

Statement Submitted for the Record to the  
United States House of Representatives  
Committee on Financial Services  
Subcommittee on Housing, Community Development and Insurance  
Hearing on  
**“What’s Your Home Worth? A Review of the Appraisal Industry”**

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Also on behalf of:  
National Consumer Law Center (on behalf of its low-income clients)

On behalf of Mountain State Justice and the National Consumer Law Center, thank you for the opportunity to submit this statement regarding the appraisal industry.<sup>1</sup> I am the Co-Director of Mountain State Justice, a non-profit legal services provider in West Virginia that represents low-income people at no cost. Since the early 2000s, we have served thousands of homeowners in danger of losing their homes as the direct result of appraisal fraud and other predatory lending practices.

With this statement I wish to express appreciation to Congress for imposing stricter standards for appraisals under the Dodd-Frank Act, and to warn against the apparent loosening of standards that will likely lead to another housing crisis—with low-income homeowners and communities of color bearing the brunt of the cost.

It is common knowledge that lax regulation of the mortgage and appraisal market led directly to the financial collapse of 2008.<sup>2</sup> Prior to that collapse, unscrupulous mortgage brokers and lenders joined forces with a handful of appraisers to fraudulently inflate home values to enable property flipping schemes and other home-secured lending of increasingly large amounts. Many of these loans contained adjustable rate or interest only features that would cause payments to skyrocket after a teaser period. Even before the market collapse in 2008, consumers and their advocates began to see this house of cards topple, as homeowners trapped in these underwater loans were unable to refinance when their adjustable rates spiked.<sup>3</sup> Thousands—and soon millions—of homeowners faced foreclosure.<sup>4</sup> Mountain State Justice, and I personally, have continued to see the ongoing fallout of these predatory mortgages to this day.

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<sup>1</sup> Mountain State Justice is a non-profit legal services firm dedicated to redressing entrenched and emerging systemic social, political, and economic imbalances of power for underserved West Virginians, through legal advocacy and community empowerment. More information about Mountain State Justice can be found at [www.mountainstatejustice.org](http://www.mountainstatejustice.org).

The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

<sup>2</sup> See, e.g., The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, available at <https://www.gpo.gov/fdsys/pkg/GPO-FCIC/content-detail.html>.

<sup>3</sup> Mountain State Justice's Executive Director testified before this Subcommittee in 2005 about these very practices. See Daniel F. Hedges, *Testimony before the Subcommittee on Housing and Community Development*, Committee on Financial Services, U.S. House of Representatives (Sept. 29, 2005), available at <http://archives.financialservices.house.gov/media/pdf/092905dh.pdf>.

<sup>4</sup> The Financial Crisis Inquiry Report: *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* 402, available at <https://www.gpo.gov/fdsys/pkg/GPO-FCIC/content-detail.html>.

This bubble in housing prices was not just created by a spike in consumer demand. Rather, in many cases throughout the country, it was created as the direct result of intentional fraud and lack of oversight. West Virginia—which saw little increased demand—is a prime example. At my organization alone, over the past decade we have seen hundreds of families facing foreclosure resulting in large part from these fraudulent appraisals.

The Dodd-Frank Act required essential increased regulation of appraisals, building on necessary safety and soundness requirements passed after the savings and loan crisis. These changes have been instrumental in steadying the housing market and tamping down fraudulent over-valuations of homes in the lending market, primarily by requiring appraisal independence while still recognizing the centrality and importance of appraisals as the most accurate methodology of obtaining a home value. Appraisal independence ensures that lenders and brokers cannot intentionally choose appraisers who will deliver implicitly (and sometimes explicitly) requested inflated appraisals. Reforms requiring true, in-person appraisals by qualified appraisers similarly have ensured not only a healthy appraisal industry, but also that lenders and investors can be certain that they have sufficient collateral to protect their risk. These reforms have been an unqualified success. They have worked.

Because the reforms did exactly what they were intended—they stopped appraisal fraud—we urge you to leave these requirements in place, to resist weakening appraisal requirements, and to create a more robust system of oversight and standards for the use of technology. Appraisal requirements and valuation oversight do not just help consumers, they also support honest appraisers and lending institutions, and protect investors and the economy as a whole.

## **Background**

### ***Appraisal Standards***

Home appraisals are required to safeguard homeowners, home mortgage investors, and government insurance programs alike. Appraisals protect homeowners who are making the largest investment—and taking on the largest debt—of their lives, by enabling them to make wise and well-informed financial decisions. Appraisals are necessary to ensure that loans do not exceed the values of homes that serve as their collateral. This collateral protects investors and insurers, such as the Federal Housing Administration and the Government Sponsored Entities, against the risk of long-term home lending. Provision of sufficient collateral thus enables and supports lending, which in turn creates a healthy housing market.

Home appraisals—if done according to regulatory standards—are conducted by highly trained and skilled professionals with knowledge of the local area. Appraisals, under current standards, require the appraiser to personally view both the interior and exterior of the home, the surrounding area, and comparable homes that have recently sold on the open market, in order to ensure an accurate opinion of value. Appraisers are educated in a classroom and serve as apprentices under the supervision of an experienced appraiser before they obtain their final certification. They maintain their licensure under oversight by state appraisal boards and with requirements for continuing education and compliance with the Uniform Standards of Professional Appraisal Practice (USPAP). All of these requirements ensure that appraisers are qualified and

competent to complete their essential work. They further protect homeowners and lenders from increased risk associated with high loan to value ratios and overvalued collateral.

### **Widespread Appraisal Fraud**<sup>5</sup>

Without independent and qualified appraisals, home secured lending poses significant risks to consumers and investors, as well as the entire economy. Indeed, appraisal fraud played a vital role in the market collapse in the 2000s.

### ***Incentives for Appraisal Fraud***

Without the strict requirements imposed by the Dodd-Frank Act and other federal regulation, the financial incentives of those involved in the mortgage loan process work against honest appraisals.<sup>6</sup> Origination fees for lenders and loan brokers are commonly based on the amount of the mortgage loan.<sup>7</sup> This can make lenders and brokers complicit in, or simply indifferent to, appraisal fraud because higher loan volume and higher loan amounts lead to greater profits.<sup>8</sup> Some lenders may deliberately seek inflated appraisals in order to trap borrowers in abusive loans and prevent them from refinancing.<sup>9</sup> Lenders' indifference to appraisal fraud may be traceable, at least in part, to securitization, which allows them to pass on the risk of loss while retaining minimal liability in the event of default by the borrower.<sup>10</sup> Lenders also rely on mortgage

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<sup>5</sup>Significant portions of the following text, especially background on appraisal fraud, the mortgage market, and regulatory overviews are drawn from the National Consumer Law Center's book on mortgage lending, National Consumer Law Center, *Mortgage Lending* (2d ed. 2014).

<sup>6</sup> See *Wallace v. Midwest Fin. & Mortg. Services, Inc.*, 714 F.3d 414, 422 (6th Cir. 2013) (reversing summary judgment in favor of creditor on civil racketeering claim; noting that lender not dissuaded by facially unreasonable appraisal); *Fed. Hous. Fin. Auth. v. JPMorgan Chase & Co.*, 902 F. Supp. 2d 476 (S.D.N.Y. 2012) (quoting amended complaint, "WaMu falsely overstated appraisals in order to secure low LTV ratios for mortgages, thereby making the loans more attractive to prospective purchasers of certificates"); David Callahan, Home Insecurity: How Widespread Appraisal Fraud Puts Homeowners at Risk (Mar. 2005), available at [www.demos.org](http://www.demos.org).

