September 29th, 2017

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Attn: Comments/Legal ESS
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The Conference of State Bank Supervisors ("CSBS" or "state regulators") is the nationwide organization of state regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. Each member state banking agency that CSBS represents has a comprehensive understanding of the local economy and the firms that service that economy. In fact, states are the chartering authority and primary regulator for 78% of the nation's banks, a figure that represents 4,537 institutions with over $5.3T in assets. State agencies are also the primary regulators of over 20,000 non-depository financial services providers, including: residential mortgage lenders and servicers, money service businesses and money transmitters, debt collectors, consumer and small dollar loan lenders, and emerging and established financial technology companies.

State regulators appreciate the opportunity to comment on the proposed rulemaking introduced by the OCC, Board and FDIC ("the Agencies") to amend the Agencies' regulations requiring appraisals of real estate for certain transactions. The proposal does not increase the threshold for residential real estate transactions, but solicits feedback as to how the threshold can be increased, consistent with consumer protection, safety and soundness, and reduction of unnecessary regulatory burden. The proposal aims to increase the threshold level at or below which appraisals would not be required for commercial real estate ("CRE") transactions from $250,000 to $400,000.

Based on supervisory observation and discussion with regulatory stakeholders, state regulators have the following recommendations to improve the efficiency of interagency appraisal regulations and reduce regulatory burden, and suggest that the Agencies:

- Raise the threshold for transactions secured by residential real estate to reflect inflation and average transaction values;
- Address limited appraiser availability in rural states by amending appraiser credentialing requirements and clarifying the Title XI waiver process;

- Provide a de-minimis exemption from residential appraisal regulations for banks that make and retain a limited number of mortgage loans in portfolio;
- Evaluate the effectiveness of a threshold increase to $400,000 utilizing more granular analysis; and
- Clarify the applicability of business-loan exemptions for small and medium sized agricultural borrowers that are not passive land investors.

I. Threshold Increase for Transactions Secured by Residential Real Estate

Within the Notice of Proposed Rulemaking (NPRM), the Agencies address whether it is appropriate to increase the $250,000 threshold for transactions secured by residential real estate, and provide their reasoning for leaving the threshold as is. The NPRM asserts that an increase in the threshold would not materially reduce burden, as appraisals for most transactions secured by residential real estate would still be required by the government-sponsored enterprises, or GSEs.[1] Thus, any increase in the threshold for transactions secured by residential real estate would have minimal impact, as USPAP-conforming appraisals would still be required by the GSEs.[2] The Agencies also noted that the threshold cannot be raised without concurrence from the Consumer Financial Protection Bureau ("Bureau"),[3] and that Bureau staff agreed that the current threshold provides consumer protection benefits.

Although state regulators recognize that safety and soundness should be taken into consideration when evaluating the appraisal thresholds, it is notable that the Agencies have taken steps to address the thresholds for nonresidential transactions first, despite historic volatility in the market. State regulators encourage the Agencies to similarly evaluate the thresholds for appraisals secured by residential real estate, which has not been adjusted since 1994.

State regulator comments, recommendations and observations regarding the threshold for transactions secured by residential real estate are detailed below.

Raising the Residential Appraisal Threshold to Reflect Inflation & Transaction Values

State regulators strongly recommend that the Agencies increase the threshold for transactions secured by residential real estate. Pursuant to 12 CFR 323.2, the value of a transaction secured by residential real estate is determined by the amount of the loan or extension of credit. As it stands now, any residential real estate related transaction with a value above $250,000 requires an appraisal. Per data from the Mortgage Bankers Association, the average forward conventional mortgage loan was $312,000 at the close of Q22017, and the average forward mortgage loan – including conventional, FHA/VA, and USDA/RHS loans – totaled $310,400.[4]

The average conventional mortgage amount has not fallen beneath the $250,000 threshold since Q42013, and has continued to steadily rise since year-end 2012. At the time that the thresholds were set in 1994, only 15% of first-lien 1-4 family mortgage loans were above the $250,000 threshold.[5] As per

