2002 WL 34560882 (Bankr. E.D. Pa. Sept. 27, 2002).

²¹ See, e.g., *Wallace v. Midwest Fin. & Mortg. Services, Inc.*, 714 F.3d 414, 417 (6th Cir. 2013) (inflated appraisal “factored significantly into” the underwriting of the loan; discussing importance of inflated appraisal to conspiracy to sell borrower a high-interest rate loan with high fees); *United States v. Rivera*, 2004 WL 3153171 (D. Conn. Aug. 5, 2004); *Chavarria v. Fleetwood Retail Corp. of N.M.*, 115 P.3d 799 (N.M. Ct. App. 2005) (affirming judgment against manufactured home seller based on fraudulent conduct of two employees in inflating trade-in value of borrower’s previous manufactured home and including fictitious home improvements in the loan amount; reducing duplicative damages and reversing award of punitive damages), *aff’d in part, rev’d in part*, 143 P.3d 717 (N.M. 2006) (affirming judgment against seller but reversing compensatory and punitive damages award); Office of the New York State Att’y Gen., Press Release, N.Y. Attorney General Sues First American and Its Subsidiary for Conspiring with Washington Mutual to Inflate Real Estate Appraisals (Nov. 1, 2007), available at www.ag.ny.gov (alleging that large national lender demanded that appraisers inflate property values).

markups.²² Homeowners end up saddled with a debt load that exceeds the market value of the property. These homeowners are unable to resell the home in an arms-length transaction because the mortgage indebtedness exceeds the fair market value of the property. Ultimately, the homeowners may lose their homes to foreclosure sales²³ because the home's condition is much worse than represented, promised repairs are not performed, and the consumer's mortgage payments may be higher than the consumer can afford.²⁴ Then the scams can begin again against different homeowners if the wrongdoers or their confederates purchase the homes at the foreclosure sales.

An inflated appraisal, which is necessary to both reassure the homeowner and to secure an inflated loan, is the linchpin of both property flipping and predatory refinance transactions.²⁵ While many of these schemes rely on steering borrowers to high-cost lenders,²⁶ other schemes depend on the availability of government insurance.²⁷ Because Federal Housing Administration (FHA) insurance, unlike regular mortgage insurance, covers 100% of lender's losses, lenders quickly profit from inflated loans they know will foreclose.²⁸ The loan officer gets a commission; the Department of Housing and Urban Development (HUD) is left with the costs associated with the bad loan.²⁹ Some of these scams landed their perpetrators in prison after the market collapse. Others just led to disastrous consequences for homeowners.

My office, like others across the country, has worked with countless homeowners facing foreclosure as the result of these schemes. These homeowners continue—a decade after the market collapsed—to face foreclosure, demonstrating the very real ongoing impact of lax oversight and regulation. It is *not* time to look the other way.

For example, just a year ago, I met Mrs. S., an elderly Black woman living in a historically Black neighborhood in a small city in West Virginia that has had steady home values for decades.

²² See, e.g., *Synovus Bank v. Karp*, 887 F. Supp. 2d 677 (W.D.N.C. 2012); *Kaing v. Pulte Homes, Inc.*, 2010 WL 625365 (N.D. Cal. Feb. 18, 2010), *aff'd*, 464 Fed. Appx. 630 (9th Cir. 2011). See also Upton Sinclair, *The Jungle* 77–78 (1920) (describing a scheme in which a developer repeatedly sold poorly constructed homes, foreclosed on them, and then resold them as “new”).

²³ See, e.g., *United States v. Geig*, 176 Fed. Appx. 638, 639 (6th Cir. 2006) (upholding restitution award and prison term for participant in property flipping scheme that “left buyers with overvalued properties with a high risk of foreclosure”); David Cho, *Housing Boom Tied to Sham Mortgages, Lax Lending Aided Real Estate Fraud*, Wash. Post., Apr. 10, 2007, at A1 (more than 300 homes go into disrepair and foreclosure in wake of property flipping scheme, surrounding homeowners lose as much as half of the value of their homes).

²⁴ See *Edmonds v. Hough*, 344 S.W.3d 219 (Mo. Ct. App. 2011).

²⁵ See *United States v. Owens*, 301 F.3d 521 (6th Cir. 2002) (describing appraiser's key role in a property flipping scheme); *Vaughn v. Consumer Home Mortg. Inc.*, 2003 WL 21241669 (E.D.N.Y. Mar. 23, 2003).

²⁶ See, e.g., *United States v. Sheneman*, 2012 WL 1831660 (N.D. Ind. May 18, 2012); *Edmonds v. Hough*, 344 S.W.3d 219 (Mo. Ct. App. 2011).

²⁷ See, e.g., *Vaughn v. Consumer Home Mortg., Inc.*, 293 F. Supp. 2d 206 (E.D.N.Y. 2003); *Consumer Prot. Div. v. Morgan*, 874 A.2d 919 (Md. 2005).

