



# Regulation of Real Estate Appraisers

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## Summary

Real estate appraisers attempt to measure the value of a property that is being purchased or refinanced. In mortgage contracts, the property serves as collateral for the loan. Banks and their regulators may rely on the appraisal to reduce the potential losses if the borrower fails to repay the loan. Property purchasers may also rely on an appraisal if they wish to reassure themselves that the price they offered was reasonable given market conditions. This report discusses the regulation of appraisers and provides information on related statutes and rules.

The fallout from the housing bubble raised questions about the effectiveness of the regulation of residential real estate appraisers before and during the financial crisis. Real estate prices rose rapidly in some areas, then fell rapidly. When the real estate bubble burst, questions arose about the accuracy of the appraisals that supported the mortgage loans during the housing bubble.

Traditionally, regulation of real estate appraisers was handled at the state level, with a federal agency, the Appraisal Subcommittee (ASC), overseeing the state boards that licensed and certified appraisers. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd Frank Act, P.L. 111-203) increased federal requirements for real estate appraisers and transferred some federal oversight powers from banking regulators to the new Consumer Financial Protection Bureau (CFPB).

The Appraisal Foundation, a professional organization, issues the specific standards for conducting appraisals. These standards form the Uniform Standards of Professional Appraisal Practice (USPAP), but are not federal law. The Appraisal Subcommittee (ASC) of the Federal Financial Institutions Examinations Council (FFIEC) provides some of the funding for the Appraisal Foundation and oversees its activities.

Business practices of banks and securities firms that offer or purchase a large share of mortgages can influence appraisal standards. The rules that banking regulators and the Federal Housing Finance Agency (FHFA) set for these institutions can influence industry-wide standards, even when the rules do not technically apply to all firms. During the financial crisis, the Home Valuation Code of Conduct (HVCC) was an informal industry standard created as part of a settlement between the attorney general of New York and Fannie Mae and Freddie Mac, which are regulated by the FHFA. The Dodd-Frank Act included a sunset provision for the HVCC, and directed the banking regulators to propose interim regulations until the CFPB began operating.

Title XIV, subtitle F of the Dodd-Frank Act included other changes to the regulation of real estate appraisals. Major provisions of subtitle F include a requirement of a property visit for appraisals of a home financed by a high-risk mortgage; conditions for a second appraisal at no cost to the home purchaser; mandated independence for appraisers; portability of some residential property appraisals; rules for customary and reasonable fees; standards for appraiser education; and a mandatory annual report to Congress by the ASC on its activities.

The ASC, banking regulators, and the CFPB are proposing and implementing several new rules. For example, the agencies issued an interim final rule for reasonable and customary fees for appraisers, as required by Section 1472 of the Dodd-Frank Act.

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# Real Estate Price Volatility and Appraisal Regulation

Appraisers provide an estimate of the value of real estate prior to the completion of a sale or refinance of the property. Lenders typically rely on independent real estate appraisers because the property serves as collateral for the loan used to finance the transaction. The lender is in a position to seize and sell the property if the borrower defaults. Borrowers who are purchasing or refinancing the property may also desire an appraisal in order to reassure themselves that the price of the property is in line with an objective evaluation of its value. Either the buyer or the seller may be dissatisfied with the property appraisal if prices rise or fall rapidly after the sale; as a result, reexamination of appraisal regulation is not unusual following a real estate related financial crisis.

Current regulation of property appraisals is based on legislation passed following two financial crises linked to real estate bubbles. Legislation governing appraisal regulation includes Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA, P.L. 101-73)<sup>1</sup> enacted after the Savings and Loan Crisis, and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act, P.L. 111-203) enacted after the Subprime Mortgage Crisis. In addition to the changes included in the Dodd-Frank Act, requirements for appraiser independence were included in the Housing and Economic Recovery Act (HERA) of 2008.

FIRREA created a federal framework to oversee the state licensing and certification of real estate appraisers. It did so by establishing the Appraisal Subcommittee (ASC) within the Federal Financial Institutions Examinations Council (FFIEC),<sup>2</sup> but the licensing and certifying of appraisers was left to the states. FIRREA required the states to establish licensing and certification requirements and to 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 the states created appraisal boards to license and certify appraisers.<sup>3</sup>

The mortgage crisis that began in 2007 has primarily affected residential properties, not commercial properties. The Dodd-Frank Act transferred some of the regulation of residential mortgages to the new Consumer Financial Protection Bureau (CFPB), established more specific criteria for residential property appraisals and the appraiser profession, and also required a property visit for appraisals financed by a high risk residential mortgage. Other changes mandated in the DFA include mandated independence for appraisers, requiring regulators to establish customary and reasonable fees for appraisal activities, requiring that banks separate the loan officers who underwrite loans from the people who pick the appraisers, and establishing standards for the professional education of licensed and certified appraisers.