[1] *See* Interagency Appraisal and Evaluation Guidelines, 10(i)
[2] See here, Q6. Each property underlying multifamily mortgage-backed securities are subject to USPAP standards.
[3] 12 USC 3341(b)
[4] *See* OMBLCTOT & MBLSPURC Index, Bloomberg Data
[5] https://fraser.stlouisfed.org/files/docs/historical/frbdal/circulars/frbdallas_circ_19940624_no94-065.pdf

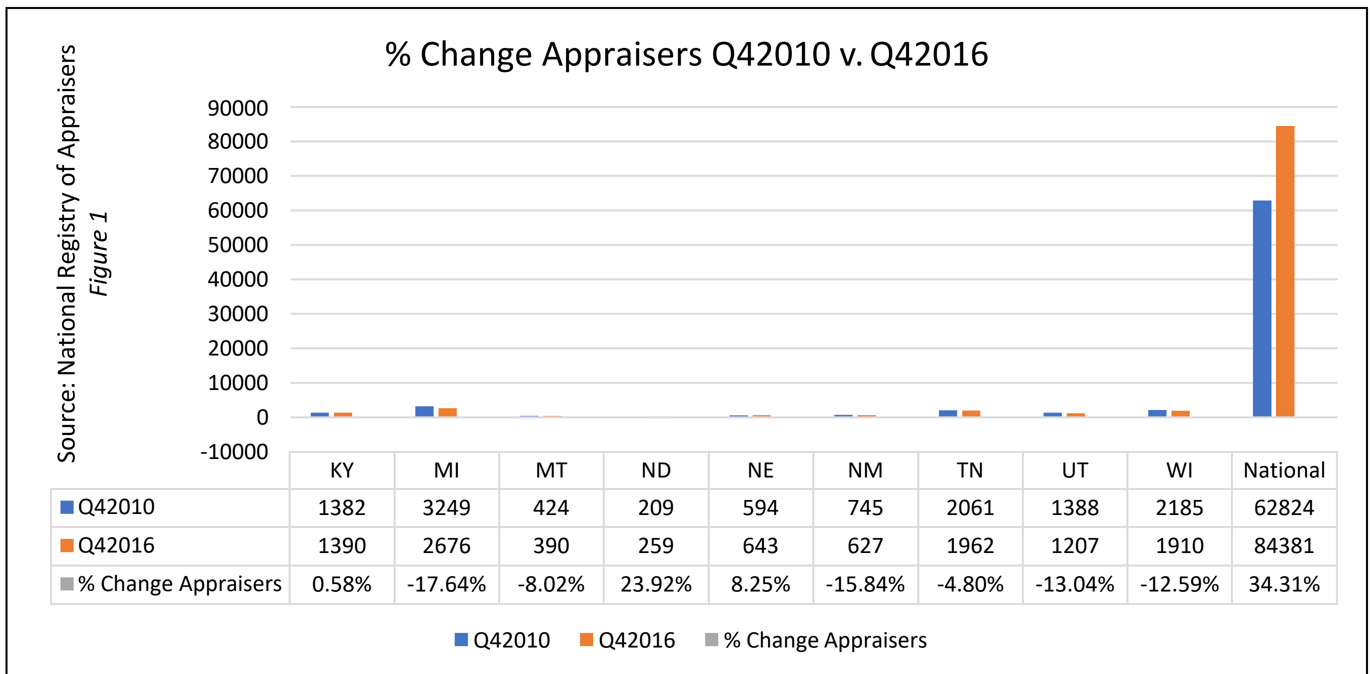
the 2015 HMDA dataset, approximately 35% of first lien 1-4 family mortgage loans are above the threshold, and it is likely that this number will increase over time. State regulators see a clear, practical need to increase the threshold for transactions secured by residential real estate, as property values and mortgage loan averages will continue to rise as indicated by general Consumer Price Index (CPI) trends.[6] Further, state regulators urge the Agencies to devise methodology to index thresholds for inflation over time, eliminating the need for periodic reexamination of the thresholds.

