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## Single-Family Residential Appraisals: An Overview

A real estate appraisal is an estimate of the value that a property can be sold for given prevailing market conditions. An appraisal (also called a valuation) is typically conducted prior to the completion of a sale of a single-family residential property or when a homeowner decides to refinance an existing mortgage. A lender requires an appraisal before granting a mortgage because the financed property is often used as collateral, which can be seized and resold to recoup losses if the borrower defaults on the loan. This In Focus summarizes valuation challenges, regulatory developments, and a recent policy issue pertaining to single-family property appraisals.

### Property Valuation Challenges

Conceptually, products with identical characteristics or features as well as high sales volumes should have values that are relatively easy to determine. Single-family properties, however, are not identical, thus increasing the difficulty to determine their values.

- Housing structures are attached to immobile land plots, making every location unique. Furthermore, the value of the underlying land is often most important for determining the total property value. A large house built in a less desirable neighborhood, for example, may not be valued the same as a small house located in a more desirable area. After factoring in location, the square footage of housing—including numbers of bathrooms, bedrooms, and upgrades—is next in importance when determining the total property value.
- Housing markets are typically *thin*, meaning that houses generally trade in small volumes and on an irregular basis. Consequently, few final sale transactions may be available to factor into valuations. Determining the value of like houses—such as those comprised of condominiums or newly constructed communities of adjacent, similar units—is less challenging because their similarities allow for greater comparability. By contrast, estimating value for a house in a rural area, for example, with fewer like units and transactions is more difficult given the lack of comparable transactions.
- Rather than converge to a stable price, house prices tend to rise at faster rates than they fall due to market speculation. Speculation about higher future prices may encourage buyers to expedite their housing purchases, offer more than sellers' listing prices, and cause housing inventories to deplete rapidly. Appraisals, which incorporate prevailing market conditions, may be influenced by the willingness of numerous buyers to pay more than sellers' list prices in booming housing markets. By contrast, speculation about current values can result in homes staying on the market for extended

periods of time until sellers agree to lower their list prices. Because offer and list prices may reflect market speculation rather than actual housing inventory conditions, appraisers tend to use the final sale prices of nearby properties to assess value when possible.

For these reasons, determining property values is challenging. Valuations are oftentimes estimated using properties that lack identical characteristics. Extreme low- or high-end properties located in decidedly distinct geographic areas tend to have fewer like transactions, making them more difficult to appraise. Furthermore, appraisals reflect market conditions when they were prepared, causing past estimations to diverge from current values should market conditions change over time.

### Federal Regulation of Appraisal Industry

The sections below discuss (in chronological order) the legislative developments resulting in the current federal regulatory framework of the appraisal industry.

#### Establishment of Federal Regulatory Framework

Congressional interest in real estate appraisals dates back to at least the late 1980s following the Savings and Loan (S&L) crisis. (S&L associations were nonprofit, member-owned cooperative financial institutions that relied on member savings deposits to fund residential home mortgages. See CRS Report R46499, *The Federal Home Loan Bank (FHLB) System and Selected Policy Issues*, by Darryl E. Getter for more information.) Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA, P.L. 101-73), with Title XI establishing provisions for an appraisal regulatory framework.

- FIRREA requires that lenders obtain written appraisals that meet Title XI standards for all federally related transactions unless a property qualifies for an exemption. A federally related transaction is one that a federal financial institution regulatory agency (that sits on the Appraisal Subcommittee, defined below) engages in, contracts for, or regulates and that requires the services of an appraiser.
- FIRREA authorizes the Appraisal Foundation (AF), a nonprofit organization of professional real estate industry groups, to determine minimum appraisal standards. Specifically, the AF establishes (1) the Appraisal Qualification Board to implement minimum qualification criteria for state certification and appraiser licensing and (2) the Appraisal Standards Board to issue the Uniform Standards of Professional Appraisal Practice (USPAP), the guidelines for the preparing and reporting of appraisals. (The USPAP are promulgated

by industry professions similar to the way accounting standards are established through the Financial Accounting Standards Board.)