²⁸ See *M & T Mortg. Corp. v. White*, 2006 WL 47467 (E.D.N.Y. Jan. 9, 2006) (finding predatory lending scheme was caused in part by HUD's issuance of insurance without due diligence); *Vaughn v. Consumer Home Mortg., Inc.*, 293 F. Supp. 2d 206 (E.D.N.Y. 2003) (denying HUD's motion to dismiss declaratory judgment that FHA insurance was issued without due diligence). See also *LaBoy v. Better Homes Depot, Inc.*, 2004 WL 6393656, at *8 (E.D.N.Y. July 14, 2004) (recognizing role of FHA insurance in property flipping scheme involving inflated appraisals).

²⁹ E.g., *Saucier v. Countrywide Home Loans*, 64 A.3d 428 (D.C. 2013); *Hoffman v. Stamper*, 867 A.2d 276 (Md. 2005).

Her story illustrates the true, lasting impact of an appraisal on a household. In the early 2000s, Mrs. S and her husband were targeted for solicitation into a home mortgage by two notorious, now-defunct predatory lending companies. The lender and broker conspired with a notorious appraiser to convince Mrs. S that her home had a value of nearly \$90,000, when in fact it was worth about *half* that amount. The broker and lender were paid their commission on the larger loan, and Mrs. S began making her payments. For fifteen years, Mrs. S made every payment on her loan, even when it was a struggle to pay the 10% interest rate—ultimately paying around three times the value of her house during that time. But then—after all that time—she learned that the loan also had a balloon payment that came due in December 2017. Due to the fraudulent appraisal, the balloon payment far exceeded the actual value of her home. She could not refinance and she could not sell. The only path ahead of her was foreclosure—loss of her family home and homelessness in her 70s. **Mrs. S sought our help in 2018. This crisis is not over.**

Another client was Mrs. R, a single, middle-aged woman. Mrs. R was repeatedly solicited to refinance her loan in the early 2000s. After purchasing her home for \$15,000 in the mid-1990s, Mrs. R fell prey to a mortgage broker-appraiser team, who soon had her in a loan exceeding \$70,000. Scared of losing her home and looking for lower payments, Mrs. R entered her information into a website that advertised that it could lower her bills. Soon an out-of-state lender contacted her and promised lower payments. This lender did not bother with an appraisal from a licensed appraiser; instead, it utilized an automated valuation model (AVM) of her home which provided a wholly inaccurate and inflated valuation of her home based on faulty market data. Although her home was actually only worth \$34,000, the lender told her that her home was worth \$84,000 based on the AVM. The lender pressured her to borrow additional funds up to the “value” of her home to pay other debts. I met Mrs. R. when the interest only feature of her loan expired and she was faced with impossibly high payments. Mrs. R. tried to refinance, but she was rejected because the loan so far exceeded the value of her home. Now she faced foreclosure.

These examples highlight the far reaching impacts of failures to obtain proper appraisals for homes—even (or especially) low cost homes. Requirements of appraiser independence help avoid Mrs. S’s calamitous situation. And a requirement of an actual appraisal conducted by properly educated and regulated appraisers, rather than technology, would have prevented the foreclosure action on Mrs. R’s home.

Impacts on Communities of Color

These predatory lending practices and impacts have particularly impacted communities and people of color, such as Mrs. S, as the result of redlining and reverse redlining.

The term “redlining” was coined in the 1930s by the Home Owner’s Loan Corporation (HOLC), a government sponsored organization created to assess credit-worthiness.³⁰ The HOLC created a color coded rating system explicitly based on ethnic and racial bias, which provided positive, green ratings for white neighborhoods and negative, red ratings for neighborhoods of

³⁰ National Consumer Law Center, *Credit Discrimination, Redlining*, <https://library.nclc.org/cd/060604-0> (citing Charles L. Nier, III, *Perpetuation of Segregation: Toward a New Historical and Legal Interpretation of Redlining Under the Fair Housing Act*, 32 J. Marshall L. Rev. 617 (1999)(last visited June 21, 2019).

color created through widespread segregation.³¹ In 1934, the Federal Housing Administration modeled itself after the HOLC system, which helped to substantiate the idea that market stability, at least in part, was due to racial and ethnic segregation, and led to decades of denying government assistance to communities of color, thereby limiting the availability of homeownership and accumulation of wealth in these communities.³² While eventually the Fair Housing Act was passed in the 1960s to expand housing opportunities for people of color, studies continue to demonstrate that people of color are denied mortgage loans at a much higher rate than white applicants, and that homes in formerly rated redlined neighborhoods are valued lower than those in neighborhoods which were given a higher rating.³³