The Appraiser Shortage Persists in States with Rural Populations

State regulators continue to observe a shortage of appraisers in regions across the country, and urge the agencies to provide relief. Every year, CSBS conducts annual outreach to the community banking industry as part of the annual CSBS-Federal Reserve Community Banking in the 21st Century Research and Policy Conference. As part of this initiative, CSBS recently deployed its *Five Questions for Five Bankers*[7] to industry stakeholders. This data serves as a complement to the National Survey of Community Banks, is administered by state banking Commissioners via interview, and is part of an effort to understand challenges and opportunities faced by community banks. *Five Questions for Five Bankers* respondents consistently noted that a shortage of qualified appraisers in regions across the country has led to significant delays in the home purchase process. States that are experiencing a shortage of appraisers, per recent community banker survey responses, include: Kentucky, New Mexico and Utah. Additionally, as part of outreach through the recent Economic Growth and Paperwork Reduction Act (EGRPRA)[8] process, CSBS solicited feedback from state regulators as to which federal regulations were outdated, unnecessary or unduly burdensome. State regulators from Nebraska, Montana, Wisconsin, Michigan, North Dakota and Tennessee similarly noted that federal appraisal rules cause significant burden, and that access to appraiser services is limited in rural areas.

[6] The Consumer Price Index (CPI) is a measure of the average monthly change in the price for goods and services paid by urban consumers between any two-time periods. The CPI can be used to recognize periods of inflation, deflation, and relative inflation over time.
[7] *See* here. The National Survey results will be released the week of October 3rd, 2017.
[8] The Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) requires that regulations prescribed by the FFIEC, OCC, FDIC and Fed be reviewed by the agencies at least every 10 years. The purpose of this review is to identify, with input from the public, outdated, unnecessary or unduly burdensome regulations, and consider how to reduce regulatory burden on insured depository institutions while ensuring their safety and soundness.

Concerns regarding appraiser shortages were largely focused on appraisals of 1-4 family residential property, and *Figure 1* represents counts of Certified Residential, Certified General and Licensed appraisers per state, as all three license types can perform a 1-4 family residential appraisal. *Figure 1* illustrates that nearly every state, apart from Nebraska, North Dakota and Kentucky has experienced a decline in appraiser availability since 2010. *Figure 1* highlights that appraiser shortages tend to be regional in nature, as there was a 34.31% increase in appraisers nationally during the same period. Additionally, because Certified General appraisers are permitted to evaluate all types of real property, it can be reasonably assumed that individuals holding a General certification have limited availability to appraise residential property relative to Licensed and Certified Residential appraisers.



	KY	MI	MT	ND	NE	NM	TN	UT	WI	National
Q42010	1382	3249	424	209	594	745	2061	1388	2185	62824
Q42016	1390	2676	390	259	643	627	1962	1207	1910	84381
% Change Appraisers	0.58%	-17.64%	-8.02%	23.92%	8.25%	-15.84%	-4.80%	-13.04%	-12.59%	34.31%

As the Agencies consider reforming the appraisal thresholds for transactions secured by residential real estate, state regulators recommend that the agencies utilize more regional data to form their conclusions. For instance, certain states may be experiencing a decline in the appraiser population, but an increase in mortgage origination volume. This would cause significant delays in the home purchase process within that state, and could potentially limit credit availability.

Options for Relief – The Title XI Waiver Process is Unclear

As a response to EGRPRA comments that emphasized the persistence of appraiser shortages in rural areas, the Agencies issued several communications regarding the waiver, including: an FDIC Financial Institution Letter (FIL), an OCC Bulletin, and a Federal Reserve SR letter, all entitled *Advisory on the Availability of Appraisers*.[9] The Agencies' communications all detail an option designed to help insured depository institutions address appraiser shortages – regionally applied, temporary waivers of any

[9] See here for FIL-19-2017, here for OCC Bulletin 2017-19, and here for the SR 17-4.

requirement relating to individuals certified or licensed to perform appraisals under Title XI.[10] Through a notice and comment process, the Appraisal Subcommittee of (ASC) the Federal Financial Institutions Examination Council (FFIEC) has the authority to grant temporary waivers. Although state regulators acknowledge the Agencies' response to EGRPRA comments, the Title XI waiver application process is unclear, and the waiver has not been widely used.