- The Appraisal Subcommittee (ASC), a subcommittee of the Federal Financial Institutions Examination Council, was created to monitor the AF to ensure that its policies, practices, and procedures are consistent with Title XI. The ASC consists of the Office of the Comptroller of the Currency, the Federal Reserve, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the U.S. Department of Housing and Urban Development (HUD), the Federal Housing Finance Agency, and the Consumer Financial Protection Bureau (CFPB).

Title XI's purpose is to protect federal financial and public policy interests. The establishment of appraisal guidelines, for example, is meant to promote the independence of appraisers and reduce possible conflicts of interest with lenders. In addition, reliable appraisals may reduce uncertainty about the market value of the collateral (i.e., properties) that would be used to recoup potential losses facing federally backed lending institutions before calling upon taxpayers to provide financial support.

### Appraisal Independence

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. Appraisers were suspected of being chosen not on the basis of competence but on their willingness to provide appraisals less likely to obstruct mortgage originations. In the settlement, the New York attorney general agreed to end a state investigation of Fannie Mae if it agreed to purchase mortgages only from banks that separated the loan processing staff from those who chose the loan appraisers. A similar agreement was reached with Freddie Mac.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA; P.L. 111-203) treated appraisal independence as a consumer protection issue. First, DFA separated residential and commercial appraisal oversight. Rulemaking authority for residential mortgage appraisals was transferred to the CFPB for issues such as customary fees. Authority for commercial real estate appraisals remained with the banking regulators' ASC. Section 1471 of DFA also requires a physical property visit by an appraiser for certain higher-cost mortgages.

Second, DFA revised FIRREA's independence standards and directed the regulators to write new independence rules prior to the HVCC's sunset. Hence, a lender's loan production staff, mortgage brokers, and other transaction participants are prohibited from selecting the appraiser. Section 1472 of DFA 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 a professional who has 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. Consequently, many lenders now order appraisals from appraisal management companies (AMCs), which then randomly select qualified appraisers.

### Appraisal Exemption Thresholds

Section 103 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (P.L. 115-174) amended FIRREA. P.L. 115-174 directs the CFPB to exempt from appraisal requirements certain federally related, rural real estate transactions valued at or below \$400,000 (up from the \$250,000 threshold set in 1994) if the lender can document specified difficulties obtaining an appraisal and meeting certain other conditions. The innovation of less expensive automated appraisal valuations has arguably reduced the need for manual appraisals on less expensive homes. Hence, lenders may use automated appraisals (rather than a more expensive licensed or certified appraiser) for exempt residential transactions. The results must still be based upon actual physical condition of the properties rather than unsupported assumptions.

### Recent Policy Issue: Appraisal Bias

Following concerns that appraisals were generally biased upward, recent concerns focus on downward appraisal bias, particularly in minority neighborhoods. On February 23, 2022, the CFPB released proposals to prevent algorithmic bias in home valuations. The Biden Administration also announced the establishment of an interagency task force, the Interagency Task Force on Property Appraisal and Valuation Equity (PAVE), led by HUD Secretary Marcia Fudge, to address possible inequities in home appraisals. Observed racial discrepancies in appraisals may reflect the following market influences:

- According to a 2022 survey of appraisers and industry professionals conducted by the National Association of Realtors, 66% of appraisers are asked to conduct appraisals outside of the geographic locations where they have greater familiarity with the market dynamics, which may be due to increased use of AMCs that randomly pick appraisers. Given past suspicions of inflated appraisals, appraisers may be inclined to prepare more conservative valuations in unfamiliar neighborhoods.
- The PAVE study reports that housing markets in Black and Latino neighborhoods are thin relative to White neighborhoods, with fewer comparable property transactions, thereby increasing valuation subjectivity. Appraisers may also be inclined to prepare more conservative valuations in thin markets, particularly if associated neighborhoods have fewer businesses and shops, lower-ranked schools, higher crime rates, and lower amounts of tax revenues.

Consequently, distinguishing between causality and correlation—the extent that thin markets, which lack sufficient comparable transactions, or discrimination can explain racial discrepancies in appraisals—is challenging.

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