MORTGAGE BANKERS ASSOCIATION®
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Docket ID: OCC-2008-0021

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Attn: ID OTS-2008-0012

Subject: Proposed Interagency Appraisal and Evaluation Guidelines

Dear Sir or Madam:

The Mortgage Bankers Association[1] (MBA) appreciates the opportunity to comment on the proposed Interagency Appraisal and Evaluation Guidelines. The Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) jointly

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate financial industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies include all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web Site: www.mortgagebankers.org.

issued the 1994 Guidelines to provide further guidance to regulated financial institutions on prudent appraisal and evaluation policies, procedures, practices, and standards.[2] These Agencies now seek comment on a set of proposed Guidelines incorporating revisions that have been made since the 1994 Guidelines were established. The proposed guidelines seek to clarify the importance of independent appraisal and evaluation programs, the competence of persons performing appraisals, the standards for development and reporting of appraisals and evaluations, sound collateral valuation practices, and risk management principles.[3] In our comments below, MBA notes the need and importance of accurate and independent appraisals as well as MBA's continued support of the principles outlined in the current Agency Guidelines and Uniform Standards of Professional Appraisal Practice (USPAP).

I. **Background: The Need for Independent Appraisals**.

Accurate appraisals are one of the most fundamental components of the loan decision because a borrower's credit and willingness and ability to repay are only two of the three 'Cs' (credit, capacity and collateral) used by lenders to make lending decisions. In the event a borrower is unable to meet the payment obligations of a loan, the underlying property serves as the collateral for the obligation. Appraisal estimates are expected to be unbiased reports. With increased concerns about lending practices brought about by current market conditions and the rise in delinquencies, proposals with a focus on altering existing appraiser and appraisal standards are more frequently on regulators' short list of objectives.

MBA is especially concerned that policymakers will unnecessarily increase industry regulation where it is already sufficient, rather than ensuring that the current regulations are being adequately enforced, both at the state and federal level.

In order to ensure appraisals are fair and accurate, MBA believes:

1. Lenders, real estate brokers, borrowers and appraisers are best served by ensuring that the existing principles of the Uniform Standards of Professional Appraisal Practice (USPAP) are obeyed.
2. Any new federal appraiser coercion law must consider all of the parties to the real estate transaction (including real estate brokers, mortgage brokers, lenders and borrowers), and use objective, legally defined terms to describe pressure ("extort, bribe or coerce").
3. More adequate funding of state appraisal boards is needed.

4. Increased efforts to detect and deter fraudulent schemes are needed, including a national mortgage fraud database and the creation of a national valuation registry.

II. Request for Comment

The OCC, OTS, FRB, FDIC, and NCUA (Agencies) request comment on all aspects of the proposed Guidelines. In particular, the Agencies request comment on the clarity of the proposed Guidelines regarding the interpretations of its thirteen appraisal exemptions, the appropriateness of its risk management expectations and controls in the evaluation process, and its expectations in the Guidelines on reviewing appraisals and evaluations. Moreover, the Agencies seek specific comment on whether the use of automated tools or sampling methods that the proposed Guidelines allow for reviews of appraisals or evaluations supporting lower risk single-family residential mortgages is appropriate for other low-risk mortgage transactions and whether appropriate constraints can be placed on the use of these tools and methods to ensure the overall integrity of the institutions appraisal process.[4]

Significantly, the proposed Guidelines seek to supersede the 1994 Guidelines and are intended to reflect the guidance issued by the Agencies in recent years on the independence of the appraisal and evaluation program, appraisals for residential tract developments, and the USPAP Scope of Work Rule. The principal element is a safe and sound appraisal and evaluation program; including the following five main areas which these proposed Guidelines address: (1) independence of an institution's appraisal and evaluation program from influence by the borrower or the loan production staff; (2) the competence of individuals who perform appraisals and evaluations; (3) standards for the development and reporting of appraisals and evaluations; (4) an institution's collateral review function; and (5) guidance and expectations for risk management principles and control measures for institutions' appraisal and evaluation programs.[5]

MBA's general comments on the importance of accurate appraisals performed by appraisers, in conjunction with MBA's specific comments and responses are contained below. MBA's comments first examine the major provisions and changes the proposed Guidelines would make to the 1994 Guidelines. The comments will also discuss issues that concern MBA regarding the appraisal exemptions set forth in proposed Appendix A, as well as the appraisal evaluation alternatives as set forth in proposed Appendix B. Finally, MBA will address a few points not covered by the proposed Guidelines, which MBA feels merit consideration in a comprehensive appraisal regulation revision and clarification.

