



Introduction to Real Estate Appraisals

A real estate appraisal is a measure of the value of property based upon the price that a professional appraiser believes the property could be sold for under normal market conditions. Lenders rely on an appraisal because the property serves as collateral for a mortgage loan. Real estate buyers might view the appraisal as a check on their own willingness to pay.

Although the details of conducting an appraisal are largely the product of industry professionals, the states and the federal government play a role. The states, for example, regulate the licensing and certification of professional *appraisers*. The federal government's role includes oversight of the state appraisal qualification boards; contributions to the funding of the nonprofit appraisal foundation that promulgates appraisal standards; setting minimum requirements for conducting appraisals; and setting standards to maintain the independence of appraisers.

This In Focus discusses federal appraisal legislation in the context of real estate booms and busts and then summarizes some current policy issues related to the regulation of appraisers.

Real Estate Volatility and Federal Appraisal Legislation

Congress has been concerned about the proper methods of real estate appraisal because inadequate appraisals have contributed to federally backed depositories experiencing significant losses that have required support from the Department of Treasury. Nevertheless, Congress has left standards for real estate appraisals to the states and financial regulators.

Federal legislation revising the appraisal process followed real estate busts of the Savings and Loan (S&L) Crisis of the late 1980s and the financial crisis of the late 2000s. These legislative initiatives created the basic framework for the federal role in appraisal regulation and current requirements for appraiser independence.

The basic framework for qualifying appraisers and creating appraisal standards followed the S&L Crisis. In 1989, Title XI of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA; P.L. 101-73) set a dollar threshold value to require an appraisal, created an Appraisal Subcommittee (ASC) among the bank regulators to coordinate appraisal regulation, and provided initial grant funding for a nonprofit Appraisal Foundation. FIRREA mandates that real property appraisers meet the qualifications established by the Foundation's Appraisal Qualification Board (AQB) and that individual appraisals conform to the Foundation's Appraisal Standards Board's (ASB) Uniform Standards of Professional Appraisal Practice (USPAP).

In general, Congress has neither legislated appraisal standards nor delegated the writing of standards to a federal agency; rather, the specifics of the USPAP are promulgated by industry professionals through the nonprofit Appraisal Foundation, analogous to the way accounting standards are established through the Financial Accounting Standards Board (FASB).

In 2009, the Home Valuation Code of Conduct (HVCC) was established as part of a legal settlement between New York state officials and the mortgage securitizers, Fannie Mae and Freddie Mac. Concerns had been raised that appraisers were being picked not on the basis of competence, but on their willingness to provide an appraisal that would allow the mortgage to be made. In the agreement, the New York attorney general agreed to end a state investigation of Fannie Mae if Fannie Mae agreed to purchase mortgages only from banks that separated loan production staff from the staff who pick the appraiser for the loan. A similar agreement was reached with Freddie Mac.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank; P.L. 111-203) revised FIRREA's independence standards and set a sunset date for the HVCC. In place of the HVCC, Dodd-Frank split residential and commercial appraisal oversight to the newly created Consumer Financial Protection Bureau (CFPB) and transferred rulemaking authority for residential mortgage appraisals to the CFPB for issues such as customary fees. Authority for commercial real estate appraisals remained with the banking regulators' ASC. Dodd-Frank directed the regulators to write new independence rules prior to the HVCC's sunset. Section 1471 of Dodd-Frank also requires a physical property visit for certain higher-cost mortgages.

Although Dodd-Frank technically sunsetted the HVCC, a lenders' loan production staff, mortgage brokers, and other transaction participants are still prohibited from selecting the appraiser. Section 1472 of Dodd-Frank prohibits people from attempting to influence an appraiser to encourage a targeted appraisal value or to facilitate the price of the transaction. Section 1472 also mandates that professionals who have a reasonable basis to believe that an appraiser is failing to comply with the USPAP, violating applicable laws, or otherwise engaging in unethical or unprofessional conduct, refer the matter to the state appraiser certifying and licensing agency.

Appraisers: Policy Issues

This section summarizes selected policy issues related to appraisers and appraisals.