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<sup>1</sup> 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.

<sup>2</sup> The FFIEC includes the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA).

<sup>3</sup> The higher qualification for appraisers, certification, was typically reserved for complex commercial properties, not residential real estate.

The Housing and Economic Recovery Act (HERA, P.L. 110-289) included a provision designed to increase the independence of appraisers. It prohibited mortgage lenders, mortgage brokers, mortgage bankers, real estate brokers, appraisal management companies, employees of appraisal management companies, and any other people with an interest in a real estate transaction from improperly influencing, or attempting to improperly influence, the development, reporting, result, or review of a real estate appraisal in connection with a federally related mortgage.

## **Federally Related Mortgage Transactions**

Federal regulation of appraisals is typically linked to federally related transactions. In practice, federal regulation applies to most of the mortgage market because it includes any loans from federally chartered or insured banks, thrifts, and credit unions. It includes any loans that are part of a Federal Housing Administration (FHA) or Department of Housing or Urban Development (HUD) program. It also includes any loans originated with the intent to be eligible for sale to the housing government sponsored enterprises (GSEs).<sup>4</sup> However, not all property sales and transfers require a mortgage; therefore, there are some property transactions for which federal appraisal regulation would have limited applicability.

Appraisers are licensed and certified at the state level. More complex real estate transactions require a certified appraiser.<sup>5</sup> Licensed appraisers may conduct less-complex appraisals. In general, residential appraisals are considered less complex than commercial real estate transactions. Although state boards license and certify appraisers, the boards themselves are subject to oversight by federal authorities in the Appraisal Subcommittee.

## **The Appraisal Subcommittee (ASC)**

The ASC is a federal agency that oversees state licensing and certification of appraisers and appraisal management companies. The ASC is part of the Federal Financial Institutions Examinations Council (FFIEC), which coordinates federal banking regulators. The ASC's board is appointed by the heads of related agencies. Each member agency of the FFIEC (banking regulators) appoints one ASC board member. The head of the Federal Housing Finance Agency (FHFA) and the head of the CFPB each appoint one board member. At least one member of the board must have demonstrated knowledge of the appraisal profession through licensure, certification, or designation.

The ASC has a number of regulatory responsibilities and must report annually to Congress.<sup>6</sup> The ASC monitors the requirements established by the state boards for the certification and licensing of appraisers, state registration and supervision of appraisal management companies (AMCs), appraisal standards for federally related transactions, and the level of required appraisal (licensed or the more stringent certified) for federally related transactions. The ASC also maintains national

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<sup>4</sup> The GSEs include Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (FHLBs).

<sup>5</sup> Professional qualifications for certified appraisers are more stringent than for licensed appraisers. Banking regulators and the Federal Housing Administration (FHA) require a certified appraiser for some transactions.

<sup>6</sup> Annual Report, 2011, Appraisal Subcommittee, FFIEC, available at <https://www.asc.gov/Documents/AnnualReports/2011%20Annual%20Report.pdf>.

registries of certified and licensed appraisers and of appraisal management companies. The ASC oversees the state codes of professional responsibility for real estate appraisers.

## ASC Supervision of State Appraisal Boards

The ASC reviews about half of the state appraiser boards every year.<sup>7</sup> Boards are assessed in seven categories of federal regulations, including statutes/policies, temporary practice, national registry, application process, reciprocity, education, and enforcement. The most common areas of noncompliance during 2009-2011 were enforcement and application.<sup>8</sup>

Based on these seven categories, the ASC rates each state as being (1) in substantial compliance, (2) not in substantial compliance, or (3) not in compliance. The rating “not in substantial compliance” applies when the ASC has concerns regarding the state board’s compliance with ASC Policy Statements or Appraisal Qualifications Board (AQB) Criteria but the concerns do not rise to the level of “not in compliance.” Until 2011, “not in substantial compliance” had been the most common rating. In 2007, 26 of the 30 state boards reviewed received not in substantial compliance; that ratio had fallen to 11 of 27 by 2011.<sup>9</sup>

**Table 1** shows the trend in state board ratings during 2009-2011. The number of states receiving not in substantial compliance fell from 18 in 2009 to 11 in 2011. In the last three years (2009, 2010, and 2011), one state has been found not in compliance, although the rating “not in substantial compliance” is common. The state found not in compliance in 2011 was Illinois, which resulted in a move from the standard two-year review cycle to a one-year review cycle. Florida is also on a one-year review cycle.

