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CRS Report for Congress

Regulation of Real Estate Appraisers and the "Cuomo Agreements"

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Summary

Falling house prices and rising foreclosures in the subprime and Alt-A mortgage markets have led some to question the effectiveness of the current regulation of real estate appraisers. The Appraisal Subcommittee (ASC) of the Federal Financial Institutions Examinations Council (FFIEC) oversees the state licensing and certification of real estate appraisers. The ASC also oversees the issuance of the Uniform Standards of Professional Appraisal Practice (USPAP) by the Appraisal Foundation. The ASC has limited enforcement powers over state boards that do not comply. The recently passed housing bill (H.R. 3221, P.L. 110-289) included language similar to an appraisal reform bill, H.R. 3837, that makes it unlawful to improperly influence real estate appraisals.

The government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, signed agreements in March 2008 with the state attorney general of New York, the "Cuomo Agreements," in which the GSEs agreed not to purchase loans from banks that conducted appraisals in-house. The agreement also established a Home Valuation Code of Conduct (HVCC).

Because the GSEs provide a large share of mortgage funding to banks, the federal banking regulators of the FFIEC have objected to the Cuomo Agreements. The GSE conservatorship orchestrated in September 2008 places the agreements in further doubt.

This report will be updated as conditions warrant.

Context

Appraisers provide an estimate of the value of real estate prior to the completion of a mortgage transaction. Lenders typically rely on real estate appraisers because the property serves as collateral for the loan, and the lender might seize and sell the property if the borrower defaults.

The regulation of both commercial and residential real estate appraisers was altered following the savings and loan crisis of the late 1980s and early 1990s, during which defaults on commercial real estate rose significantly. Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)[1] established a federal Appraisal Subcommittee (ASC) within the Federal Financial Institutions Examinations Council (FFIEC),[2] but the licensing and certifying of appraisers was left to the states. FIRREA required the states to establish licensing and certification requirements and coordinate through the ASC and a nongovernmental organization, the Appraisal Foundation, which establishes the Uniform Standards of Professional Appraisal Practice (USPAP). Federal banking regulators established the threshold for requiring an appraisal for federally related loans, and all 50 states created appraisal boards to license and certify appraisers. Currently, the ASC of FFIEC provides the federal lead for the regulation of appraisers, the various state appraisal boards certify and license individual appraisers, and the independent Appraisal Foundation helps coordinate industry standards of practice.

The subprime mortgage crisis has drawn renewed attention to the regulation of appraisers. With house prices falling, some have questioned the integrity of appraisals that had estimated values higher than current prices. Representative Kanjorski introduced the Escrow, Appraisal, and Mortgage Servicing Improvements Act (H.R. 3837), which would prohibit interested parties in a real estate transaction from improperly influencing a real estate appraisal. H.R. 3837 would provide other consumer protections as well. Similar language was included in the recently passed Housing and Economic Recovery Act of 2008 (H.R. 3221, P.L. 110-289), which contains section (g)(1):

> No mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, nor any other person with an interest in a real estate transaction involving an appraisal in connection with a mortgage insured under this section shall improperly influence, or attempt to improperly influence, through coercion, extortion, collusion, compensation, instruction, inducement, intimidation, nonpayment for services rendered, or bribery, the development, reporting, result, or review of a real estate appraisal sought in connection with the mortgage.

The Appraisal Subcommittee (ASC)

The ASC is part of the FFIEC, which establishes regulations for appraisals for federally related transactions. Such regulation governs when appraisals are required, who must perform the appraisals, and the manner in which appraisals shall be performed. The FFIEC appoints the members of the ASC, and the chairperson of the ASC serves a two-year term.[3] The ASC reviews and monitors the procedures and activities of the Appraisal Foundation, which issues the USPAP.[4] The ASC monitors the requirements established by the state boards for the certification and licensing of appraisers, including a code of

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[1] Sponsored by Henry B. Gonzales, H.R. 1278, P.L. 101-73, became law August 9, 1989. The appraisal subcommittee of the FFIEC can be found at 12 U.S.C. 3301 et. seq.

[2] The FFIEC includes the Federal Reserve Board (FRB), The Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA).

[3] Sections 1103-1107 of FIRREA describe the composition and duties of the Appraisal Subcommittee.

[4] Rules promulgated by the ASC must follow notice and comment procedures (Sec. 1107).

professional responsibility. The ASC determines the level of required appraisal (licensed or the more stringent certified) for federally related transactions. The ASC maintains a national registry of state certified and licensed appraisers.

To fund its activities, the ASC collects fees from registered appraisers. For the fiscal year ending September 30, 2007, the ASC had expenses of $2.6 million, including $1.2 million in grants to the Appraisal Foundation.[5] There were more than 100,000 appraisers in the registry generating $3.2 million in fees for the ASC. The ASC reviewed 35 state appraisal agencies. **Table 1** presents the results of the ASC field reviews; violations included failing to document records properly and approving unacceptable continuing education courses, among other concerns.

Table 1. Appraisal Subcommittee Reviews of State Agencies

Problem Area	No. of States	Examples of Descriptions
Education	4	— Accepted insufficient number of hours — Did not accept ABQ changes — Approved unacceptable courses
Experience	8	— No reliable means to verify experience — Failed to maintain documentation of claims of experience
Continuing Education	16	— Approved unacceptable courses — Failed to require the appropriate continuing education hours when reactiviting a credential
Temporary Practice	9	— Failed to issue temporary practice permits within 5 days
Enforcement	19	— Failed to investigate/resolve complaints in a timely manner — Insufficient file documentation
National Registry Submissions	8	— Provided insufficient data — Failed to provide timely National Registry fee payments — Failed to submit disciplinary actions

Source: *ASC Annual Report, 2007*, p. 72.