<sup>7</sup> Cf. 15 U.S.C. § 1639b(c)(1) (explicitly permitting compensation for loan originators to be based on loan amount).

<sup>8</sup> See *Fed. Hous. Fin. Auth. v. JPMorgan Chase & Co.*, 902 F. Supp. 2d 476 (S.D.N.Y. 2012) (quoting amended complaint, "WaMu falsely overstated appraisals in order to secure low LTV ratios for mortgages, thereby making the loans more attractive to prospective purchasers of certificates"); *In re Bear Stearns Mortg. Pass-Through Certificates Litig.*, 851 F. Supp. 2d 746 (S.D.N.Y. 2012) ("[L]oan officers applied 'intense' pressure on underwriters to approve risky loans and rewarded 'high producers.'"); *Cedeno v. IndyMac Bancorp, Inc.*, 2008 WL 3992304 (S.D.N.Y. Aug. 26, 2008) (alleging that lender selected appraisers, who provided inflated appraisals, in order to complete more transactions and earn greater profits; granting lender's motion to dismiss RESPA and TILA claims). Cf. *United States v. Grintjes*, 237 F.3d 876 (7th Cir. 2001) (discussing evidence that tended to show that mortgage broker had knowledge of clients' property flipping scheme); *Am. Mortg. Network v. Shelton*, 2006 WL 909415 (W.D.N.C. Apr. 6, 2006) (discussing how a buyer arranged for and helped prepare a fraudulent appraisal), *aff'd*, 486 F.3d 815 (4th Cir. 2007).

<sup>9</sup> See, e.g., *Tocco v. Argent Mortg. Co.*, 2007 WL 170855 (E.D. Mich. Jan. 18, 2007) (describing a borrower's inability to refinance an Argent loan when the appraisal for the refinancing came in \$300,000 lower than the appraisal, performed less than a year previously, on which the original loan had been based); Office of the New York State Att'y Gen., Press Release, N.Y. Attorney General Sues First American and Its Subsidiary for Conspiring with Washington Mutual to Inflate Real Estate Appraisals (Nov. 1, 2007), available at [www.ag.ny.gov](http://www.ag.ny.gov) (alleging that large national lender demanded that appraisers inflate property values).

<sup>10</sup> See, e.g., *Wallace v. Midwest Fin. & Mortg. Services, Inc.*, 714 F.3d 414, 422 (6th Cir. 2013); *Homeward Residential, Inc. v. Sand Canyon Corp.*, 2014 WL 2510809, at \*9–10 (S.D.N.Y. May 28, 2014) (refusing to dismiss trust's breach of warranty claims against Option One based upon appraisal fraud); *Prudential Ins. Co. v. Credit Suisse Sec. (USA) L.L.C.*, 2013 WL 5467093 (D.N.J. Sept. 30, 2013) (investor suit against parties to a securitization of New Century and Option One loans; fraud claim based on pattern of false appraisals survived motion to dismiss); *Fed.*

insurance to insulate them either partially (or fully, in the case of the government-backed FHA insurance), from the risk of loss after foreclosure. Secondary market participants, those who buy loans from lax lenders, can also purchase their own insurance against failure and so have reduced incentives to police the pool,<sup>11</sup> even if the disclosures are enough to put them on notice of the inflated appraisals.<sup>12</sup>

In some cases, appraisers received direct benefits for their participation in the fraud, through the promise of repeat business or more overt kickbacks or payment schemes.<sup>13</sup> Other times, lenders and brokers pressure appraisers to hit or exceed a predetermined value.<sup>14</sup> Failure to do so could lead the lender or broker to withhold business from the appraiser, to refuse to pay the appraiser, or to blacklist the appraiser.<sup>15</sup>

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Hous. Fin. Auth. v. JPMorgan Chase & Co., 902 F. Supp. 2d 476 (S.D.N.Y. 2012); Fed. Hous. Fin. Agency v. UBS Americas, Inc., 858 F. Supp. 2d 306, 320 (S.D.N.Y. 2012), *aff'd*, 712 F.3d 136 (2d Cir. 2013); HSH Nordbank AG v. Barclays Bank PLC, 986 N.Y.S.2d 866, 2014 WL 841289, at \*15, 18 (Sup. Ct. 2014) (table) (refusing to dismiss investor claims of fraud against seller and depositor in deal involving Fremont Inv. & Loan and New Century Mortg. Co. loans based on appraisal fraud; data showed approximately 24.5%–51.6% of the loans had combined loan-to-value ratios of over 100%, which contradicted the offering documents). *See also* Settlement Agreement, Annex 1, Statement of Facts at 4–5, U.S. Dep’t of Justice & JPMorgan Chase & Co. (Nov. 19, 2013), available at [www.justice.gov](http://www.justice.gov) (describing JPMorgan’s purchase and pooling into securities of loans it knew were missing appraisals, its tolerance for appraisals of 15% below loan amount, even when the loan-to-value ratio was 100%, and its inclusion in securitizations of loans that exceeded even that tolerance).

Secondary market purchasers may not be vigilant in policing lenders because they underestimate the risk of inflated appraisals or because they may be insured against this kind of fraud. *See, e.g.,* Mass. Mut. Life Ins. Co. v. Residential Funding Co., 843 F. Supp. 2d 191 (D. Mass. 2012) (securities disclosures insufficient to put secondary market purchaser on notice that appraisers were systematically abandoning the represented appraisal procedures). In these cases, the insurer bears the risk of loss instead of the trust or other secondary market purchaser.

Some of the notorious FAMCO loan trusts were insured by mortgage guaranty policies issued by MBIA Insurance Corp. Stipulation of Settlement, Fed. Trade Comm’n v. First Alliance Mortg. Co. (In re First Alliance Mortg. Co.), No. SA CV 00-964 (C.D. Cal. Feb. 25, 2002), available at [www.ftc.gov](http://www.ftc.gov).

<sup>11</sup> *See, e.g.,* Stipulation of Settlement, Fed. Trade Comm’n v. First Alliance Mortg. Co. (In re First Alliance Mortg. Co.), No. SA CV 00-964 (C.D. Cal. Feb. 25, 2002), available at [www.ftc.gov](http://www.ftc.gov) (noting insurance of some of the notorious FAMCO loan trusts by mortgage guaranty policies issued by MBIA Insurance Corp.).

<sup>12</sup> *See, e.g.,* Mass. Mut. Life Ins. Co. v. Residential Funding Co., 843 F. Supp. 2d 191 (D. Mass. 2012) (securities disclosures insufficient to put secondary market purchaser on notice that appraisers were systematically abandoning the represented appraisal procedures).

<sup>13</sup> *See* First Magnus Fin. Corp. v. Star Equity Funding, L.L.C., 2007 WL 414272 (D. Kan. Feb. 2, 2007) (discussing scheme between mortgage brokers and appraisers).

<sup>14</sup> *See, e.g.,* Wallace v. Midwest Fin. & Mortg. Services, Inc., 714 F.3d 414, 417 (6th Cir. 2013) (describing scheme whereby broker requested appraisal value needed from the appraiser); Davis v. Wells Fargo Bank, 976 F. Supp. 2d 870, 876 (S.D. Tex. 2013) (describing pressure brought to bear on appraisers to produce low values at foreclosure sales of property, allegedly in order to maximize paper losses for tax purposes), dismissed on other grounds, 2014 WL 585403 (S.D. Tex. Feb. 14, 2014); Office of the New York State Att’y Gen., Press Release, N.Y. Attorney General Sues First American and Its Subsidiary for Conspiring with Washington Mutual to Inflate Real Estate Appraisals (Nov. 1, 2007), available at [www.ag.ny.gov](http://www.ag.ny.gov) (detailing scheme in which a large national lender demanded that appraisers inflate property values).