These dynamics have made communities of color a prime target for predatory lending, dubbed “reverse redlining.” Without access to federally supported financing or other “prime” mortgage products, people of color—including those who are as credit-worthy as equivalent white customers—have been forced into subprime loans with unfavorable terms in order to access the American dream of homeownership.³⁴ In this context, appraisal fraud was used as a tool to induce homebuyers into larger (and thus more profitable) loans. This practice of making unfair and expensive loans to people with low valuation on their homes makes the loan all but impossible for the borrower to afford.³⁵ Thus, these borrowers faced disproportionately high rates of foreclosure because of the discriminatory and predatory nature of the loan, thus stripping these communities of wealth and substantially contributing to the current racial wealth gap in America.³⁶

Consequences of Appraisal Fraud

The consequences of appraisal fraud are far reaching.³⁷ When a borrower becomes bound to a mortgage that exceeds the value of his home at origination, he is immediately prohibited from refinancing to obtain better loan terms, such as a fixed interest rate or lower interest rate. Unlike with other types of loans, this is of significant import because the borrower’s home is placed at risk. Moreover, predatory lenders often pair overvalued mortgages with other exploitative terms that make a borrower’s need to refinance even more pressing.³⁸ In addition, the borrower cannot

³¹ National Consumer Law Center, *Credit Discrimination, Redlining*, <https://library.nclc.org/cd/060604-0> (citing Michael Fitzpatrick, Al Hofeld Jr., & Ira Rheingold, *From Redlining to Reverse Redlining: A History of Obstacles for Minority Homeownership in America*, 34 Clearinghouse Rev. 642 (2001) (quoting John O. Calmore, Spatial Equality and the Kerner Commission Report: A Back to the Future Essay, in *Race, Poverty, and American Cities* 324 (John Charles Boger & Judith Welch Wegner eds., 1998) (last visited June 21, 2019).

³² *Id.*

³³ Aaron Glantz & Emmanuel Martinez, Kept Out: For People of Color, Banks are Shutting the Door to Homeownership, *Reveal News* (Feb. 15, 2018), available at www.revealnews.org (documenting disparities in 61 metropolitan areas even after controlling for income, loan amount, and neighborhood).

³⁴ National Consumer Law Center, *Credit Discrimination, Reverse Redlining, General*, <https://library.nclc.org/cd/060604-0> (last visited June 21, 2019).

³⁵ *Supra* note 10 at *Borrowers Should Not Need to Demonstrate Qualification for a Loan* (last visited June 21, 2019).

³⁶ Jacob S. Rugh & Douglas S. Massey, Racial Segregation & the American Foreclosure Crisis, *Am Sociol Rev.* 2010 Oct 1; 75(5): 629–651, available at <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4193596/>.

³⁷ As the Sixth Circuit noted, “a borrower has much to lose from entering into a too-big loan.” *Wallace v. Midwest Fin. & Mortg. Services, Inc.*, 714 F.3d 414, 422 (6th Cir. 2013).

³⁸ *See, e.g., id.* at 421 (noting key role of inflated appraisal in inducing borrower to take out overpriced payment-option ARM, with high fees and “unreasonable” terms, resulting ultimately in borrower’s loss of home and bankruptcy).

sell his home to relocate, even if he needs to do so to find work.³⁹ And when the borrower finds himself in this dire situation, the last resort protections provided by the bankruptcy code provide him with little assistance. Even if he chooses to declare bankruptcy, the homeowner must pay the full balance of the mortgage or forfeit his home; he cannot avail himself of the relief available for unsecured debts or debts secured by personal property, which can be discharged or reduced to the value of the collateral.⁴⁰ The homeowner becomes trapped with no way out of the loan except foreclosure. Finally, unlike with other loans, realizing on the security interest for a home-secured loan can result in homelessness, a far greater impact than loss of personal goods or loss of credit, and has negative spillover onto the surrounding community.⁴¹

Indeed, for many of these reasons, placing a borrower underwater significantly increases the risk of foreclosure.⁴² Empirical data demonstrates that higher loan to value ratios lead to an increased risk of foreclosure. For example, securities ratings agencies have determined that loans with LTV ratios between 95% and 100% are 4.5 times more likely to enter foreclosure than loans with ratios below 80%. Loans that exceed 100% of the market value of the collateral are even more likely to enter foreclosure.⁴³ As a HUD-Treasury Report during the Bush Administration explained,

Many of the borrowers who are victims of this [fraudulent appraisal] scheme cannot afford to repay or refinance the mortgage based on the inflated price, and these loans may go into default and foreclosure quickly. Appraisers and others engaging in this fraudulent practice are helping to send first-time home buyers and whole communities into economic ruin.⁴⁴

While homeowners feel the direct impact of these foreclosures, investors, insurers, neighboring homeowners, and ultimately taxpayers incur significant losses from foreclosures caused by appraisal fraud.

