Guardrails for Appraisal Modernization

The private mortgage insurance (MI) industry recognizes there are opportunities to modernize appraisal processes and improve the quality of residential property valuation practices. However, it is critical there be appropriate transparency, monitoring, and governance. If done properly, collateral valuation and risk assessment can benefit from the significant advancements in technology, data aggregation, and analytics. Accurate valuations are of utmost importance for buyers and sellers, and have a material impact on risk within the housing finance system as the underlying valuations affect loan-to-value (LTV) ratios and the appropriateness of pricing and risk assessments. As the government-sponsored enterprises (GSEs) seek to modernize their valuation policies and technologies, it is critical there be a balance between innovation and the need for transparent standards and appropriate protections from undue risk in the housing finance system. USMI strongly believes the Federal Housing Finance Agency (FHFA) should implement rules to ensure that innovations are done when there is demonstrable benefit to the broader housing finance system, including greater transparency, efficiency, accuracy of property valuations, and lower costs for borrowers and market participants.

USMI urges FHFA to implement measures to better tailor the use of appraisal alternatives that support the following principles:

1. Employ a risk-based framework to determine the appropriateness of alternatives to full appraisals, such as appraisal waivers and desktop appraisals, which include transparent compensating factors.
2. To the greatest extent possible, FHFA should promote policies that prioritize an inspection of properties collateralizing mortgage loans for the purposes of value estimation and property eligibility.
3. Greater transparency and sharing of data around the GSEs' automated valuation models (AVMs) and how they leverage data in collateral valuation and underwriting.

Our additional observations and recommendations for elements of appraisal modernization and alternatives are listed below.

Appraisal Waivers

- FHFA should require that a property receiving an appraisal waiver have a prior full appraisal on file that was completed within the past five years for transactions with LTV ratios above 70%. The appraisal on file must not predate a natural disaster event in the geographic area where the property is located.
- There should be prudent LTV maximums for appraisal waiver decisioning to protect against the mispricing of mortgage credit risk and increased risk to the American taxpayer. Specifically, appraisal waivers should be limited to mortgage transactions that meet certain eligibility criteria and with the following LTV maximums:
    - 90% for rate/term refinance of a one-unit primary residence or second home
    - 80% for purchase of a one-unit primary residence or second home
    - 70% for all other transactions
- Implement a risk-based framework to determine the appropriateness of appraisal waivers on a loan-by-loan basis and prevent inappropriate competition between the GSEs, especially as it relates to the 80% LTV threshold that triggers MI requirements and LTV eligibility/pricing thresholds (e.g., 85% or 90%). The framework should include a transparent and uniform set of compensating factors to be considered during

the waiver decisioning process and specific risk factors that trigger an upgrade to a desktop review or full appraisal during the underwriting process. Please see Appendix A for possible considerations for appraisal alternative decisioning.

- FHFA should implement policies to address the potential for "gaming" to test and shop appraisal waiver programs to reduce LTVs and/or reduce or eliminate MI coverage requirements. "Automated underwriting system (AUS) switching" has the potential to incorrectly value collateral and negatively affect long-term credit risk management.
- FHFA and GSE policies should promote standardization, accountability, and oversight of AVMs and automated valuation providers. There should be greater transparency for market participants regarding which AVM is used and the rigor of the AVM approval process.

Desktop Appraisals

- Rather than relying on the extensive use of appraisal waivers during underwriting, FHFA should promote policies and processes that utilize desktop appraisals and retain an inspection of properties collateralizing mortgage loans for the purpose of the value estimation and property eligibility.
- FHFA should implement explicit requirements for the GSEs and lenders to develop effective processes for ensuring that appraisers being considered for desktop appraisal assignments are sufficiently proximate and experienced in the local market in which a property is located to credibly assert local market knowledge.

Appraisal Flexibilities

- The vast majority of COVID-19 appraisal flexibilities should remain part of the GSEs' appraisal modernization efforts and are beneficial in disaster situations to lessen market impacts. However, the one flexibility that should be reexamined is the use of unvalidated property information. The use of unvalidated/uncorroborated property information by a borrower or seller poses a risk to the reliability of such information when used by an AVM, exterior-only appraisal, or desktop appraisal in collateral valuation. Property condition, quality, and features are prominent components of property value and should be obtained from sources who are reasonably considered to be objective and impartial rather than from parties with a vested interest in the transaction.
- As FHFA and the GSEs contemplate the expanded use of appraisal flexibilities and technology, it is important that there be a true balance between accurate property valuation and transactional efficiency. FHFA should establish a transparent piloting mechanism for appraisal flexibilities before broad application, and stakeholders should have the opportunity to provide comments and analyze data to help FHFA determine whether adjustments are warranted.

Data Democratization

- FHFA should initiate a process to make collateral valuation data available to the market participants that contribute to the analysis and are part of the underwriting process, including appraisers and appraisal management companies, lenders, private mortgage insurers, title insurance companies, investors, and data analytics providers. This includes a better understanding of how the GSEs leverage data in their valuation decisioning processes. Greater insight into the GSEs' collateral valuation technologies and processes will assist market participants' analyses of individual mortgage transactions.

- FHFA should implement policies that require the GSEs to share more information about their AVMs, including the tolerances that are incorporated and statistical thresholds for the underlying methodologies, as well as establish limits on standard deviation. Data democratization will greatly enhance transparency within the housing finance system and improve risk management practices and strategies across the market.
- The GSEs should be required to issue periodic reports on the use of appraisal waivers, desktop appraisals, AVMs, and trends related to undervaluation and overvaluation.

Discrimination and Fair Lending Consideration in Collateral Valuation Processes

- USMI fully supports collaboration between FHFA, the GSEs, market participants, and consumer advocates to further study discrimination and fair housing concerns related to policies governing appraisals and valuations.
- USMI recommends the GSEs and other government entities share appraisal data, particularly where collateral is either overvalued or undervalued by appraisers and AVMs.
- USMI supports industry and other stakeholder efforts to develop a more diverse appraiser workforce.

APPENDIX A: Possible Considerations for Appraisal Alternative Decisioning

	Appraisal Waiver	Desktop Appraisal
Transaction Characteristics		
Maximum LTV	90% LTV: Rate-term refi transaction for principal residence or second home. 80%: Purchase transaction for principal residence or second home. 70%: All other transactions (including cash out refi).	90% and limited to purchase transactions for principal residences.
Positive Home Price Appreciation (HPA)	Yes	Yes
Negative HPA (defined as one quarter of negative Metropolitan Statistical Area (MSA) HPA according to FHFA House Price Index (HPI))	No	No
Property flipping (flip to sell typically considered within 6 months)	No	No
Non-arm's length Transaction	No	No
Physical Assessment of Property Condition		
Last appraisal	<5 years ago	<5 years ago or recent comparable appraised and available.
Inspection required - legally	No	No
General Condition		
Condition	Permitted for C1-C3	Permitted for C1-C3
Purchase of REO property	No	No
Effective Age	1979 or newer	1979 or newer
Unique Property Characteristics		
Rural / Acreage	<5 acres	<10 acres
Unique property	Not allowed	Not allowed
Zoning changes (i.e., property conversion or mixed use)	Not allowed	Not allowed
Construction-Related Factors		
New Construction	No	No
Rehabilitation	No	No
Manufactured housing	No	No
Climate-Related Factors		
Recent natural disaster	No	No
Located in flood zone (as determined by the Federal Management Agency (FEMA) Flood Map)	No	No