<sup>15</sup> *See* Davis v. Wells Fargo Bank, 976 F. Supp. 2d 870, 876 (S.D. Tex. 2013) (appraiser who did not meet target values was blacklisted), dismissed on other grounds, 2014 WL 585403 (S.D. Tex. Feb. 14, 2014); Fed. Hous. Fin. Auth. v. JPMorgan Chase & Co., 902 F. Supp. 2d 476 (S.D.N.Y. 2012) (quoting amended complaint; “WaMu selected individual appraisers who were willing to produce false, inflated appraisals and refused to hire appraisers who maintained their independence.”); Gaudie v. Potestivo Appraisal Services, 837 F. Supp. 2d 799 (N.D. Ill. 2011)

*Appraisers themselves advocated for tighter regulation to protect their industry.* In 2007, a petition with 11,000 appraiser signatures was delivered to Washington explaining that “Lenders . . . as a normal course of business, apply pressure on appraisers to hit or exceed a predetermined value. . . . We believe that this practice has adverse effects on our local and national economies and that the potential for great financial loss exists. We also believe that many individuals have been adversely affected by the purchase of homes which have been over-valued.”<sup>16</sup> The appraisers went on to request that the government appropriately regulate the market to protect appraisers from “pressur[e] . . . to do dishonest appraisals.”<sup>17</sup> Given the potential incentives for lenders and appraisers to inflate appraisal amounts, the need for focused oversight and effective supervision of both appraisers and appraisal practices has long been recognized.<sup>18</sup>

### ***Impacts on Lending and Fraud***

Due to the incentives for appraisal fraud, it is not surprising that inflated appraisals are key to predatory mortgage lending that directly led to the 2008 market collapse.<sup>19</sup> For instance, loan churning, which involves repeated refinancing with additional fees and costs rolled into the new principal balance, often depends on inflated appraisals to justify higher loan amounts.<sup>20</sup> Without the inflated appraisal, these loans would be denied for insufficient equity.<sup>21</sup> Similarly, property flipping scams involve speculators who buy dilapidated residential properties or develop shoddy new construction at low prices and resell them to unsophisticated first time home buyers at huge

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(discussing appraiser’s possible motivation in inflating appraisal, noting that the appraiser was dependent on lender for employment and “had to give [it] the the appraised values [it] desired if [he] wanted to work in that field”); Office of Pol’y Dev. & Research, U.S. Dep’t of Hous. & Urb. Dev., Report to Congress on the Root Causes of the Foreclosure Crisis 40–41 (2010), available at [www.huduser.org](http://www.huduser.org) (arguing that appraisal fraud depends on lack of underwriting control of the broker and appraiser). See also *People v. First Am. Corp.*, 878 N.Y.S.2d 860 (Sup. Ct. 2009) (recounting complaint’s allegations of lender control of appraisers, in violation of state law and Uniform Standards of Professional Appraisal Practice), *aff’d*, 902 N.Y.S.2d 521 (App. Div. 2010).

<sup>16</sup> Appraisers Petition, available at <http://appraiserspetition.com>.

<sup>17</sup> *Id.*

<sup>18</sup> Office of Pol’y Dev. & Research, U.S. Dep’t of Hous. & Urb. Dev., Report to Congress on the Root Causes of the Foreclosure Crisis 40–41 (2010), available at [www.huduser.org](http://www.huduser.org) (arguing that appraisal fraud depends on lack of underwriting control of the broker and appraiser). See, e.g., Fed. Reserve Bank of Atlanta, Appraisal Reviews Are Important to Safe Banking, Fin. Update, 4th Quarter, 2004, available at [www.frbatlanta.org](http://www.frbatlanta.org).

<sup>19</sup> *Cf. Wallace v. Midwest Fin. & Mortg. Services, Inc.*, 714 F.3d 414, 422 (6th Cir. 2013) (reversing summary judgment for broker and lender on civil racketeering claims based on an inflated appraisal of borrower’s home; noting, “Though the decision to obtain a mortgage is no doubt complicated, the appraisal of the home used to secure it is a fundamental part of the calculus.”).

<sup>20</sup> See, e.g., *Hill v. Meritech Mortg. Services, Inc. (In re Hill)*, 2002 WL 34560882 (Bankr. E.D. Pa. Sept. 27, 2002).

<sup>21</sup> See, e.g., *Wallace v. Midwest Fin. & Mortg. Services, Inc.*, 714 F.3d 414, 417 (6th Cir. 2013) (inflated appraisal “factored significantly into” the underwriting of the loan; discussing importance of inflated appraisal to conspiracy to sell borrower a high-interest rate loan with high fees); *United States v. Rivera*, 2004 WL 3153171 (D. Conn. Aug. 5, 2004); *Chavarria v. Fleetwood Retail Corp. of N.M.*, 115 P.3d 799 (N.M. Ct. App. 2005) (affirming judgment against manufactured home seller based on fraudulent conduct of two employees in inflating trade-in value of borrower’s previous manufactured home and including fictitious home improvements in the loan amount; reducing duplicative damages and reversing award of punitive damages), *aff’d in part, rev’d in part*, 143 P.3d 717 (N.M. 2006) (affirming judgment against seller but reversing compensatory and punitive damages award); Office of the New York State Att’y Gen., Press Release, N.Y. Attorney General Sues First American and Its Subsidiary for Conspiring with Washington Mutual to Inflate Real Estate Appraisals (Nov. 1, 2007), available at [www.ag.ny.gov](http://www.ag.ny.gov) (alleging that large national lender demanded that appraisers inflate property values).

markups.<sup>22</sup> Homeowners end up saddled with a debt load that exceeds the market value of the property. These homeowners are unable to resell the home in an arms-length transaction because the mortgage indebtedness exceeds the fair market value of the property. Ultimately, the homeowners may lose their homes to foreclosure sales<sup>23</sup> because the home's condition is much worse than represented, promised repairs are not performed, and the consumer's mortgage payments may be higher than the consumer can afford.<sup>24</sup> Then the scams can begin again against different homeowners if the wrongdoers or their confederates purchase the homes at the foreclosure sales.

An inflated appraisal, which is necessary to both reassure the homeowner and to secure an inflated loan, is the linchpin of both property flipping and predatory refinance transactions.<sup>25</sup> While many of these schemes rely on steering borrowers to high-cost lenders,<sup>26</sup> other schemes depend on the availability of government insurance.<sup>27</sup> Because Federal Housing Administration (FHA) insurance, unlike regular mortgage insurance, covers 100% of lender's losses, lenders quickly profit from inflated loans they know will foreclose.<sup>28</sup> The loan officer gets a commission; the Department of Housing and Urban Development (HUD) is left with the costs associated with the bad loan.<sup>29</sup> Some of these scams landed their perpetrators in prison after the market collapse. Others just led to disastrous consequences for homeowners.

My office, like others across the country, has worked with countless homeowners facing foreclosure as the result of these schemes. These homeowners continue—a decade after the market collapsed—to face foreclosure, demonstrating the very real ongoing impact of lax oversight and regulation. It is *not* time to look the other way.

For example, just a year ago, I met Mrs. S., an elderly Black woman living in a historically Black neighborhood in a small city in West Virginia that has had steady home values for decades.