Regulation

In 1989, Congress, in response to the savings and loan crisis of the 1980s, enacted the Financial Institutions, Recovery, Reform, and Enforcement Act of 1989 (FIRREA).⁴⁵ Under FIRREA, Congress mandated appraisal standards, review of appraisals and supervision of

³⁹ The public policy against such transactions tracks the longstanding public policy against restraints on landowners that limit their ability to transfer or otherwise control their real property. *See, e.g., McCreery v. Johnston*, 110 S.E. 464, 466 (W. Va. 1922).

⁴⁰ *See* 11 U.S.C. §§ 521(a)(2)(A), 1322(b)(2).

⁴¹ *See* Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 Yale J. on Reg. 1, 69 (2011); David Callahan, *Home Insecurity: How Widespread Appraisal Fraud Puts Homeowners at Risk* (Mar. 2005), available at www.demos.org/sites/default/files/publications/home_insecurity_v3.pdf.

⁴² Laurie S. Goodman et al., *Negative Equity Trumps Unemployment in Predicting Defaults*, 19 J. Fixed Income 67 (2010).

⁴³ *See* Federal Housing Finance Agency v. Nomure Holding America, Inc., 104 F.Supp.3d 441, 465 (S.D.N.Y. 2015).

⁴⁴ *See* HUD-Treasury National Predatory Lending Task Force, Joint Report: Curbing Predatory Home Mortgage Lending (2000), available at <http://archives.hud.gov/reports/treasrpt.pdf>.

⁴⁵ Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183; H. Rep. No. 101-54(I), at 311, reprinted in 1989 U.S.C.A.N. 86 (discussing role of faulty appraisals in the crisis).

appraisers by lenders, and appraiser independence. FIRREA has the express purposes of ensuring that:

Federal financial and public policy interests in real estate related transactions will be protected by requiring that real estate appraisals utilized in connection with federally related transactions are performed . . . by individuals whose competency has been demonstrated and whose professional conduct will be subject to effective supervision.⁴⁶

Guidelines promulgated by the federal banking agencies under FIRREA require covered institutions to establish an effective real estate and evaluation program that, among other things, ensures appraiser independence, provides for adequate review of appraisals, and monitors appraisers and reviewers. Institutions are also directed to establish policies and procedures for resolving any inaccuracies or weaknesses in an appraisal prior to the credit decision.⁴⁷

As part of FIRREA,⁴⁸ in order to ensure that appraisals were conducted according to “uniform standards,”⁴⁹ Congress required that each federal banking regulator adopt rules governing appraisal standards, including the promulgation of appraisal standards and appraisal reviews for compliance with the Uniform Standards of Professional Appraisal Practice (USPAP).⁵⁰ Among other things, the rules of conduct state that an appraiser may not accept a fee for an assignment that is contingent upon the reporting of a predetermined result or of a particular amount of the value opinion.⁵¹

In March 2017 the Federal Financial Institutions Examination Council issued a Joint Report to Congress discussing the home value threshold for requiring appraisals.⁵² Ultimately, after notice and comment, the agencies decided against raising the threshold from the current \$250,000, explaining that “[b]ased on considerations of safety and soundness and consumer protection, the agencies do not currently believe that a change to the current \$250,000 threshold for residential mortgage loans would be appropriate.”⁵³ In addition, according to the report, “CFPB staff shared concerns about potential risks to consumers resulting from an expansion of the number of residential mortgage transactions that would be exempt from the Title XI appraisal requirement.”⁵⁴

⁴⁶ 12 U.S.C. § 3331.

⁴⁷ 75 Fed. Reg. 77,450, 77,463 (Dec. 10, 2010).

⁴⁸ Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183.

⁴⁹ 12 U.S.C. § 3331.

⁵⁰ Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, tit. XI, § 1110, 103 Stat. 183 (as codified at 12 U.S.C. § 3339).

⁵¹ 2016-2017 USPAP at 8-9, available at www.appraisalfoundation.org.

⁵² Federal Financial Institutions Examination Council, Joint Report to Congress: Economic Growth and Regulatory Paperwork Reduction Act (March 2017) (2017 EGRPRA Report), available at https://www.ffiec.gov/pdf/2017_FFIEC_EGRPRA_Joint-Report_to_Congress.pdf.

⁵³ *Id.* at 36. *See also* 83 Fed. Reg. at 63,114-63,115 (acknowledging, in the current proposal, that “[c]onsumer protection considerations contributed to the agencies’ reluctance to propose increasing the appraisal threshold for residential real estate transactions immediately after the EGRPRA”).

⁵⁴ *Id.* at 36.