Pursuant to 12 CFR 1102.2, a request is only complete if it details the nature of the scarcity of certified or licensed appraisers (including supporting documentation). State regulators continue to receive inquiries from interested parties as to what supporting documentation would be appropriate, and how to demonstrate that there is a scarcity of appraisers. State supervisors recommend that the Agencies release further guidance related to the waiver process – including details on how supporting documentation is to be generated, who it is to be sent to, and examples of past requests.

Additionally, how an appraisal is to be prepared and reviewed under a Title XI waiver is unclear. Agency communications state that if the ASC grants a waiver, any requirement relating to certification or licensing of individuals to perform appraisals pursuant to 12 CFR 225.64(e) is waived, and that institutions are not required to use state-certified or licensed appraisers for appraisals of federally related transactions. All other minimum appraisal standards required by 12 CFR 225.64 are required, including that the appraisal, regardless of waiver status, must:

> "*Conform to generally accepted appraisal standards as evidenced by the USPAP promulgated by the Appraisal Standards Board of the Appraisal Foundation, unless principles of safe and sound banking require compliance with stricter standards*." (12 CFR 225.64(a))

State regulators request clarity as to which "generally accepted appraisal standards" an appraiser operating under a Title XI waiver should follow, and how depositories should determine that an appraisal is USPAP-conforming. Interagency guidance states that the appraisal must contain a "certification" that the appraiser has complied with USPAP. The Agencies explain that an institution can confirm this by referring to the appraiser's USPAP certification in its assessment of the appraiser's independence concerning the transaction and the property.[11] If appraisers within a state are exempt from credentialing and licensing requirements, depositories would be unable to confirm USPAP compliance by referring to individual credentials. State regulators recommend that the Agencies release guidance clarifying which "generally accepted" standards should be followed under a waiver, and how depositories can confirm that an appraisal is USPAP-conforming without credentials.

Options for Relief – Appraiser Qualifications Board (AQB) Requirements

The Appraiser Qualifications Board (AQB) establishes minimum education, experience and examination requirements for appraisers to obtain a certification under FIRREA provisions.[12] In 2015, the AQB

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[10] Section 1119 of Title XI of FIRREA (12 U.S.C. 3348(b)) authorizes the Appraisal Subcommittee (ASC), after making certain findings and with the approval of the FFIEC, to grant temporary waivers of any requirement relating to certification and licensing of individuals to perform appraisals under Title XI in states or geographic political subdivisions of any states where there is a shortage of appraisers leading to significant delays in obtaining appraisals in connection with federally related transactions.

[11] See here. Federal Register, Vol. 75, No. 237 (77459).

[12] 12 U.S.C. 3345(e)

instituted changes to the Real Property Appraiser Qualification Criteria that required Licensed appraisers to have thirty semester hours of college level education, and for Certified Residential and Certified General appraisers to hold bachelor's degrees. Previously, the educational requirements for the highest credential, Certified General appraiser, did not exceed thirty college-level credit hours. The AQB published an exposure draft in May of this year that rescinded the 2015 educational requirements, but ultimately those changes were not adopted.[13]

State supervisors see the heightened education requirements as a barrier to entry into the appraiser profession, and anticipate that the shortage will only continue if educational standards are not adjusted. It is not clear whether a Bachelor's degree is necessary to complete the requisite duties of an appraiser, and the AQB has proposed removing the requirement in the past.

State regulators recommend that the educational requirements be amended, allowing for more appraisers to be credentialed, and ultimately easing the burden caused by appraiser shortages. In many instances, rural counties have only one appraiser, and the requirement of a Bachelor's degree directs interested parties away from entering the appraiser profession. For example, a community banker in South Dakota noted that despite there being only one appraiser for all of Hughes County (which holds Pierre, the state capital),[14] educational requirements bar applicants from attaining the Certified General appraiser credential. The community banker went on to explain that despite this individual holding an Associate's degree related to agricultural studies, they were not able to attain proper credentialing to evaluate collateral associated with transactions secured by farmland.