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<sup>22</sup> See, e.g., *Synovus Bank v. Karp*, 887 F. Supp. 2d 677 (W.D.N.C. 2012); *Kaing v. Pulte Homes, Inc.*, 2010 WL 625365 (N.D. Cal. Feb. 18, 2010), *aff'd*, 464 Fed. Appx. 630 (9th Cir. 2011). See also Upton Sinclair, *The Jungle* 77–78 (1920) (describing a scheme in which a developer repeatedly sold poorly constructed homes, foreclosed on them, and then resold them as “new”).

<sup>23</sup> See, e.g., *United States v. Geig*, 176 Fed. Appx. 638, 639 (6th Cir. 2006) (upholding restitution award and prison term for participant in property flipping scheme that “left buyers with overvalued properties with a high risk of foreclosure”); David Cho, *Housing Boom Tied to Sham Mortgages, Lax Lending Aided Real Estate Fraud*, Wash. Post., Apr. 10, 2007, at A1 (more than 300 homes go into disrepair and foreclosure in wake of property flipping scheme, surrounding homeowners lose as much as half of the value of their homes).

<sup>24</sup> See *Edmonds v. Hough*, 344 S.W.3d 219 (Mo. Ct. App. 2011).

<sup>25</sup> See *United States v. Owens*, 301 F.3d 521 (6th Cir. 2002) (describing appraiser's key role in a property flipping scheme); *Vaughn v. Consumer Home Mortg. Inc.*, 2003 WL 21241669 (E.D.N.Y. Mar. 23, 2003).

<sup>26</sup> See, e.g., *United States v. Sheneman*, 2012 WL 1831660 (N.D. Ind. May 18, 2012); *Edmonds v. Hough*, 344 S.W.3d 219 (Mo. Ct. App. 2011).

<sup>27</sup> See, e.g., *Vaughn v. Consumer Home Mortg., Inc.*, 293 F. Supp. 2d 206 (E.D.N.Y. 2003); *Consumer Prot. Div. v. Morgan*, 874 A.2d 919 (Md. 2005).

<sup>28</sup> See *M & T Mortg. Corp. v. White*, 2006 WL 47467 (E.D.N.Y. Jan. 9, 2006) (finding predatory lending scheme was caused in part by HUD's issuance of insurance without due diligence); *Vaughn v. Consumer Home Mortg., Inc.*, 293 F. Supp. 2d 206 (E.D.N.Y. 2003) (denying HUD's motion to dismiss declaratory judgment that FHA insurance was issued without due diligence). See also *LaBoy v. Better Homes Depot, Inc.*, 2004 WL 6393656, at \*8 (E.D.N.Y. July 14, 2004) (recognizing role of FHA insurance in property flipping scheme involving inflated appraisals).

<sup>29</sup> E.g., *Saucier v. Countrywide Home Loans*, 64 A.3d 428 (D.C. 2013); *Hoffman v. Stamper*, 867 A.2d 276 (Md. 2005).

Her story illustrates the true, lasting impact of an appraisal on a household. In the early 2000s, Mrs. S and her husband were targeted for solicitation into a home mortgage by two notorious, now-defunct predatory lending companies. The lender and broker conspired with a notorious appraiser to convince Mrs. S that her home had a value of nearly \$90,000, when in fact it was worth about *half* that amount. The broker and lender were paid their commission on the larger loan, and Mrs. S began making her payments. For fifteen years, Mrs. S made every payment on her loan, even when it was a struggle to pay the 10% interest rate—ultimately paying around three times the value of her house during that time. But then—after all that time—she learned that the loan also had a balloon payment that came due in December 2017. Due to the fraudulent appraisal, the balloon payment far exceeded the actual value of her home. She could not refinance and she could not sell. The only path ahead of her was foreclosure—loss of her family home and homelessness in her 70s. **Mrs. S sought our help in 2018. This crisis is not over.**

Another client was Mrs. R, a single, middle-aged woman. Mrs. R was repeatedly solicited to refinance her loan in the early 2000s. After purchasing her home for \$15,000 in the mid-1990s, Mrs. R fell prey to a mortgage broker-appraiser team, who soon had her in a loan exceeding \$70,000. Scared of losing her home and looking for lower payments, Mrs. R entered her information into a website that advertised that it could lower her bills. Soon an out-of-state lender contacted her and promised lower payments. This lender did not bother with an appraisal from a licensed appraiser; instead, it utilized an automated valuation model (AVM) of her home which provided a wholly inaccurate and inflated valuation of her home based on faulty market data. Although her home was actually only worth \$34,000, the lender told her that her home was worth \$84,000 based on the AVM. The lender pressured her to borrow additional funds up to the “value” of her home to pay other debts. I met Mrs. R. when the interest only feature of her loan expired and she was faced with impossibly high payments. Mrs. R. tried to refinance, but she was rejected because the loan so far exceeded the value of her home. Now she faced foreclosure.

These examples highlight the far reaching impacts of failures to obtain proper appraisals for homes—even (or especially) low cost homes. Requirements of appraiser independence help avoid Mrs. S’s calamitous situation. And a requirement of an actual appraisal conducted by properly educated and regulated appraisers, rather than technology, would have prevented the foreclosure action on Mrs. R’s home.

### ***Impacts on Communities of Color***

These predatory lending practices and impacts have particularly impacted communities and people of color, such as Mrs. S, as the result of redlining and reverse redlining.

The term “redlining” was coined in the 1930s by the Home Owner’s Loan Corporation (HOLC), a government sponsored organization created to assess credit-worthiness.<sup>30</sup> The HOLC created a color coded rating system explicitly based on ethnic and racial bias, which provided positive, green ratings for white neighborhoods and negative, red ratings for neighborhoods of

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<sup>30</sup> National Consumer Law Center, *Credit Discrimination, Redlining*, <https://library.nclc.org/cd/060604-0> (citing Charles L. Nier, III, *Perpetuation of Segregation: Toward a New Historical and Legal Interpretation of Redlining Under the Fair Housing Act*, 32 J. Marshall L. Rev. 617 (1999)(last visited June 21, 2019).

color created through widespread segregation.<sup>31</sup> In 1934, the Federal Housing Administration modeled itself after the HOLC system, which helped to substantiate the idea that market stability, at least in part, was due to racial and ethnic segregation, and led to decades of denying government assistance to communities of color, thereby limiting the availability of homeownership and accumulation of wealth in these communities.<sup>32</sup> While eventually the Fair Housing Act was passed in the 1960s to expand housing opportunities for people of color, studies continue to demonstrate that people of color are denied mortgage loans at a much higher rate than white applicants, and that homes in formerly rated redlined neighborhoods are valued lower than those in neighborhoods which were given a higher rating.<sup>33</sup>

These dynamics have made communities of color a prime target for predatory lending, dubbed “reverse redlining.” Without access to federally supported financing or other “prime” mortgage products, people of color—including those who are as credit-worthy as equivalent white customers—have been forced into subprime loans with unfavorable terms in order to access the American dream of homeownership.<sup>34</sup> In this context, appraisal fraud was used as a tool to induce homebuyers into larger (and thus more profitable) loans. This practice of making unfair and expensive loans to people with low valuation on their homes makes the loan all but impossible for the borrower to afford.<sup>35</sup> Thus, these borrowers faced disproportionately high rates of foreclosure because of the discriminatory and predatory nature of the loan, thus stripping these communities of wealth and substantially contributing to the current racial wealth gap in America.<sup>36</sup>