Regulations issued under the Truth in Lending Act set some additional requirements for appraisals done in connection with higher-priced mortgage loans,⁵⁵ including that the appraisal be completed by a licensed appraiser who conducts a physical inspection of the interior of the home.⁵⁶ If the loan is a purchase-money loan, the property was purchased by the seller within the previous six months, and the new purchase price exceeds the old by certain amounts, the lender is responsible for getting two written appraisals.⁵⁷

Additionally, regulations promulgated in the Truth in Lending Act, pursuant to the Dodd-Frank Act, regulate the supervision of appraisers.⁵⁸ Lenders are prohibited from extending credit when they know that an appraisal materially misrepresents the value of the consumer's principal dwelling. Creditors may only escape liability if they exercised "reasonable diligence."⁵⁹ Creditors and settlement service providers are required to report any material failure to follow USPAP by an appraiser.⁶⁰

Standards for appraisals and review of appraisals are not, by themselves, enough to prevent coercion of appraisers by lenders and brokers anxious to make the deal. Independence is a key component of protecting the market from the widespread overvaluation that triggered the savings and loan crisis in the 1980s and the subprime collapse in the 2000s. Since 1989, federal law has attempted to protect appraisers by forbidding lenders from offering anything of value in exchange for an appraisal performed by anyone other than a certified or licensed appraiser.⁶¹ In 2008, the Federal Reserve Board used its authority to prohibit unfair or deceptive acts and practices to prohibit creditors, mortgage brokers, and their affiliates from exercising inappropriate influence over the amount at which a consumer's home is appraised.⁶² Fannie Mae and Freddie Mac have both issued guidance specifically addressed to the question of appraiser independence.⁶³ Bolstering the independence of appraisers and sheltering them from lender coercion has been at the heart of

⁵⁵ See National Consumer Law Center, Truth in Lending §§ 9.5.2, 9.5.4 (9th ed. 2015), updated at www.nclc.org/library (discussing the definition of higher-priced mortgage loans for purposes of the appraisal rules).

⁵⁶ National Consumer Law Center, Truth in Lending § 9.5.4.6 (9th ed. 2015), updated at www.nclc.org/library (discussing the appraisal regulations for higher-priced mortgage loans).

⁵⁷ 12 C.F.R. § 1026.35(c)(4) (eff. Jan. 18, 2014). See generally National Consumer Law Center, Truth in Lending § 9.5.4.6 (9th ed. 2015), updated at www.nclc.org/library (discussing the appraisal regulations for higher-priced mortgage loans).

⁵⁸ See generally National Consumer Law Center, Truth in Lending §§ 9.4.2 (discussing the appraisal regulations issued under Truth in Lending Act), 9.4.4 (reviewing Truth in Lending Act remedies for violations of these regulations) (9th ed. 2015), updated at www.nclc.org/library.

⁵⁹ 12 C.F.R. § 1026.42(e).

⁶⁰ 12 C.F.R. § 1026.42(g)(1). See generally National Consumer Law Center, Truth in Lending §§ 9.4.2 (discussing the appraisal regulations issued under Truth in Lending Act), 9.4.4 (reviewing Truth in Lending Act remedies for violations of these regulations) (9th ed. 2015), updated at www.nclc.org/library.

⁶¹ 12 U.S.C. § 3349(a)(1).

⁶² 12 C.F.R. § 1026.42.

⁶³ Fannie Mae, Appraiser Independence Requirements (Nov. 10, 2010), available at www.efanniemae.com; Freddie Mac, Oct. 15 Guide Bulletin 2010-23, available at www.freddiemac.com.

actions taken by the New York attorney general (in negotiating the settlement of an appraisal fraud investigation)⁶⁴ and regulations issued under the Dodd-Frank Act.⁶⁵

Regulations promulgated under the Dodd-Frank Act's amendments to the Truth in Lending Act have prohibited the falsification or alteration of an appraisal and a number of coercive practices that might influence an appraiser's valuation.⁶⁶ In addition, the regulations limit conflicts of interest and require reasonable compensation of appraisers.⁶⁷ The Dodd-Frank Act also included provisions regarding licensure of appraisers and appraisal management companies.⁶⁸

Discussion Topics

The current floor of regulation—to the extent that it has been implemented—has worked. Nonetheless, apparently forgetting the recent past and ignoring all testimony, evidence, and findings to the contrary, there appears to be a trend toward relaxing the well-established value of appraisals to our real estate market and economy. Currently, the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation are proposing eliminating the requirement for bona fide appraisals for homes worth less than \$400,000. Meanwhile, Fannie Mae and Freddie Mac are permitting no appraisals to be used in underwriting certain loans, relying instead on “inspections” conducted by people with no training, oversight, or guidelines; computerized black-box Automated Valuation Models that have no governing standards; or “hybrid appraisals” that are not appraisals at all, given that no appraiser is required to complete an on-site inspection of the home. These moves undermine safety and soundness in the marketplace and put huge numbers of American homeowners at substantial risk of losing their most valuable asset.