**Table 1. ASC Reviews of State Appraisal Boards**

	2009	2010	2011
State Boards Reviewed	32	26	27
In Substantial Compliance	14	9	15
Not in Substantial Compliance	18	17	11
Not in Compliance	0	0	1

**Source:** ASC Annual Report, 2011, Appendix C, p. 60.

## National Registry of Appraisers

The ASC maintains a registry of state licensed and certified appraisers. Information that is made public includes whether the appraiser is licensed or certified and whether the appraiser’s credentials have been suspended or revoked. The database includes nonpublic information such

<sup>7</sup> Ibid. p. 15.

<sup>8</sup> Ibid. p. 60.

<sup>9</sup> Ibid. p. 60.

as disciplinary actions other than suspensions and revocations. Only certain state and federal regulatory officials have access to the nonpublic data.

## **ASC Revenues, Operating Expenses, and Grants**

The ASC does not receive an annual appropriation. The ASC was provided \$5 million in startup funds in FIRREA. Since that time, the ASC's funding has largely come from registration, certification, and licensing fees of appraisers. According to the 2011 Annual Report, the ASC received \$2.6 million in fees in FY2011, down from \$2.8 million in FY2010.<sup>10</sup>

Other than the grant to the Appraisal Foundation, most of the ASC's operating expenses are allocated to personnel. In FY2011, personnel and expenses made up \$1.5 million of the \$2.3 million operating expenses (excluding grants).<sup>11</sup> The category of expenses with the largest increase was depreciation, which rose from \$49,838 to \$76,883 dollars from FY2010 to FY2011.<sup>12</sup> The only other category of expenses with significant increase was contracted expenses, which rose from \$210,379 to \$227,647 during the same period.<sup>13</sup>

The ASC is required by FIRREA to provide grants for appraisal related activities. Grants represented \$1.4 million of the ASC's outlays in FY2011, down from \$1.3 million in FY2010.<sup>14</sup> Most of the grants go to the Appraisal Foundation in order to help defray the costs of issuing appraisal standards and maintaining appraisal qualifications, as required by FIRREA. The ASC also makes some grants to state certification and licensing boards, which are required to conduct audits and report data on the appraisers and appraisal management companies they oversee. The ASC also funds some professional education programs.

## **The Appraisal Foundation and the USPAP**

The Appraisal Foundation (Foundation) is an independent non-profit organization for appraisal professionals, not a government agency. However, the Foundation was authorized by Congress to establish standards for the appraisal profession, and receives funding from the ASC. The Foundation's core activities include promulgating appraisal standards, appraiser qualifications, and appraisal practices.

The Foundation's Appraisal Standards Board (ASB) issues and amends professional appraisal standards, called the Uniform Standards of Professional Appraisal Practice (USPAP). FIRREA requires appraisers to adhere to the USPAP for all federally related transactions. The USPAP are not federal statutes, but they are the standards guiding industry professionals. Some readers may be helped by thinking of the USPAP as similar to accounting standards, which are issued by industry professionals, but are used in many regulatory contexts.

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<sup>10</sup> Ibid. p. 36.

<sup>11</sup> Ibid. p. 36.

<sup>12</sup> Ibid. p. 36.

<sup>13</sup> Ibid. p. 36.

<sup>14</sup> Ibid. p. 36.

The Foundation also hosts the Appraiser Qualification Board (AQB) and the Appraisal Practices Board (APB). The AQB establishes the professional requirements (education, experience, etc.) for certification. The APB is a relatively new (2010) professional board that focuses on technical issues, such as recognized valuation methods and techniques.

## **Dodd-Frank Act**

As described above, the Dodd-Frank Act (DFA) made a number of changes to the regulation of property appraisals. It set new federal standards for the independence of appraisers, particularly for properties on which higher risk loans were being made. It eliminated the Home Valuation Code of Conduct (HVCC). Other significant provisions include a requirement of a property visit for appraisals financed by a high-risk mortgage; conditions for a second appraisal at no cost to the home purchaser; mandated independence for appraisers; portability of some residential property appraisals; rules for customary and reasonable fees; standards for appraiser education; and a mandatory annual report to Congress by the ASC on its activities. Selected issues are described in more detail below.