Calibrating Appraisal Regulation for Banks that Hold Mortgage Loans in Portfolio

In the NPRM, the Agencies state that increasing the threshold for residential transactions would have a limited impact on burden, as the GSEs are exempt from interagency appraisal regulations. However, it is the case that many small and less complex banks do not sell loans to Fannie Mae or Freddie Mac, and instead hold mortgages in portfolio. These institutions are held to the $250,000 threshold – and raising the threshold per inflation and average mortgage loan size would provide relief to banks that engage in portfolio lending.

Figure 2 illustrates that small banks tend to hold loans in portfolio at a higher rate than mid-sized and large institutions. The Mortgage Lender Sentiment Survey, issued on a quarterly basis by Fannie Mae, tracks the mortgage market by institution size. Smaller institutions are comprised of Fannie Mae customers whose 2016 total industry loan origination volume was in the bottom 65% of the market, or less than $242 million in volume. For this analysis, the data presented in *Figure 2* is isolated to depository institutions, excluding non-depository mortgage lenders and credit unions.

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[13] *See* here. The AQB did not adopt this draft. Comments were due on May 12th, 2017.

[14] As of 9/14/17, only one appraiser was listed in the National Registry for not only Hughes County, but all of Pierre, South Dakota.

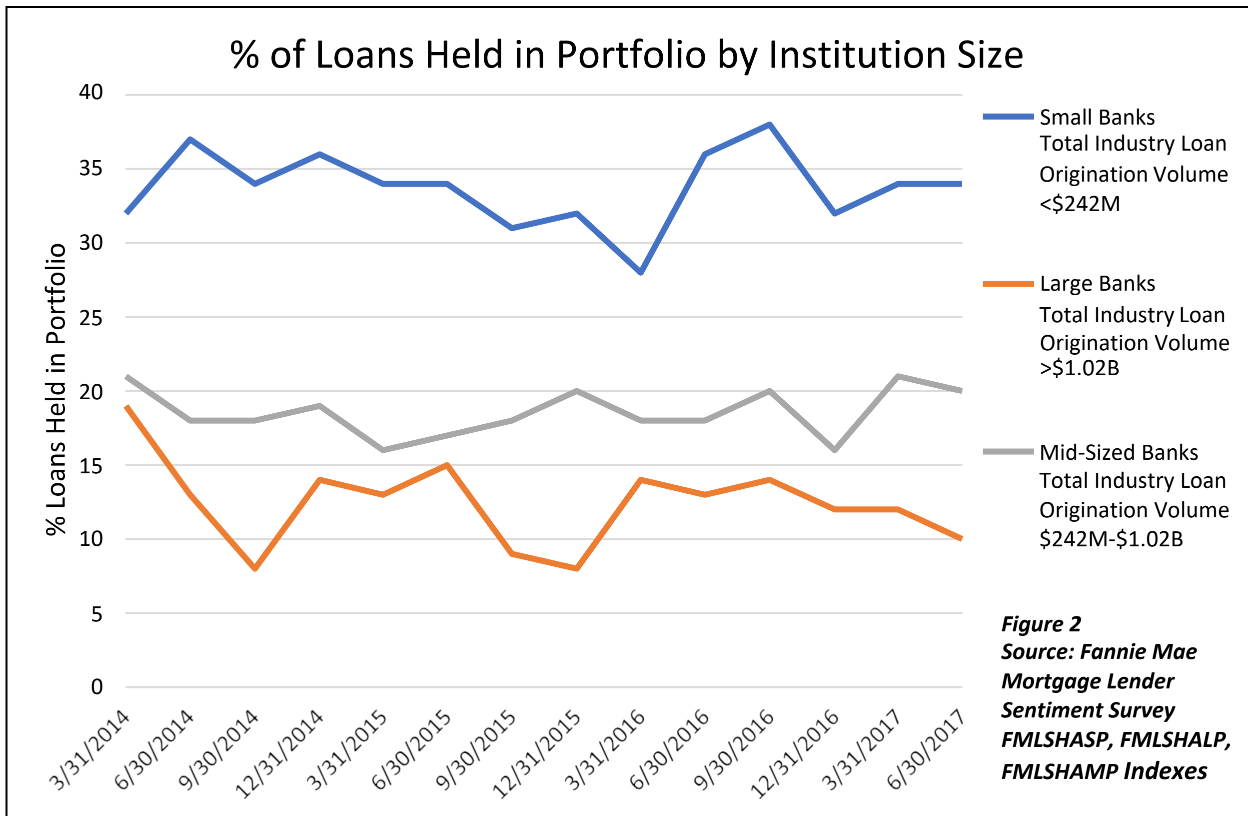

Figure 2
Source: Fannie Mae Mortgage Lender Sentiment Survey FMLSHASP, FMLSHALP, FMLSHAMP Indexes

For institutions that do not deliver loans to the GSEs, an increase in the threshold for transactions secured by residential real estate would ease delays caused by limited appraiser availability.[15] However, in addition to a threshold raise, state regulators believe that community banks that originate and retain a limited number of mortgages in portfolio should be provided a de-minimis exemption from interagency appraisal regulations for residential transactions. Banks that engage in portfolio lending tend to rely heavily on social relationships and personal knowledge, which informs their underwriting practices and risk-analyses.[16] This tendency to use relationship-based information to make lending decisions has been shown to lead to a lower rate of default.[17] Even if these institutions were to be provided relief from interagency appraisal regulations for residential transactions, an evaluation consistent with current guidance would still be required, ensuring that property is valued properly. As per surveys administered by the Federal Reserve to community banks that maintained satisfactory

[15] See pp. 32 of the FFIEC EGRPRA Joint Report to Congress (2017). Per the EGRPRA Report, several commenters asserted that there is a shortage of appraisers in rural areas, and that because of this shortage, appraisers are significantly backlogged and appraisals take much longer to complete.