Raising the De Minimis Threshold Will Harm Homeowners & the Economy

As set forth extensively in our written comments and letters on the topic, raising the de minimis threshold for appraisal requirements under FIRREA is unwise and unwarranted, and recently recognized by the impacted agencies.⁶⁹

⁶⁴ Office of the New York State Att’y Gen., Press Release, New York Attorney General Cuomo Announces Agreement with Fannie Mae, Freddie Mac, and OFHEO (Mar. 3, 2008), available at www.ag.ny.gov.

⁶⁵ Pub. L. No. 111-203, §§ 1472, 1473, 124 Stat. 1376 (2010); 75 Fed. Reg. 66,554 (Oct. 28, 2010). See 12 C.F.R. § 1026.42; National Consumer Law Center, Truth in Lending § 9.4.2.1 (9th ed. 2015), updated at www.nclc.org/library (replacement of Federal Reserve Board’s 2008 appraisal rules and effective dates).

⁶⁶ See 12 C.F.R. § 1026.42; National Consumer Law Center, Truth in Lending § 9.4.2.1 (9th ed. 2015), updated at www.nclc.org/library (replacement of Federal Reserve Board’s 2008 appraisal rules and effective dates).

⁶⁷ See National Consumer Law Center, Truth in Lending §§ 9.4.2.3–9.4.2.5 (9th ed. 2015), updated at www.nclc.org/library (substantive prohibition of appraisal regulation).

⁶⁸ Pub. L. No. 111-203, § 1473, 124 Stat. 1376 (2010).

⁶⁹ See Comments to the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation regarding OCC Docket No. OCC–2018–0038, RIN 1557–AE57 FRB Docket No. R–1639, RIN 7100–AF30, FDIC RIN 3064–AE87, 83 Fed. Reg. 63,110 (December 7, 2019) (February 5, 2019), available at https://www.nclc.org/images/pdf/foreclosure_mortgage/mortgage_servicing/real-appraisal-comments-83-fed-reg.pdf.

In 2017, the Federal Financial Institutions Examinations Council (FFIEC) and its member agencies rejected an attempt to lower the de minimis threshold for appraisals.⁷⁰ The FFIEC stated that it had concerns for the “safety and soundness” of the market and concerns that raising the threshold would put consumers at risk for overvaluation of properties⁷¹ Specifically, the FFIEC stated that raising the threshold from the current \$250,000 residential standard would have limited impact on burden because the VA, FHA, and other federal agencies impose their own appraisal requirements.⁷² Further, raising the threshold could have serious implications for the market, as seen from the last financial crisis where “imprudent residential mortgage lending can pose significant risks to financial institutions.”⁷³ Importantly, lowering this threshold—which currently only requires an appraisal for loans over \$250,000 or for Higher Priced Mortgage Loans over \$25,000—would protect homeowners and communities. The majority of homes throughout the country are worth less than \$250,000.⁷⁴ Low- and moderate-income homeowners—and the government entities that insure or invest in their loans—deserve the same protections as higher income homebuyers.

The proposed rule to increase the de minimis threshold for appraisals deviates from Congress’ amendment to FIRREA and has dangerous implications for rural areas and communities of color. Indeed, the factors that led FFIEC to reject lowering the threshold in 2017 remain unchanged. In addition, given the importance of appraisals and the Congressional mandate to exercise caution, the agencies should not adopt the proposed increase because there is insufficient data to properly evaluate it. There has also been insufficient time to assess the recent changes Congress made to appraisal standards. Rather than leap into deregulation, with potentially calamitous impacts for consumers and the economy, the agencies and the Consumer Financial Protection Bureau should jointly implement a process to collect the needed data and then hold public hearings on setting the appropriate threshold.

Evaluations and so-called hybrid appraisals are inadequate. These processes allow unvetted, untrained, unsupervised people to enter consumers’ homes for the purposes of supposedly reaching a home value. There are no requirements that these individuals pass background checks or otherwise demonstrate their reliability. There are no requirements that they follow USPAP or any other standards. There are no minimum training or knowledge requirements. And if they engage in fraud, theft, or simple negligence, there is no recourse whatsoever—where appraisers are subject to licensure requirements by state regulatory boards, there is no method to track, sanction, or supervise individuals conducting evaluations and inspections. Given the incentives to shoddy or fraudulent home valuations set forth above, this is a clear recipe for disaster.

⁷⁰ Federal Financial Institutions Examination Council, Joint Report to Congress: Economic Growth and Regulatory Paperwork Reduction Act at 36 (March 2017) (EGRPRA Report), available at https://www.ffiec.gov/pdf/2017_FFIEC_EGRPRA_Joint-Report_to_Congress.pdf.

⁷¹ *Id.* at 35-36. *See also* 83 Fed. Reg. at 63,114-63,115 (acknowledging, in the current proposal, that “[c]onsumer protection considerations contributed to the agencies’ reluctance to propose increasing the appraisal threshold for residential real estate transactions immediately after the EGRPRA”).