### ***Consequences of Appraisal Fraud***

The consequences of appraisal fraud are far reaching.<sup>37</sup> When a borrower becomes bound to a mortgage that exceeds the value of his home at origination, he is immediately prohibited from refinancing to obtain better loan terms, such as a fixed interest rate or lower interest rate. Unlike with other types of loans, this is of significant import because the borrower’s home is placed at risk. Moreover, predatory lenders often pair overvalued mortgages with other exploitative terms that make a borrower’s need to refinance even more pressing.<sup>38</sup> In addition, the borrower cannot

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<sup>31</sup> National Consumer Law Center, *Credit Discrimination, Redlining*, <https://library.nclc.org/cd/060604-0> (citing Michael Fitzpatrick, Al Hofeld Jr., & Ira Rheingold, *From Redlining to Reverse Redlining: A History of Obstacles for Minority Homeownership in America*, 34 Clearinghouse Rev. 642 (2001) (quoting John O. Calmore, *Spatial Equality and the Kerner Commission Report: A Back to the Future Essay*, in *Race, Poverty, and American Cities* 324 (John Charles Boger & Judith Welch Wegner eds., 1998) (last visited June 21, 2019).

<sup>32</sup> *Id.*

<sup>33</sup> Aaron Glantz & Emmanuel Martinez, *Kept Out: For People of Color, Banks are Shutting the Door to Homeownership*, *Reveal News* (Feb. 15, 2018), available at [www.revealnews.org](http://www.revealnews.org) (documenting disparities in 61 metropolitan areas even after controlling for income, loan amount, and neighborhood).

<sup>34</sup> National Consumer Law Center, *Credit Discrimination, Reverse Redlining, General*, <https://library.nclc.org/cd/060604-0> (last visited June 21, 2019).

<sup>35</sup> *Supra* note 10 at *Borrowers Should Not Need to Demonstrate Qualification for a Loan* (last visited June 21, 2019).

<sup>36</sup> Jacob S. Rugh & Douglas S. Massey, *Racial Segregation & the American Foreclosure Crisis*, *Am Sociol Rev.* 2010 Oct 1; 75(5): 629–651, available at <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4193596/>.

<sup>37</sup> As the Sixth Circuit noted, “a borrower has much to lose from entering into a too-big loan.” *Wallace v. Midwest Fin. & Mortg. Services, Inc.*, 714 F.3d 414, 422 (6th Cir. 2013).

<sup>38</sup> *See, e.g., id.* at 421 (noting key role of inflated appraisal in inducing borrower to take out overpriced payment-option ARM, with high fees and “unreasonable” terms, resulting ultimately in borrower’s loss of home and bankruptcy).

sell his home to relocate, even if he needs to do so to find work.<sup>39</sup> And when the borrower finds himself in this dire situation, the last resort protections provided by the bankruptcy code provide him with little assistance. Even if he chooses to declare bankruptcy, the homeowner must pay the full balance of the mortgage or forfeit his home; he cannot avail himself of the relief available for unsecured debts or debts secured by personal property, which can be discharged or reduced to the value of the collateral.<sup>40</sup> The homeowner becomes trapped with no way out of the loan except foreclosure. Finally, unlike with other loans, realizing on the security interest for a home-secured loan can result in homelessness, a far greater impact than loss of personal goods or loss of credit, and has negative spillover onto the surrounding community.<sup>41</sup>

Indeed, for many of these reasons, placing a borrower underwater significantly increases the risk of foreclosure.<sup>42</sup> Empirical data demonstrates that higher loan to value ratios lead to an increased risk of foreclosure. For example, securities ratings agencies have determined that loans with LTV ratios between 95% and 100% are 4.5 times more likely to enter foreclosure than loans with ratios below 80%. Loans that exceed 100% of the market value of the collateral are even more likely to enter foreclosure.<sup>43</sup> As a HUD-Treasury Report during the Bush Administration explained,

Many of the borrowers who are victims of this [fraudulent appraisal] scheme cannot afford to repay or refinance the mortgage based on the inflated price, and these loans may go into default and foreclosure quickly. Appraisers and others engaging in this fraudulent practice are helping to send first-time home buyers and whole communities into economic ruin.<sup>44</sup>

While homeowners feel the direct impact of these foreclosures, investors, insurers, neighboring homeowners, and ultimately taxpayers incur significant losses from foreclosures caused by appraisal fraud.

## **Regulation**

In 1989, Congress, in response to the savings and loan crisis of the 1980s, enacted the Financial Institutions, Recovery, Reform, and Enforcement Act of 1989 (FIRREA).<sup>45</sup> Under FIRREA, Congress mandated appraisal standards, review of appraisals and supervision of

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<sup>39</sup> The public policy against such transactions tracks the longstanding public policy against restraints on landowners that limit their ability to transfer or otherwise control their real property. *See, e.g., McCreery v. Johnston*, 110 S.E. 464, 466 (W. Va. 1922).

<sup>40</sup> *See* 11 U.S.C. §§ 521(a)(2)(A), 1322(b)(2).

<sup>41</sup> *See* Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 *Yale J. on Reg.* 1, 69 (2011); David Callahan, *Home Insecurity: How Widespread Appraisal Fraud Puts Homeowners at Risk* (Mar. 2005), available at [www.demos.org/sites/default/files/publications/home\\_insecurity\\_v3.pdf](http://www.demos.org/sites/default/files/publications/home_insecurity_v3.pdf).

<sup>42</sup> Laurie S. Goodman et al., *Negative Equity Trumps Unemployment in Predicting Defaults*, 19 *J. Fixed Income* 67 (2010).

<sup>43</sup> *See* Federal Housing Finance Agency v. Nomure Holding America, Inc., 104 F.Supp.3d 441, 465 (S.D.N.Y. 2015).

<sup>44</sup> *See* HUD-Treasury National Predatory Lending Task Force, Joint Report: Curbing Predatory Home Mortgage Lending (2000), available at <http://archives.hud.gov/reports/treasrpt.pdf>.

<sup>45</sup> Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183; H. Rep. No. 101-54(I), at 311, reprinted in 1989 U.S.C.C.A.N. 86 (discussing role of faulty appraisals in the crisis).

appraisers by lenders, and appraiser independence. FIRREA has the express purposes of ensuring that:

Federal financial and public policy interests in real estate related transactions will be protected by requiring that real estate appraisals utilized in connection with federally related transactions are performed . . . by individuals whose competency has been demonstrated and whose professional conduct will be subject to effective supervision.<sup>46</sup>

Guidelines promulgated by the federal banking agencies under FIRREA require covered institutions to establish an effective real estate and evaluation program that, among other things, ensures appraiser independence, provides for adequate review of appraisals, and monitors appraisers and reviewers. Institutions are also directed to establish policies and procedures for resolving any inaccuracies or weaknesses in an appraisal prior to the credit decision.<sup>47</sup>

As part of FIRREA,<sup>48</sup> in order to ensure that appraisals were conducted according to “uniform standards,”<sup>49</sup> Congress required that each federal banking regulator adopt rules governing appraisal standards, including the promulgation of appraisal standards and appraisal reviews for compliance with the Uniform Standards of Professional Appraisal Practice (USPAP).<sup>50</sup> Among other things, the rules of conduct state that an appraiser may not accept a fee for an assignment that is contingent upon the reporting of a predetermined result or of a particular amount of the value opinion.<sup>51</sup>

In March 2017 the Federal Financial Institutions Examination Council issued a Joint Report to Congress discussing the home value threshold for requiring appraisals.<sup>52</sup> Ultimately, after notice and comment, the agencies decided against raising the threshold from the current \$250,000, explaining that “[b]ased on considerations of safety and soundness and consumer protection, the agencies do not currently believe that a change to the current \$250,000 threshold for residential mortgage loans would be appropriate.”<sup>53</sup> In addition, according to the report, “CFPB staff shared concerns about potential risks to consumers resulting from an expansion of the number of residential mortgage transactions that would be exempt from the Title XI appraisal requirement.”<sup>54</sup>

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<sup>46</sup> 12 U.S.C. § 3331.