[16] *See* here. Per research conducted by Yeager and Hall (2002), "Community bankers typically know their customers better than bankers at larger organizations, and perhaps this knowledge of local people and local businesses offsets the exposure to local economic downturns. As a consequence, community banks seem to hang tight through the choppy waters of local economic downturns."
[17] *See* here. Loan-default rates are significantly higher when borrowers are located outside the geographic market of their lenders, even after accounting for the physical distance between bank and small business. Additionally, loans originated by rural community banks and/or loans borrower by rural businesses default substantially less often than loans made by urban banks and/or in urban areas.

CAMELS levels throughout the crisis, smaller banks tend to "lend aggressively in markets where they have expertise and relationships, but generally resists opportunities in other business or markets where they lack detailed knowledge."[18] Thus, state regulators assert that providing this relief to community banks, because of their knowledge of and stake in local economic conditions, would come at no cost to safety and soundness, and would align the interests of the bank and the borrower.

II. Threshold Increase for Commercial Real Estate Transactions

In the NPRM, the Agencies propose a threshold increase for commercial real estate transactions from $250,000 to $400,000. Additionally, the Agencies propose a definition for "commercial real estate" that would capture the following categories of loans: loans for construction, land development and other land loans; loans secured by farmland; loans secured by residential properties with five or more units; and loans secured by nonfarm, nonresidential properties.

The $400,000 Threshold

If the current $250,000 threshold were to be adjusted per the Federal Reserve CRE Index, it would equal approximately $830,000 as of December 2016.[19] Thus, state supervisors agree that, based on inflation and current coverage of the $250,000 threshold, a threshold increase for loans secured by commercial real estate is warranted. However, based on the analysis provided by the Agencies, it appears as if the $400,000 proposed threshold raise will have minimal impact. The Agencies' proposed threshold increase would only result in an additional 11% of commercial real estate transactions being exempt from appraisal regulations. Additionally, the total dollar volume of loans exempted from the threshold would only increase by .8%. Although this low increase in exempted transactions is indicative of minimal risk, state regulators recommend that the Agencies conduct analyses of higher figures to determine if the $400,000 threshold is appropriate, especially considering current transaction values.