⁷² 2017 EGRPRA Report at 35.

⁷³ *Id.*

⁷⁴ *See* S&P Dow Jones Indices LLC, S&P/Case-Shiller 20-City Composite Home Price Index© [SPCS20RSA], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/SPCS20RSA>, November 13, 2016.

The increase in the de minimis standard for appraisals does not just undermine safety and soundness in the marketplace, it also places entire communities at risk—especially communities of color that have historically been barred from increasing their wealth through homeownership. As discussed above, the phenomenon of redlining has been well-documented—credit worthy non-white borrowers were intentionally barred from home ownership by restrictions on lending through our federally funded programs. This resulted in white families being able to amass wealth, while people of color were unable to invest in homeownership. As a result, the most recent generation of homebuyers of color were often the first in their families to purchase their own home, but were only able to access financing at exploitative terms. These communities of color were those who lost out the most during the mortgage crisis of 2008—entire neighborhoods were decimated, and families lost their entire net worth overnight. These communities were particularly hard hit, facing foreclosure at nearly twice the rate of white communities, while they simultaneously held a much higher portion of their wealth in their homes.⁷⁵ The crisis left these neighborhoods blighted and empty and stole families’ entire savings. Homes lost more than 50% of their value, which they have yet to regain.⁷⁶ While the median home value for any homeowner in America is less than \$250,000, the median value for homes owned by Black homeowners is just \$153,500.⁷⁷ Exempting these homes from appraisal requirements puts these same communities—just now starting to recover from the crisis and rebuild faith in our national housing market—at dramatic risk once again. Indeed, it is well-documented that housing in Black communities is, even controlling for other factors, systemically undervalued. As a result, under the proposed increased threshold, communities of color would be disproportionately negatively impacted.⁷⁸ To an individual buying a \$250,000 home, the risk of foreclosure is real and it can be devastating. Time and time again we have been shown that that risk increases exponentially if the home is not subject to a true, qualified appraisal at the time it is purchased or the home loan is refinanced. Appraisals save homes.

Rather than looking to decrease protections for homeowners, Congress should be seeking to increase those protections, particularly for the most vulnerable communities who have been excluded from the wealth-building tool of homeownership. Adequate, well-regulated appraisals should be required for federally backed transactions to protect the government, homeowners, and our economy.

Unregulated Technology Will Hurt Consumers

As in all sectors, the use of new technologies presents tremendous opportunity to move the market forward and improve accessibility, as well as tremendous risk in the absence of adequate oversight and consideration.

⁷⁵ See Michael Gerrity, 2007 Foreclosure Crisis Still Negatively Impacting Black and Hispanic Communities, World Property Journal (Apr. 26, 2019), available at <https://www.worldpropertyjournal.com/real-estate-news/united-states/detroit/zillow-2019-housing-reports-sarah-mikhitarian-black-homeownership-data-hispanic-homeownership-data-foreclosure-crisis-real-estate-news-11378.php>.

⁷⁶ *Id.*

⁷⁷ See Housing in Black America, Black Demographics, <https://blackdemographics.com/households/housing/>.

⁷⁸ See Andre Perry, Jonathan Rothwell, David Harshbarger, Brookings Institute, The Devaluation of Assets in Black Neighborhoods (Nov. 2018), available at <https://www.brookings.edu/research/devaluation-of-assets-in-black-neighborhoods/>.

As illustrated by the case of Mrs. R above, the use of automated valuations can be devastating. The automated valuation used by her lender was based on aggregate data from unverified public records that is often inaccurate, incomplete, or outdated. Moreover, programs like these cannot adequately consider neighborhood, condition of the property, location appeal, or altered building characteristics. Each of these factors is essential in understanding the true value of a home.

Moreover, despite Congressional mandate through the Dodd-Frank Act, there are *no* minimum standards for AVMs. As a result, AVMs are proprietary, black-box algorithms that cannot be meaningfully understood or evaluated for accuracy, safety and soundness, or potential discriminatory or even fraudulent impacts. These algorithms are not a way to avoid error—they are only as good as the humans that create them, and these humans face the very same incentives to enrich their employers that gave rise to the recent foreclosure crisis.

We urge that AVMs only be used to *supplement* true appraisals; and in this context that the Appraisal Standards Board of the Appraisal Foundation be granted authority to create clear, transparent, and reviewable standards for these automated models.

A potentially positive opportunity for the use of technology in appraisals exists in the Practical Applications in Real Estate Appraising (PAREA) approach being developed by the Appraisal Qualifications Board of the Appraisal Foundation. PAREA, if sufficiently funded and appropriately developed, will supplement current methods of appraiser training through the use of virtual reality and other methods of training through technology. PAREA presents an opportunity to level the playing field to move away from inadequate or inconsistent training based on the skills and knowledge of the supervising appraiser. PAREA can also potentially open the field of real estate appraising beyond the traditional domain of white men by making training accessible without the need for established connections in the profession. This in turn can counteract implicit bias within the profession, and add a diversity of voices and build trust in home valuation that is sorely needed throughout American communities. Of course, technology is not a silver bullet, and PAREA must be coupled with hands on experience, careful oversight, transparency, and adequate funding to make the possibilities a reality.