### **Appraisal Requirements for High Risk Loans**

The Dodd-Frank Act, Title XIV, Subtitle F, set new standards for the independence of appraisers. Title XIV of the DFA is also referred to as the Mortgage Reform and Anti-Predatory Lending Act. Because of the focus on combating predatory lending, several of the changes to appraisal regulation in the DFA are limited to properties on which higher-risk loans are being made. Higher risk loans are defined as loans with higher than prevailing interest rates. A loan might have a higher than prevailing rate if the borrower has a blemished credit history, has a smaller than usual down payment, or is using a nontraditional loan. The DFA also transferred certain rulemaking authority for residential appraisals to the new Consumer Financial Protection Bureau, although the ASC retains much of its general mission.

Section 1471 of the DFA requires a written appraisal for high-risk residential mortgage loans. The appraisal must include a physical visit to the property being appraised. If the property being financed has been sold within the previous 180 days, and the new price is lower than the previous sale price, then a second appraisal is required that includes an analysis of market conditions and why the price has fallen. The cost of the second appraisal cannot be charged to the loan applicant.

### **Reasonable and Customary Fees**

Section 1472(i) of the DFA directs the regulators to establish reasonable and customary fees for fee appraisers. The definition of fee appraiser excludes employees of banks and appraisal management companies. Fee appraisers are to receive payment that is customary and reasonable for appraisal services performed in the market area of the property being appraised. In formulating the fees, regulators are to consider objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys. When collecting information to formulate customary and reasonable fees, Section 1472(i) directs the agencies to exclude fees that are connected to assignments ordered by appraisal management companies.

## **Sunset of the HVCC**

The Home Valuation Code of Conduct (HVCC) was an industry standard for appraisals created during the subprime mortgage crisis. The HVCC resulted from an out of court settlement of a legal investigation into Fannie Mae and Freddie Mac by the attorney general of the state of New York. Section 1472 (j) of the DFA eliminates the Home Valuation Code of Conduct. Although the DFA contained a sunset of the HVCC agreements, several of the principles of the HVCC were incorporated into subsequent changes to federal regulation of appraisals, including separating loan production staff from the staff who pick the appraiser for the loan (see “December 2010 Financial Institution Letter (FIL)” below).

The settlement that created the HVCC was controversial in part because it appeared that a state official might be setting federal regulatory policy. In the agreement, the New York attorney general agreed to end the state investigation of Fannie Mae if Fannie Mae agreed to purchase mortgages only from banks that did not conduct home appraisals in-house.<sup>15</sup> 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 was a de facto banking regulation because any bank that conducted in-house appraisals would lose access to a large source of funds for mortgages. Although the agreement was negotiated with the knowledge of the federal regulator of the GSEs at the time, the Office of Federal Housing Enterprise Oversight (OFHEO),<sup>16</sup> other 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.<sup>17</sup>

## **Rulemaking Authority of the CFPB and the Financial Regulators**

The DFA transferred authority and personnel for regulating many consumer-related issues from the banking regulators to the CFPB. Appraisals used for purchases and refinances of residential properties involve both consumers and lenders. The DFA instructs the financial regulators and the CFPB to jointly issue rules for appraisals of residential properties in many cases. The DFA directs the head of the CFPB to appoint a member to the board of the ASC. Section 1472 instructs courts to grant deference to CFPB rulemaking in some areas of appraisal regulation “as if the Bureau were the only agency authorized to apply, enforce, interpret, or administer the provisions of this title.”

## **Regulation of Appraisal Management Companies**

Section 1473(f) of the DFA sets regulatory standards for appraisal management companies (AMCs). It requires appraisal management companies to be registered with state appraisal boards. It directs the ASC to monitor and oversee these state boards. It directs the regulators to jointly issue rules for the registration of AMCs.

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<sup>15</sup> The agreement can be found at [http://www.fanniemae.com/media/pdf/030308\\_agreement.pdf](http://www.fanniemae.com/media/pdf/030308_agreement.pdf).

<sup>16</sup> OFHEO was merged into the new Federal Housing Finance Agency by HERA., P.L. 110-289.

<sup>17</sup> 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](http://www.tavma.org/images/HVCC_Comments/regulators_jointletter_hvcc.pdf).

The DFA sets four requirements for registered AMCs at the state level. Specifically, AMCs must

- (1) register with and be subject to supervision by a State appraiser certifying and licensing agency in each State in which such company operates;
- (2) verify that only licensed or certified appraisers are used for federally related transactions;
- (3) require that appraisals coordinated by an appraisal management company comply with the Uniform Standards of Professional Appraisal Practice; and
- (4) require that appraisals are conducted independently and free from inappropriate influence and coercion pursuant to the appraisal independence standards established under section 129E of the Truth in Lending Act (TILA).

## **Banking Agency and CFPB Rulemaking**

Regulators issue rules for appraisals within the statutory framework. Although the Dodd-Frank Act required a number of rules related to appraisals, banking regulators had also been considering a number of changes to property valuations that they believe would support real estate transactions.