III. Proposed Revisions to the Appraisal Guidelines

Independence of the Appraisal and Evaluation Program

As early as 1986, Congress issued a report[6] concluding that faulty and fraudulent appraisals were an important contributor to the losses that the federal government suffered during the savings and loan crisis. In response, legislators passed Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)[7] to address both the quality of appraisals and the qualifications of appraisers. Title XI requires that real estate appraisals used in connection with federally related transactions be performed (1) in writing, in accordance with uniform professional standards, and (2) by individuals whose competency has been demonstrated and whose professional conduct is subject to effective supervision. Title XI also created a regulatory system that relies upon the actions of private, state and federal entities to help assure the quality of appraisals and the qualifications of appraisers.[8] In 1994, the Agencies promulgated Interagency Appraisal and Evaluation Guidelines.

By retaining the core principles of the 1994 Guidelines, the proposed Guidelines emphasize the importance of the independence of an institution's appraisal and evaluation program from outside influences. To this end, the proposed Guidelines call for standards of independence as part of an effective collateral valuation program for real estate lending. The proposed Guidelines note the importance of isolating the program from the institution's loan production staff, as well as the need for independence of persons who are performing the Appraisals. MBA supports the continuing use of the core principles of the 1994 Guidelines.

Independence and Competence of Persons who Perform Appraisals

When a consumer applies for a home loan, the lender evaluates, among other things, the borrower's creditworthiness, income relative to existing and proposed indebtedness, and the appraised value of the property. A lender relies on an appraiser's assessment of the value, condition and marketability of a property in determining whether the property provides adequate security for a loan. If an accurate value of the property is obtained and the loan goes into default, lenders should be able to recoup most of their loan principal, interest and advances through the foreclosure of the collateral, or home. If the appraisal contains inflated, inaccurate or material omissions related to the value of the property, the lender will likely suffer a greater loss if the loan goes into foreclosure. Furthermore, a borrower who obtains financing based on an inflated value may be less likely to continue making payments when he or she discovers the value of their home is lower than the outstanding loan balance.

MBA strongly supports the Appraisal Standards Board's (ASB) minimum standards for appraisals contained in the Uniform Standards of Professional Appraisal Practice (USPAP) which, under Title XI of FIRREA, apply to all federally related transactions with loan amounts over $250,000. USPAP directs appraisers to conduct their inspection and their relationship with the party that requested the appraisal under ethical Guidelines. Appraisers are expected to be knowledgeable about the neighborhood where they operate, impartial in their judgment and ethical in their conduct. Federal regulators require that all appraisals prepared by appraisers for eligible federally related transactions conform, at a minimum, to USPAP, that they be written, and that they contain sufficient information and analysis to support the institution's decision to engage in the transaction. In addition, regulators may take informal and formal enforcement actions, including prohibition, removal, and cease and desist orders, and imposing civil money penalties against lending institutions that violate their appraisal regulations.

A 2006 survey of appraisers[9] found that 90 percent of appraisers reported pressure from mortgage brokers, real estate brokers, the consumer and others to raise property valuations to enable mortgage transactions to be closed at a false loan-to-value (LTV) ratio. That was up from a similar survey conducted in 2003, in which 55 percent of appraisers reported attempts to influence their findings. While appraisers are compensated by flat fees that vary based on the type of appraisal (such as a "full" Uniform Residential Appraisal Report) that the lender orders for a given loan, other parties to the transaction are compensated by commission, such as the real estate broker and the mortgage broker. Unscrupulous parties to the transaction may attempt to artificially increase the appraised value of a property to increase the sale or loan amount, thereby increasing their profit or by increasing the likelihood that the proposed transaction closes. While it is sometimes very difficult to distinguish a faulty or inaccurate appraisal from a fraudulent one, fraud in the appraisal process can be perpetrated when an appraiser succumbs to pressure to knowingly establish an inflated property value.[10] A fraudulent or a bad appraisal will often apply inappropriate comparisons of properties, might overlook more relevant comparable properties or fail to identify poor conditions or repairs that are needed at the subject property. When an appraiser does intentionally establish an inflated property value, the appraiser is complicit to fraud and is in violation of USPAP. MBA opposes all fraud that affects the mortgage industry, and it is important to understand that mortgage lending institutions do not benefit from inflated appraisals.