Appraisal Standards and Requirements Protect Communities of Color

As stated throughout this statement, communities and homeowners of color are particularly vulnerable to appraisal fraud and predatory lending—as the direct result of a history of intentional, government-backed racial discrimination. In 2011, the median white household had \$111,146 in wealth holdings, compared to just \$7,113 for the median Black household and \$8,348 for the median Latino household, as the direct result of redlining and other discriminatory social policy.⁷⁹ Research demonstrates that eliminating disparities in both the homeownership rate and the returns on investment would significantly narrow this gap.⁸⁰ The United States government must focus on building and protecting wealth in communities of color, not subjecting it to increased risk. To this end, we have discussed the impacts of each of the areas of inquiry in particular relationship to

⁷⁹ Laura Sullivan, et al., *The Racial Wealth Gap: Why Policy Matters* (June 2016), *available at* <https://www.demos.org/research/racial-wealth-gap-why-policy-matters>.

⁸⁰ *Id.*

racial discrimination. As discussed throughout, exempting lower valued homes from appraisal requirements particularly places minority homeowners at risk, whereas efforts to ensure clear, transparent, minimum standards for home valuation will protect these communities that are struggling through no fault of their own. To the extent that measures are adopted to expand appraisal options for FHA loans, legislators should ensure that there is adequate training on FHA lending for those appraisers and that those already in the industry are subject to such training requirements.

Appraiser Independence

Due in large part to increased requirements of appraiser independence and other substantive regulations and standard setting, unethical lenders, brokers, and appraisers can no longer join forces to defraud homeowners, communities, investors, and insurers. These requirements build upon earlier steps taken under FIRREA to ensure minimum standards for appraisals and appropriate training. The requirement of a complete appraisal by a licensed and educated appraiser further protects the market.

There is some cause for concern. Appraisal Management Companies (AMCs) have become increasingly financially connected to large lenders, thereby potentially undermining the supposed independence they create. Careful oversight of these purportedly arms-length transactions must be conducted to ensure that there is true financial independence, given the incentives to jointly create wealth for a parent company. We further propose that AMCs be required to disclose the complete breakdown of how valuation costs are being assessed, paid, and applied. Limits should be implemented to fees paid by the homeowner—if any—to an AMC.

Conclusion

Minimum regulatory requirements for appraisals are necessary to protect homeowners and the economy at large. Any appraiser shortage would be appropriately addressed through market forces: increased demand would lead to increased customary rates, which would accordingly lead to a greater supply of appraisers entering the marketplace. Moreover, any shortage is likely to be temporary and to disappear as interest rates increase and the demand for mortgage refinances decreases. To the extent there is a true, demonstrable shortage of appraisers in specific regions, solutions should be carefully targeted to increasing the supply of qualified appraisers in those areas, not to decreasing protections for everyone. Lowering standards and qualifications, including permitting lenders to rely on alternative valuation products and broker price opinions, will further increase any such shortage, rather than remedy the need for qualified appraisers. Such reliance would further enable lenders to return to obtaining unreliable reports which, in turn, create instability in the market. In short, the regulatory regime is a floor that is essential to avoid both unintentional errors as well as fraud.

A floor of overarching federal regulatory standards for lending and appraisals is necessary to ensure that both consumers and others impacted by the mortgage market are uniformly protected from fraud nationwide. National standards are appropriate for a national market in mortgage lending, investment, and insurance, and to enable appraisers to more easily act with reciprocity in jurisdictions and across state lines, where appropriate. Without this uniform baseline, the

marketplace would become more costly and complicated for participants. Both the savings and loan crisis of the 1980s and the mortgage industry collapse in the 2000s demonstrate the clear and pressing need for this federal regulatory framework to establish a floor for acceptable appraisal conduct. Eliminating these protections and relying solely on the states would open the door to more economic crises that devastate homeowners and financial institutions alike. Of course, these federal protections are, appropriately, a floor and not a ceiling on appraisal safeguards. States have always been and continue to be able to create additional, state appropriate protections. This interplay between basic protections on a federal level with *additional* localized regulation is necessary and positive for the market and consumers.

In sum, it is essential that a national regulatory floor be retained and built upon to protect the American dream of homeownership into the future. Without these protections, the market will become more costly in the short term, and lead to new financial crises in the future, even while we have barely recovered from the last one. The appraisal protections were wisely adopted by Congress in response to real, demonstrated need in the very recent past. We urge you to keep these essential protections in place, and to build upon them to protect homeownership for *all* Americans into the future.