The Agencies used several data points in their analyses, including a comparison of the value of commercial real estate properties valued at $250,000 and adjusted for inflation by the following years: 2016, 2010, 2007 and 2003. The Agencies utilize the data point at the lowest point in the cycle – $430,000 – to set the $400,000 threshold, as it considers market volatility. Although state regulators understand this rationale, this analysis seems limited. As a recommendation, the Agencies should consider the risk presented by higher threshold values. For instance, state regulators recommend that the Agencies analyze the rate of loss associated with transactions above $400,000 relative to other threshold values. Based on the relatively low estimated burden reduction figures put forth in the proposal, state regulators recommend that the Agencies evaluate higher thresholds.

Clarifying the Use of the Business-Loan Threshold for Loans Secured by Farmland

As it currently stands, most nonresidential real estate transactions secured by farmland are considered qualifying business loans, and are held to the $1,000,000 threshold.[20] For a transaction secured by farmland to be considered a qualifying business loan, the primary source of repayment cannot be

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[18] *See* here. Weathering the Storm: A Case Study of Healthy Fifth District State Member Banks over the Recent Downturn.

[19] *See* here, pp. 20 of the Proposed Rulemaking; *see* FRB CRE Index here.

[20] *See* here. The Agencies did not include transactions secured by farmland in their analysis, because they comprise a very small percent of overall CRE transactions.

derived from the sale or lease of the land. However, there is a portion of transactions secured by farmland that will be captured by the proposed $400,000 threshold. Considering that this proposal adds a third type of threshold to interagency regulations, the Agencies should provide guidance as to which loans secured by farmland are subject to the business-loan threshold.

The Farm Credit Association (FCA), noting the confusion caused by the business-loan threshold exemption, released guidance clarifying when transactions secured by farmland are to be subject to the $1,000,000 threshold. As it stands, the exemption allows institutions to utilize the business loan appraisal threshold if the following conditions are met: the business loan cannot be dependent on income derived from the sale or cash rental of real estate as the primary source of repayment, and must have a transaction value of $1,000,000 million or less. The FCA clarified this exemption further, adding that even if income derived from lease of the land is included as a part of the repayment plan, the borrower is subject to operational losses associated with agriculture and, therefore, is not considered a passive investor. Thus, the business loan still applies.

This clarifying guidance was provided by the FCA to reduce regulatory burden, and state regulators recommend that the Agencies release guidance as to when a transaction secured by farmland is subject to either the newly proposed threshold for commercial real estate, or the threshold for business loans.[21] State regulators continue to observe shortages of appraisers in regions with agricultural lending concentrations, and in combination with tightening farm credit availability, guidance is needed as to when differing thresholds apply.[22]

Conclusion

State regulators appreciate the opportunity to comment on the Agencies' Notice of Proposed Rulemaking regarding appraisals for transactions secured by commercial real estate. Financial markets have changed substantially since the thresholds were last raised in 1994, and state regulators continue to observe the burden presented by inflexible appraisal standards. State regulators are committed to working with the Agencies to address the appraiser shortage in areas across the country, and urge the Agencies to not just provide immediate relief, but to raise the transaction thresholds for residential real estate to reflect inflation. State regulators acknowledge agency efforts in raising the threshold for commercial real estate, but also recommend that higher values be considered. State regulators look forward to collaboration with the Agencies as they address appraisal-related burden, and are eager to offer their on-the-ground perspective on the matter at hand.

Sincerely,

John W. Ryan
President and CEO, CSBS

[21] *See* here, Informational Memorandum Collateral Evaluation Requirements and Frequently Asked Questions
[22] *See* here. According to the Kansas City Federal Reserve Bank, farm lending activity at commercial banks slowed significantly in Q42016, and outlook for farm income has generally remained weak and farmland values have continued to decline.