<sup>47</sup> 75 Fed. Reg. 77,450, 77,463 (Dec. 10, 2010).

<sup>48</sup> Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183.

<sup>49</sup> 12 U.S.C. § 3331.

<sup>50</sup> Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, tit. XI, § 1110, 103 Stat. 183 (as codified at 12 U.S.C. § 3339).

<sup>51</sup> 2016-2017 USPAP at 8-9, available at [www.appraisalfoundation.org](http://www.appraisalfoundation.org).

<sup>52</sup> Federal Financial Institutions Examination Council, Joint Report to Congress: Economic Growth and Regulatory Paperwork Reduction Act (March 2017) (2017 EGRPRA Report), available at [https://www.ffiec.gov/pdf/2017\\_FFIEC\\_EGRPRA\\_Joint-Report\\_to\\_Congress.pdf](https://www.ffiec.gov/pdf/2017_FFIEC_EGRPRA_Joint-Report_to_Congress.pdf).

<sup>53</sup> *Id.* at 36. See also 83 Fed. Reg. at 63,114-63,115 (acknowledging, in the current proposal, that “[c]onsumer protection considerations contributed to the agencies’ reluctance to propose increasing the appraisal threshold for residential real estate transactions immediately after the EGRPRA”).

<sup>54</sup> *Id.* at 36.

Regulations issued under the Truth in Lending Act set some additional requirements for appraisals done in connection with higher-priced mortgage loans,<sup>55</sup> including that the appraisal be completed by a licensed appraiser who conducts a physical inspection of the interior of the home.<sup>56</sup> If the loan is a purchase-money loan, the property was purchased by the seller within the previous six months, and the new purchase price exceeds the old by certain amounts, the lender is responsible for getting two written appraisals.<sup>57</sup>

Additionally, regulations promulgated in the Truth in Lending Act, pursuant to the Dodd-Frank Act, regulate the supervision of appraisers.<sup>58</sup> Lenders are prohibited from extending credit when they know that an appraisal materially misrepresents the value of the consumer's principal dwelling. Creditors may only escape liability if they exercised "reasonable diligence."<sup>59</sup> Creditors and settlement service providers are required to report any material failure to follow USPAP by an appraiser.<sup>60</sup>

Standards for appraisals and review of appraisals are not, by themselves, enough to prevent coercion of appraisers by lenders and brokers anxious to make the deal. Independence is a key component of protecting the market from the widespread overvaluation that triggered the savings and loan crisis in the 1980s and the subprime collapse in the 2000s. Since 1989, federal law has attempted to protect appraisers by forbidding lenders from offering anything of value in exchange for an appraisal performed by anyone other than a certified or licensed appraiser.<sup>61</sup> In 2008, the Federal Reserve Board used its authority to prohibit unfair or deceptive acts and practices to prohibit creditors, mortgage brokers, and their affiliates from exercising inappropriate influence over the amount at which a consumer's home is appraised.<sup>62</sup> Fannie Mae and Freddie Mac have both issued guidance specifically addressed to the question of appraiser independence.<sup>63</sup> Bolstering the independence of appraisers and sheltering them from lender coercion has been at the heart of

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<sup>55</sup> See National Consumer Law Center, Truth in Lending §§ 9.5.2, 9.5.4 (9th ed. 2015), updated at [www.nclc.org/library](http://www.nclc.org/library) (discussing the definition of higher-priced mortgage loans for purposes of the appraisal rules).

<sup>56</sup> National Consumer Law Center, Truth in Lending § 9.5.4.6 (9th ed. 2015), updated at [www.nclc.org/library](http://www.nclc.org/library) (discussing the appraisal regulations for higher-priced mortgage loans).

<sup>57</sup> 12 C.F.R. § 1026.35(c)(4) (eff. Jan. 18, 2014). See generally National Consumer Law Center, Truth in Lending § 9.5.4.6 (9th ed. 2015), updated at [www.nclc.org/library](http://www.nclc.org/library) (discussing the appraisal regulations for higher-priced mortgage loans).

<sup>58</sup> See generally National Consumer Law Center, Truth in Lending §§ 9.4.2 (discussing the appraisal regulations issued under Truth in Lending Act), 9.4.4 (reviewing Truth in Lending Act remedies for violations of these regulations) (9th ed. 2015), updated at [www.nclc.org/library](http://www.nclc.org/library).

<sup>59</sup> 12 C.F.R. § 1026.42(e).

<sup>60</sup> 12 C.F.R. § 1026.42(g)(1). See generally National Consumer Law Center, Truth in Lending §§ 9.4.2 (discussing the appraisal regulations issued under Truth in Lending Act), 9.4.4 (reviewing Truth in Lending Act remedies for violations of these regulations) (9th ed. 2015), updated at [www.nclc.org/library](http://www.nclc.org/library).

<sup>61</sup> 12 U.S.C. § 3349(a)(1).

<sup>62</sup> 12 C.F.R. § 1026.42.

<sup>63</sup> Fannie Mae, Appraiser Independence Requirements (Nov. 10, 2010), available at [www.efanniemae.com](http://www.efanniemae.com); Freddie Mac, Oct. 15 Guide Bulletin 2010-23, available at [www.freddiemac.com](http://www.freddiemac.com).

actions taken by the New York attorney general (in negotiating the settlement of an appraisal fraud investigation)<sup>64</sup> and regulations issued under the Dodd-Frank Act.<sup>65</sup>

Regulations promulgated under the Dodd-Frank Act's amendments to the Truth in Lending Act have prohibited the falsification or alteration of an appraisal and a number of coercive practices that might influence an appraiser's valuation.<sup>66</sup> In addition, the regulations limit conflicts of interest and require reasonable compensation of appraisers.<sup>67</sup> The Dodd-Frank Act also included provisions regarding licensure of appraisers and appraisal management companies.<sup>68</sup>

## **Discussion Topics**

The current floor of regulation—to the extent that it has been implemented—has worked. Nonetheless, apparently forgetting the recent past and ignoring all testimony, evidence, and findings to the contrary, there appears to be a trend toward relaxing the well-established value of appraisals to our real estate market and economy. Currently, the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation are proposing eliminating the requirement for bona fide appraisals for homes worth less than \$400,000. Meanwhile, Fannie Mae and Freddie Mac are permitting no appraisals to be used in underwriting certain loans, relying instead on “inspections” conducted by people with no training, oversight, or guidelines; computerized black-box Automated Valuation Models that have no governing standards; or “hybrid appraisals” that are not appraisals at all, given that no appraiser is required to complete an on-site inspection of the home. These moves undermine safety and soundness in the marketplace and put huge numbers of American homeowners at substantial risk of losing their most valuable asset.