Threshold for Federally Related Transactions

Depending on size and complexity, a real estate transaction might require a certified appraiser, a licensed appraiser, or no appraiser at all. In general, residential appraisals are considered less complex than commercial real estate transactions. Under Title XI, "each

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[5] *ASC Annual Report, 2007*, available at [http://www.asc.gov/html/frameSet.aspx?assetPath=/uploads/Annual %20Reports\AnnualReport2007.pdf].

Federal financial institution's regulatory agency and the Resolution Trust Corporation may establish a threshold level at or below which a certified or licensed appraiser is not required to perform appraisals in connection with federally related transactions, if such agency determines in writing that such threshold level does not represent a threat to the safety and soundness of financial institutions."[6] The current base for residential transactions is $250,000. All transactions more than $1 million require a certified appraiser, as opposed to a licensed appraiser.

The "Cuomo Agreements"

On March 3, 2008, Fannie Mae announced an agreement with the attorney general of the State of New York that would establish rules for home appraisals that would take effect on January 1, 2009.[7] In the agreement, the attorney general agreed to cease state investigations of Fannie Mae if Fannie Mae agreed to purchase mortgages only from banks that did not conduct home appraisals in-house.[8] A similar agreement was reached with Freddie Mac, the other secondary mortgage market GSE. Because the GSEs purchase a high percentage of prime mortgages originated by banks, it could be argued that the agreement is a de facto banking regulation because any bank that conducted in-house appraisals would lose access to the largest source of funds for prime mortgages. Although the agreement was negotiated with the knowledge of the federal regulator of the GSEs, the Office of Federal Housing Enterprise Oversight (OFHEO),[9] the FFIEC and its member federal financial regulators have challenged both the substance of the agreement and the authority of a state official to establish rules for federally chartered banks.[10] The status of the agreements is further complicated by the transformation of OFHEO into the Federal Housing Finance Agency (FHFA) and the GSE conservatorship. It remains to be seen if the agreement between New York and Fannie Mae will survive the challenge of these federal banking regulators.

The Home Valuation Code of Conduct

The Cuomo Agreement would establish a new set of rules for appraising the value of homes, referred to as the Home Valuation Code of Conduct (HVCC). The expressed intent of the agreement is "...to ensure appraisal independence and valuation protection..." and to establish "...requirements governing appraisal selection, solicitation, compensation, conflicts of interest and corporate independence, among other things."[11] The HVCC calls

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[6] 12 U.S.C. 3341.

[7] Fannie Mae, "Fannie Mae Reaches Agreement with New York Attorney General, OFHEO, Regarding Home Appraisals; Investigation Terminated," Press Release, March 3, 2008, available at [http://www.fanniemae.com/newsreleases/2008/4291.jhtml?p=Media&s=News+Releases].

[8] The agreement can be found at [http://www.fanniemae.com/media/pdf/030308_agreement.pdf].

[9] OFHEO was merged into the new Federal Housing Finance Agency by the recently passed housing bill, PL 110-289.

[10] See joint letter from the agencies to the director of OFHEO, James B. Lockhart, dated June 19, 2008, at [http://www.tavma.org/images/HVCC_Comments/regulators_jointletter_hvcc.pdf].

[11] The agreement, section I (1), can be found at [http://www.fanniemae.com/media/pdf/030308_agreement.pdf].

for the creation of an Independent Valuation Institute, which is intended to be independent despite the agreement's provision for (1) funding by Fannie Mae and (2) potential affiliation with an existing industry group. The institute would propose amendments to the code, establish a consumer hotline, and provide appraisers a contact if they believed they were being pressured in any way.

Automated Valuation Models and Appraisal Management Companies

Some may be concerned about the impact of the HVCC on Automated Valuation Models. Automated Valuation Models are computerized valuations based on available information. As the name implies, it is often possible to get an estimated appraisal from these models without a person visiting the interior of the home being valued. As a rough analogy, consider information to assist car-buying, such as reports by Carfax and similar services. As long as the vehicle's maintenance and accident information is publicly available, a computer model may provide a rough estimate of the car's value. However, a prudent car buyer might still prefer a mechanic to personally inspect the car because important information may not be in the public domain. Similarly, automated valuation models attempt to provide a rough home valuation based on public information of the home and nearby comparable properties. Examples of similar home valuations can be found on real estate service websites. Like the auto mechanic in the car example, prudent home buyers and mortgage lenders might obtain an inspection of the home by a qualified professional. The HVCC expressly rejects a preference for Automated Valuation Models. Section XI states, "Nothing in this Code shall be construed to establish new requirements or obligations that (1) require a lender to obtain a property valuation, or to use any particular method for property valuation (such as appraisal or automated valuation model)...."

Some have expressed concern that the HVCC provides a preference for Appraisal Management Companies. As the name implies, these firms specialize in providing real estate appraisals. In some cases, the HVCC does provide a preference for Appraisal Management Companies compared with some other professionals. Section III, for example, states that Appraisal Management Companies may be designated to arrange compensation for appraisers but that mortgage bankers and real estate brokers may not. Similarly, Section V expressly allows for employees of Appraisal Management Companies to select appraisers but does not include real estate brokers.