Minimum Appraisal Standards

The proposed Guidelines seek to provide further clarification of the five appraisal standards contained in the Agencies' appraisal regulations. The clarifications are as follows:

1. The proposed Guidelines note that USPAP sets the minimum appraisal standards for federally related transactions and provides clarification of those appraisal standards which go above and beyond USPAP, as required by the Agencies' appraisal regulations.
2. The Agencies' appraisal regulations require that appraisals for federally related transactions be written and contain sufficient information to support the institution's credit decision. The proposed Guidelines reflect an expanded discussion of the Agencies' expectations for the content of appraisals that will satisfy this requirement.
3. The Agencies' appraisal regulations require that appraisals analyze and report deductions and discounts for a loan to finance proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units. The proposed Guidelines provide clarifications and increased detail on the application of this standard by property type, both commercial and residential.
4. The Agencies' appraisal regulations require that appraisals be based upon the regulatory definition of market value. The discussion of market value in the 1994 Guidelines has been expanded in the proposed Guidelines to link the appraisal regulatory definition of market value with the definition of value in the Agencies' real estate lending standards Guidelines. The proposed Guidelines also address the definition of "market value" in an appraisal for a loan to finance a development and construction real estate project.
5. The Agencies' appraisal regulations require that an institution use the services of a state-certified or licensed appraiser. The proposed Guidelines remind institutions that an appraiser's credential is not the sole determination of competency and that institutions should consider expanding the scope of qualification credentials to also include the appraiser's education and experience in assessing competency for a given appraisal assignment.

The proposed Guidelines also remind institutions to convey to an appraiser that the requirements of the Agencies' minimum appraisal standards are considered assignment conditions for an appraiser under USPAP.

MBA believes that lenders, real estate brokers, borrowers and appraisers are best served by ensuring that the existing principles of USPAP are obeyed. The clarifications and amendments to the Minimum Appraisal Standards will be useful insofar as they act as clarifications of existing practices, and do not create additional hurdles for lenders and borrowers.

It is crucial for the residential real estate market as a whole, that appraisers remain independent and objective in their analysis. That independence must be enforced by the ethical behavior of appraisers and a staunch unwillingness to bow to pressure, blatant or otherwise, from those parties with which they do business. Regardless of competitive pressures in the marketplace, appraisers must comply with USPAP and are responsible for their work product. These sections of the Guidelines were revised simply to reflect revisions to the July 2006 USPAP, to eliminate the USPAP Departure Rule and to adopt the USPAP Scope of Work Rule.[11]

MBA supports this revision and clarification of the revised sections of the USPAP. The discussion within the proposed Guidelines addresses the level and adequacy of information and analysis necessary to comply with both USPAP and the regulatory appraisal requirement to provide sufficient information to support the credit decision.

Reviewing Appraisals and Evaluations: Risk Focused Evaluation Content

Under the Agencies' appraisal regulations, an institution may obtain or perform an evaluation of real property collateral in lieu of an appraisal for transactions that qualify for certain appraisal exemptions. These provisions of the proposed Guidelines describe the Agencies' expectations on the information and analysis that should be included in an evaluation. An institution should obtain more detailed evaluations for higher risk real estate-related financial transactions or as its portfolio risk increases.

This section was revised to reflect the inclusion of a new appendix (Appendix B) in the proposed Guidelines on evaluation alternatives; which provides a discussion of appropriate practices and controls regarding an institution's use of Automated Valuation Models (AVMs) and tax assessment valuations as evaluation alternatives. This section also addresses the Agencies' expectations for institutions to establish a process and procedures for determining the appropriate use of evaluation alternatives for a given transaction or lending activity, considering associated risk.

This new section of the proposed Guidelines is based on material in the Program Compliance section in the 1994 Guidelines, the 2003 Interagency Statement on Independent Appraisal and Evaluation Functions, and a related statement issued by the Agencies in 2005 addressing frequently asked questions.[12] While the proposed Guidelines retain a Program Compliance section concerning effective internal controls, the Agencies note that the new section emphasizes the importance of an institution's review function to promote quality appraisals and evaluations. The Agencies expect institutions to maintain a robust review process for ensuring that appraisals and evaluations support their credit decisions. The program aims to provide for an increasingly comprehensive review of appraisals supporting transactions associated with a higher credit risk.

MBA believes this expectation for a risk-based program recognizes the importance of the collateral valuation process in promoting sound credit underwriting decisions for its member institutions.

Moreover, the proposed Guidelines indicate that an institution with prior approval from its primary regulator may employ alternative appraisal review techniques, such as automated tools or sampling methods, to support lower risk for single-family residential mortgages. MBA supports the use of alternative methods and valuation models for low-risk situations and believes that the Agencies expectation for a compliance program establishing effective internal controls is necessary and useful.

Portfolio Monitoring

This Revised section from the 1994 Guidelines seeks to emphasize the importance of sound portfolio monitoring principles that set forth criteria for when an institution should replace or update collateral valuations for existing real estate loans. In establishing criteria, MBA agrees with the Agencies that an institution should consider elements such as the appropriateness of the valuation tool or methodology; the age of the original appraisal or evaluation; property type; market conditions; and current use of the property. The proposed Guidelines remind institutions that as the reliance on real estate becomes more important for an existing credit; there is a need for timely information to assess the value of the real estate collateral and the associated risk to the institution.