### ***Raising the De Minimis Threshold Will Harm Homeowners & the Economy***

As set forth extensively in our written comments and letters on the topic, raising the de minimis threshold for appraisal requirements under FIRREA is unwise and unwarranted, and recently recognized by the impacted agencies.<sup>69</sup>

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<sup>64</sup> Office of the New York State Att’y Gen., Press Release, New York Attorney General Cuomo Announces Agreement with Fannie Mae, Freddie Mac, and OFHEO (Mar. 3, 2008), available at [www.ag.ny.gov](http://www.ag.ny.gov).

<sup>65</sup> Pub. L. No. 111-203, §§ 1472, 1473, 124 Stat. 1376 (2010); 75 Fed. Reg. 66,554 (Oct. 28, 2010). See 12 C.F.R. § 1026.42; National Consumer Law Center, Truth in Lending § 9.4.2.1 (9th ed. 2015), updated at [www.nclc.org/library](http://www.nclc.org/library) (replacement of Federal Reserve Board’s 2008 appraisal rules and effective dates).

<sup>66</sup> See 12 C.F.R. § 1026.42; National Consumer Law Center, Truth in Lending § 9.4.2.1 (9th ed. 2015), updated at [www.nclc.org/library](http://www.nclc.org/library) (replacement of Federal Reserve Board’s 2008 appraisal rules and effective dates).

<sup>67</sup> See National Consumer Law Center, Truth in Lending §§ 9.4.2.3–9.4.2.5 (9th ed. 2015), updated at [www.nclc.org/library](http://www.nclc.org/library) (substantive prohibition of appraisal regulation).

<sup>68</sup> Pub. L. No. 111-203, § 1473, 124 Stat. 1376 (2010).

<sup>69</sup> See Comments to the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation regarding OCC Docket No. OCC–2018–0038, RIN 1557–AE57 FRB Docket No. R–1639, RIN 7100–AF30, FDIC RIN 3064–AE87, 83 Fed. Reg. 63,110 (December 7, 2019) (February 5, 2019), available at [https://www.nclc.org/images/pdf/foreclosure\\_mortgage/mortgage\\_servicing/real-appraisal-comments-83-fed-reg.pdf](https://www.nclc.org/images/pdf/foreclosure_mortgage/mortgage_servicing/real-appraisal-comments-83-fed-reg.pdf).

In 2017, the Federal Financial Institutions Examinations Council (FFIEC) and its member agencies rejected an attempt to lower the de minimis threshold for appraisals.<sup>70</sup> The FFIEC stated that it had concerns for the “safety and soundness” of the market and concerns that raising the threshold would put consumers at risk for overvaluation of properties<sup>71</sup> Specifically, the FFIEC stated that raising the threshold from the current \$250,000 residential standard would have limited impact on burden because the VA, FHA, and other federal agencies impose their own appraisal requirements.<sup>72</sup> Further, raising the threshold could have serious implications for the market, as seen from the last financial crisis where “imprudent residential mortgage lending can pose significant risks to financial institutions.”<sup>73</sup> Importantly, lowering this threshold—which currently only requires an appraisal for loans over \$250,000 or for Higher Priced Mortgage Loans over \$25,000—would protect homeowners and communities. The majority of homes throughout the country are worth less than \$250,000.<sup>74</sup> Low- and moderate-income homeowners—and the government entities that insure or invest in their loans—deserve the same protections as higher income homebuyers.

The proposed rule to increase the de minimis threshold for appraisals deviates from Congress’ amendment to FIRREA and has dangerous implications for rural areas and communities of color. Indeed, the factors that led FFIEC to reject lowering the threshold in 2017 remain unchanged. In addition, given the importance of appraisals and the Congressional mandate to exercise caution, the agencies should not adopt the proposed increase because there is insufficient data to properly evaluate it. There has also been insufficient time to assess the recent changes Congress made to appraisal standards. Rather than leap into deregulation, with potentially calamitous impacts for consumers and the economy, the agencies and the Consumer Financial Protection Bureau should jointly implement a process to collect the needed data and then hold public hearings on setting the appropriate threshold.

Evaluations and so-called hybrid appraisals are inadequate. These processes allow unvetted, untrained, unsupervised people to enter consumers’ homes for the purposes of supposedly reaching a home value. There are no requirements that these individuals pass background checks or otherwise demonstrate their reliability. There are no requirements that they follow USPAP or any other standards. There are no minimum training or knowledge requirements. And if they engage in fraud, theft, or simple negligence, there is no recourse whatsoever—where appraisers are subject to licensure requirements by state regulatory boards, there is no method to track, sanction, or supervise individuals conducting evaluations and inspections. Given the incentives to shoddy or fraudulent home valuations set forth above, this is a clear recipe for disaster.

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<sup>70</sup> Federal Financial Institutions Examination Council, Joint Report to Congress: Economic Growth and Regulatory Paperwork Reduction Act at 36 (March 2017) (EGRPRA Report), available at [https://www.ffiec.gov/pdf/2017\\_FFIEC\\_EGRPRA\\_Joint-Report\\_to\\_Congress.pdf](https://www.ffiec.gov/pdf/2017_FFIEC_EGRPRA_Joint-Report_to_Congress.pdf).

<sup>71</sup> *Id.* at 35-36. *See also* 83 Fed. Reg. at 63,114-63,115 (acknowledging, in the current proposal, that “[c]onsumer protection considerations contributed to the agencies’ reluctance to propose increasing the appraisal threshold for residential real estate transactions immediately after the EGRPRA”).

<sup>72</sup> 2017 EGRPRA Report at 35.

<sup>73</sup> *Id.*

<sup>74</sup> *See* S&P Dow Jones Indices LLC, S&P/Case-Shiller 20-City Composite Home Price Index© [SPCS20RSA], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/SPCS20RSA>, November 13, 2016.

The increase in the de minimis standard for appraisals does not just undermine safety and soundness in the marketplace, it also places entire communities at risk—especially communities of color that have historically been barred from increasing their wealth through homeownership. As discussed above, the phenomenon of redlining has been well-documented—credit worthy non-white borrowers were intentionally barred from home ownership by restrictions on lending through our federally funded programs. This resulted in white families being able to amass wealth, while people of color were unable to invest in homeownership. As a result, the most recent generation of homebuyers of color were often the first in their families to purchase their own home, but were only able to access financing at exploitative terms. These communities of color were those who lost out the most during the mortgage crisis of 2008—entire neighborhoods were decimated, and families lost their entire net worth overnight. These communities were particularly hard hit, facing foreclosure at nearly twice the rate of white communities, while they simultaneously held a much higher portion of their wealth in their homes.<sup>75</sup> The crisis left these neighborhoods blighted and empty and stole families’ entire savings. Homes lost more than 50% of their value, which they have yet to regain.<sup>76</sup> While the median home value for any homeowner in America is less than \$250,000, the median value for homes owned by Black homeowners is just \$153,500.<sup>77</sup> Exempting these homes from appraisal requirements puts these same communities—just now starting to recover from the crisis and rebuild faith in our national housing market—at dramatic risk once again. Indeed, it is well-documented that housing in Black communities is, even controlling for other factors, systemically undervalued. As a result, under the proposed increased threshold, communities of color would be disproportionately negatively impacted.<sup>78</sup> To an individual buying a \$250,000 home, the risk of foreclosure is real and it can be devastating. Time and time again we have been shown that that risk increases exponentially if the home is not subject to a true, qualified appraisal at the time it is purchased or the home loan is refinanced. Appraisals save homes.

Rather than looking to decrease protections for homeowners, Congress should be seeking to increase those protections, particularly for the most vulnerable communities who have been excluded from the wealth-building tool of homeownership. Adequate, well-regulated appraisals should be required for federally backed transactions to protect the government, homeowners, and our economy.