### **October 2010 Federal Reserve TILA Rule**

The Federal Reserve issued an interim final rule for appraisal independence in October 2010.<sup>18</sup> Although the Dodd-Frank Act required the banking regulators to issue an interim rule on appraisals, the Federal Reserve had already been formulating many of the proposed changes under its Truth in Lending Act (TILA) authority prior to passage of the DFA. Some sections of the interim rule, such as reasonable and customary fees for appraisals, are directly related to specific Dodd-Frank Act provisions.

The October 2010 rule contains five major provisions. It prohibits coercion of appraisers to influence the appraised value of properties. It prohibits appraisers and appraisal management companies having financial interests in the transaction. It prohibits lenders from providing credit if they know beforehand of violations involving appraiser coercion or conflicts of interest. It requires that lenders that have information about appraiser misconduct file reports with the appropriate state licensing authorities. It sets the standards for the payment of reasonable and customary compensation to appraisers as required by the Dodd-Frank Act.

The October 2010 rule is broad. The covered transactions that it applies to are extensions of consumer credit that are or will be secured by the consumer's principal dwelling. This includes home equity lines of credit. The rule is not limited to appraisers. It also applies to any person who makes a valuation of real estate for a covered transaction, including real estate agents.

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<sup>18</sup> The rule was announced in October 2010 and set its effective date as April 1, 2011. The interim final rule can be found at <http://www.gpo.gov/fdsys/pkg/FR-2010-10-28/pdf/2010-26671.pdf>.

## **December 2010 Financial Institution Letter (FIL)**

The banking regulators issued FIL-82-2010, “Interagency Appraisal and Evaluation Guidelines,” on December 2, 2010. The FIL applies to lenders regulated by members of FFIEC. FILs do not apply to nonbank lenders like mortgage companies that are funded solely by securitization.<sup>19</sup>

The FIL makes a number of substantive changes and clarifications to permitted methods of collateral valuation by banks. It states that automated valuation models and similar technical systems cannot be substituted for an appraisal when the transaction requires an appraisal. It prohibits covered lenders from relying on valuation methods that do not provide a property’s market value, such as a broker price opinion. It requires covered lenders to file a complaint with state appraiser regulatory officials when they suspect that an appraiser failed to comply with the USPAP.

Section VI of the FIL prohibits banks from accepting appraisals under some circumstances. The agencies stated that the independence of the appraiser is compromised if the borrower recommends the appraiser or bank’s loan production staff selects the appraiser. The FIL requires banks to separate their loan officers from the staff that selects the appraisers. Borrowers cannot recommend the appraiser, or offer an appraisal that was submitted to another lender; however, a borrower may tell the bank that another appraisal exists, and the bank can request the appraisal report directly from the other institution.

## **December 2011 CFPB Rule**

In December 2011, the CFPB issued an appraisal rule.<sup>20</sup> The DFA had transferred some regulatory authority under TILA as well as some personnel from the Federal Reserve to the CFPB. The 2011 CFPB rule confirmed the Federal Reserve’s 2010 rule, and has been effective since April 2011. However, the CFPB continued to accept comments on the rule and may issue changes. Unlike the banking regulator’s FIL, the CFPB rule applies to all lenders, not just banks.

## **July 2011 FHA Appraiser Roster Rule**

The Federal Housing Administration (FHA) insures qualifying residential mortgages.<sup>21</sup> The Housing and Economic Recovery Act of 2008 required that appraisers for FHA loans be certified at the state level, not merely licensed. Only an appraiser listed on HUD’s FHA Appraiser Roster may perform the appraisal. The 2011 rule updated the FHA roster and clarified additional standards that appraisers must meet to be chosen as an appraiser for an FHA loan. For example, an appraiser must not be listed on the General Services Administration’s Suspension and Debarment list, on HUD’s Limited Denial of Participation list, or in HUD’s Credit Alert Interactive Voice Response System (CAIVRS).

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<sup>19</sup> CRS Report RS22722, *Securitization and Federal Regulation of Mortgages for Safety and Soundness*, by Edward V. Murphy.

<sup>20</sup> Available at <http://www.consumerfinance.gov/notice-and-comment/>.

<sup>21</sup> FHA Federal Housing Administration (FHA) Appraiser Roster: Appraiser Qualifications for Placement on the FHA Appraiser Roster, available at <https://www.federalregister.gov/articles/2011/07/14/2011-17498/federal-housing-administration-fha-appraiser-roster-appraiser-qualifications-for-placement-on-the#p-12>.

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