IV. New Appendices:

Appendix A: Appraisal Exemptions

This new appendix, on which the Agencies request specific comment, seeks to provide further clarification on real estate-related financial transactions exempted from the Agencies' appraisal regulations. The Agencies base this discussion on the preamble to the Agencies' 1994 regulations and response to questions received concerning exemptions to their appraisal requirements.

MBA believes the existence and use of the outlined characterizations and situations where exemptions may be used provides clear situations where an exemption is applicable. However, MBA believes this list should not be deemed to be all-inclusive. MBA believes there may be other situations that arise where an exemption may be appropriate and, in that vein, believes that the establishment of a principles-based vs. prescriptive standard for these exemptions would be helpful to provide future flexibility of the appraisal regulations.

MBA would like to submit the following comments that may affect a few of the exemptions, as outlined. Specifically, with respect to exemption number seven, *Renewals, Refinancing, and Other Subsequent Transactions*, MBA suggests that the language in subsection (2) of this exemption be re-drafted in a manner that is more precise, especially in regards to "obvious and material market changes."[13] Moreover, MBA suggests specific language be added to prevent interference with programs that are designed to help borrowers, such as the Federal Housing Administration's (FHA) streamlined refinance program. MBA believes the standard created by this exemption may be unrealistic.

Moreover, MBA believes this standard, taken in consultation with exemptions nine and ten, may result in a disadvantage to the rest of the market outside government agency reach. Inclusion of exemptions nine and ten confirms MBA's belief that the language of exemption seven must be made more precise to reflect what constitutes "obvious and material market changes." This description is too broad and unhelpful, especially given the market's recent challenges.

Appendix B: Evaluation Alternatives

Since the issuance of the 1994 Guidelines, significant developments have occurred concerning the collateral valuation practices. For example, the proposed Guidelines correctly note that, particularly in technology, developments have prompted increased use of AVMs to derive values for residential transactions which do not require a physical appraisal. Not to be overlooked in the evaluation of an appraisal are the revisions to the USPAP in 2006, which eliminated the USPAP Departure Rule and adopted the USPAP Scope of Work Rule.

MBA supports the availability and use of AVMs in situations where a physical appraisal is not necessary and MBA supports the use of AVMs and tax assessment valuations as evaluation alternatives in the Interagency Credit Risk Management Guidance for Home Equity Lending. MBA further believes that the evaluation criteria outlined in the proposed Guidelines reflect an accurate consideration for the use of AVMs.

Use of Automated Tools and Sampling Methods

The Agencies request specific comment on whether the use of automated tools or sampling methods that the proposed Guidelines allow for reviews of appraisals or evaluations supporting lower risk single-family residential mortgages is appropriate for other low-risk mortgage transactions and whether appropriate constraints can be placed on the use of these tools and methods to ensure the overall integrity of the institution's appraisal process for these low-risk mortgage transactions. MBA believes the use of automated tools or sampling methods may have use in other low-risk mortgage transactions, however, MBA stresses the fact that the lenders are bearing the overwhelming majority of the risk in these transactions. As such, appropriate safeguards must be established and MBA requests that consideration be given to a provision allowing lenders themselves to determine whether circumstances merit the use of an automated tool or sampling method for appraisals and evaluations.

Significantly, MBA suggests that the Agencies consider the valuation issues raised by the recently revised New York Attorney General agreement (Agreement) with Fannie Mae and Freddie Mac (the GSEs). The Agreement requires the GSEs to accept and abide by a "Home Valuation Code of Conduct" (Code) which, among other things, establishes requirements governing appraisal selection, solicitation, compensation, conflicts of interest and corporate independence. Moreover, the Code contains some exceptions that apply to the in-house appraiser prohibition in the Code. For example, lenders may use in-house staff appraisers to develop or use internal automated valuation models, or prepare appraisals for transactions other than mortgage origination transactions (e.g. loan workouts). The Agencies should consider this Agreement and the Code in the development of comprehensive updates to the 1994 Guidelines.

Conclusion

MBA appreciates the opportunity to comment on the proposed Interagency Appraisal and Evaluation Guidelines. The proposed Guidelines reflect much of what MBA has been advocating and supporting regarding the need for accurate appraisals conducted by independent appraisers as well as proper enforcement of current regulations. MBA reemphasizes the need and importance of accurate and independent appraisals as well as its support for the principles outlined in the current USPAP.

Sincerely,

John A. Courson

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Mortgage Bankers Association