### ***Unregulated Technology Will Hurt Consumers***

As in all sectors, the use of new technologies presents tremendous opportunity to move the market forward and improve accessibility, as well as tremendous risk in the absence of adequate oversight and consideration.

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<sup>75</sup> See Michael Gerrity, 2007 Foreclosure Crisis Still Negatively Impacting Black and Hispanic Communities, *World Property Journal* (Apr. 26, 2019), available at <https://www.worldpropertyjournal.com/real-estate-news/united-states/detroit/zillow-2019-housing-reports-sarah-mikhitarian-black-homeownership-data-hispanic-homeownership-data-foreclosure-crisis-real-estate-news-11378.php>.

<sup>76</sup> *Id.*

<sup>77</sup> See Housing in Black America, Black Demographics, <https://blackdemographics.com/households/housing/>.

<sup>78</sup> See Andre Perry, Jonathan Rothwell, David Harshbarger, Brookings Institute, The Devaluation of Assets in Black Neighborhoods (Nov. 2018), available at <https://www.brookings.edu/research/devaluation-of-assets-in-black-neighborhoods/>.

As illustrated by the case of Mrs. R above, the use of automated valuations can be devastating. The automated valuation used by her lender was based on aggregate data from unverified public records that is often inaccurate, incomplete, or outdated. Moreover, programs like these cannot adequately consider neighborhood, condition of the property, location appeal, or altered building characteristics. Each of these factors is essential in understanding the true value of a home.

Moreover, despite Congressional mandate through the Dodd-Frank Act, there are *no* minimum standards for AVMs. As a result, AVMs are proprietary, black-box algorithms that cannot be meaningfully understood or evaluated for accuracy, safety and soundness, or potential discriminatory or even fraudulent impacts. These algorithms are not a way to avoid error—they are only as good as the humans that create them, and these humans face the very same incentives to enrich their employers that gave rise to the recent foreclosure crisis.

We urge that AVMs only be used to *supplement* true appraisals; and in this context that the Appraisal Standards Board of the Appraisal Foundation be granted authority to create clear, transparent, and reviewable standards for these automated models.

A potentially positive opportunity for the use of technology in appraisals exists in the Practical Applications in Real Estate Appraising (PAREA) approach being developed by the Appraisal Qualifications Board of the Appraisal Foundation. PAREA, if sufficiently funded and appropriately developed, will supplement current methods of appraiser training through the use of virtual reality and other methods of training through technology. PAREA presents an opportunity to level the playing field to move away from inadequate or inconsistent training based on the skills and knowledge of the supervising appraiser. PAREA can also potentially open the field of real estate appraising beyond the traditional domain of white men by making training accessible without the need for established connections in the profession. This in turn can counteract implicit bias within the profession, and add a diversity of voices and build trust in home valuation that is sorely needed throughout American communities. Of course, technology is not a silver bullet, and PAREA must be coupled with hands on experience, careful oversight, transparency, and adequate funding to make the possibilities a reality.

### ***Appraisal Standards and Requirements Protect Communities of Color***

As stated throughout this statement, communities and homeowners of color are particularly vulnerable to appraisal fraud and predatory lending—as the direct result of a history of intentional, government-backed racial discrimination. In 2011, the median white household had \$111,146 in wealth holdings, compared to just \$7,113 for the median Black household and \$8,348 for the median Latino household, as the direct result of redlining and other discriminatory social policy.<sup>79</sup> Research demonstrates that eliminating disparities in both the homeownership rate and the returns on investment would significantly narrow this gap.<sup>80</sup> The United States government must focus on building and protecting wealth in communities of color, not subjecting it to increased risk. To this end, we have discussed the impacts of each of the areas of inquiry in particular relationship to

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<sup>79</sup> Laura Sullivan, et al., *The Racial Wealth Gap: Why Policy Matters* (June 2016), *available at* <https://www.demos.org/research/racial-wealth-gap-why-policy-matters>.

<sup>80</sup> *Id.*

racial discrimination. As discussed throughout, exempting lower valued homes from appraisal requirements particularly places minority homeowners at risk, whereas efforts to ensure clear, transparent, minimum standards for home valuation will protect these communities that are struggling through no fault of their own. To the extent that measures are adopted to expand appraisal options for FHA loans, legislators should ensure that there is adequate training on FHA lending for those appraisers and that those already in the industry are subject to such training requirements.

### ***Appraiser Independence***

Due in large part to increased requirements of appraiser independence and other substantive regulations and standard setting, unethical lenders, brokers, and appraisers can no longer join forces to defraud homeowners, communities, investors, and insurers. These requirements build upon earlier steps taken under FIRREA to ensure minimum standards for appraisals and appropriate training. The requirement of a complete appraisal by a licensed and educated appraiser further protects the market.

There is some cause for concern. Appraisal Management Companies (AMCs) have become increasingly financially connected to large lenders, thereby potentially undermining the supposed independence they create. Careful oversight of these purportedly arms-length transactions must be conducted to ensure that there is true financial independence, given the incentives to jointly create wealth for a parent company. We further propose that AMCs be required to disclose the complete breakdown of how valuation costs are being assessed, paid, and applied. Limits should be implemented to fees paid by the homeowner—if any—to an AMC.

### **Conclusion**

Minimum regulatory requirements for appraisals are necessary to protect homeowners and the economy at large. Any appraiser shortage would be appropriately addressed through market forces: increased demand would lead to increased customary rates, which would accordingly lead to a greater supply of appraisers entering the marketplace. Moreover, any shortage is likely to be temporary and to disappear as interest rates increase and the demand for mortgage refinances decreases. To the extent there is a true, demonstrable shortage of appraisers in specific regions, solutions should be carefully targeted to increasing the supply of qualified appraisers in those areas, not to decreasing protections for everyone. Lowering standards and qualifications, including permitting lenders to rely on alternative valuation products and broker price opinions, will further increase any such shortage, rather than remedy the need for qualified appraisers. Such reliance would further enable lenders to return to obtaining unreliable reports which, in turn, create instability in the market. In short, the regulatory regime is a floor that is essential to avoid both unintentional errors as well as fraud.

A floor of overarching federal regulatory standards for lending and appraisals is necessary to ensure that both consumers and others impacted by the mortgage market are uniformly protected from fraud nationwide. National standards are appropriate for a national market in mortgage lending, investment, and insurance, and to enable appraisers to more easily act with reciprocity in jurisdictions and across state lines, where appropriate. Without this uniform baseline, the

marketplace would become more costly and complicated for participants. Both the savings and loan crisis of the 1980s and the mortgage industry collapse in the 2000s demonstrate the clear and pressing need for this federal regulatory framework to establish a floor for acceptable appraisal conduct. Eliminating these protections and relying solely on the states would open the door to more economic crises that devastate homeowners and financial institutions alike. Of course, these federal protections are, appropriately, a floor and not a ceiling on appraisal safeguards. States have always been and continue to be able to create additional, state appropriate protections. This interplay between basic protections on a federal level with *additional* localized regulation is necessary and positive for the market and consumers.

In sum, it is essential that a national regulatory floor be retained and built upon to protect the American dream of homeownership into the future. Without these protections, the market will become more costly in the short term, and lead to new financial crises in the future, even while we have barely recovered from the last one. The appraisal protections were wisely adopted by Congress in response to real, demonstrated need in the very recent past. We urge you to keep these essential protections in place, and to build upon them to protect homeownership for *all* Americans into the future.