- **Appraiser Familiarity with Neighborhoods.** Some have complained that appraiser selection restrictions have contributed to faulty appraisals

when the chosen appraiser is not knowledgeable about a neighborhood, particularly in urban areas where nearby sales may not actually be useful comparisons. Occasional errors may be an unintended consequence of maintaining appraiser independence. It is also possible that some reports of mistakes are really expressions of dissatisfaction with current market conditions.

- **Rural Areas.** Some smaller financial institutions in rural areas have reported frustration with separating their loan production staff from the appraiser selection process, noting that the area may have few qualified appraisers. Prior to the transfer of oversight to the CFPB, the banking regulators were able to provide exceptions on a case-by-case basis if the bank could provide an alternative that still met the policy goals. Section 103 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (P.L. 115-174) directs the CFPB to implement a regulation to waive the appraisal requirement on rural mortgages under \$400,000 when the lender can document specified difficulties in obtaining an appraisal and meets certain other conditions.
- **Appraisal Management Companies.** Appraisal Management Companies (AMCs) have been created to comply with Dodd-Frank's prohibition on mortgage originators selecting specific appraisers. Since Dodd-Frank, there has been a trend away from independent appraisers to AMCs appraisers. Section 1473 of Dodd-Frank amends FIRREA to provide for a national registry of AMCs and to set minimum requirements for AMCs. Some have expressed concern that changes to the method of choosing appraisers could put independent appraisers at a practical disadvantage. If appraiser independence can be maintained in some other way, Dodd-Frank does not require the use of AMCs.
- **Duty to Report.** Section 1472(e) of Dodd-Frank requires certain mortgage transaction professionals to report an appraiser to the appropriate state board if the professional has a reasonable basis to believe that the appraiser is not following the USPAP or otherwise acting improperly or unethically. This may discourage transaction insiders such as brokers and loan officers from facilitating biased appraisal reports. Some are concerned that unsubstantiated public reports might damage innocent appraisers.
- **Appraiser Standards.** Dodd-Frank established three levels of residential appraisers, but left most requirements to the states. *Licensed residential appraisers* must have 1,000 hours of supervised experience. *Certified residential appraisers* must have 1,500 hours of supervised experience. *Certified general appraisers* must have 3,000 hours of supervised experience, including nonresidential appraisal work. In general, licensed residential appraisers may conduct less complex appraisals for residential properties under \$1 million in value and more complex appraisals if the property is valued under \$250,000. Certified appraisers are qualified to conduct more complex appraisals than licensed appraisers. Certified residential appraisers may conduct residential appraisals of any value, but not appraise subdivisions as a whole. Certified general appraisers can appraise simple and complex residential and commercial real estate. The current system allows states to match appraisal specialization to their conditions, such as differences in typical land values, complexity, and usage. Some observers call for more consistent national standards for appraisal qualifications or changes to the threshold dollar amounts for the three Dodd-Frank levels of residential appraisers.
- **New Education Requirements.** The AQB sets minimum educational and professional standards for appraisers. States have been implementing higher education and other professional requirements for appraisers pursuant to the Appraisal Foundation's guidance on appraisal qualifications. Some argue that these requirements will increase professionalism and consistency among appraisers. Others argue that legislation is needed to grandfather existing appraisers trained under older standards, particularly in rural areas with fewer qualified appraisers.
- **The Role of Congress.** Specific appraisal standards are contained in the USPAP, not set in federal statute or regulation. Industry professionals promulgate the USPAP standards through the recommendations of the ASB. People occasionally ask Congress to direct appraisers to issue specific guidelines. For example, some may want specific treatment for sellers who have improved the property with renewable energy upgrades or some other feature consistent with a particular policy goal. Others argue that the focus of appraisals should remain market value, and that industry professionals should continue to promulgate specific methods and techniques.
- **Other Estimates of House Value.** Several real estate websites have estimates of the values of homes they list. These websites use unspecified proprietary estimation techniques. Some homeowners complain that these estimates are flawed and underestimate the value of the house they are trying to sell. The websites generally note that their value estimates are not appraisals.

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