

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 200

[Docket No. FR-4744-A-01]

RIN 2502-AH81

FHA Appraiser Watch Initiative; Advance Notice of Proposed Rulemaking

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Administration, HUD.

ACTION: Advance Notice of proposed rulemaking.

SUMMARY: This document requests comments on issues related to the implementation of the Federal Housing Administration (FHA) Appraiser Watch Initiative. Through the Appraiser Watch Initiative, HUD plans to establish and monitor a performance standard that appraisers must meet to maintain their status on the FHA Appraiser Roster (Roster). HUD is considering an approach modeled on FHA's Credit Watch Termination Initiative that would provide for an electronic, fully computerized Appraiser Watch monitoring system, and would permit an appraiser to be removed from the Roster if the rate of defaults and claims on closed mortgages linked to the appraiser exceeds a rate established by HUD.

DATES: Comment Due Date: September 23, 2002.

ADDRESSES: Interested persons are invited to submit comments regarding this advance notice of proposed rulemaking to the Regulations Division, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-0500. Communications should refer to the above docket number and title. Facsimile (FAX) comments are not acceptable. A copy of each communication submitted will be available for public inspection and copying between 7:30 a.m. and 5:30 p.m. weekdays at the above address.

FOR FURTHER INFORMATION CONTACT: Vance Morris, Director, Office of Single Family Program Development, Room 9266, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-8000; telephone (202) 708-2121 (this is not a toll-free number). Persons with hearing or speech impairments may access this number via TTY by calling the toll-free Federal Information Relay Service at 1-800-877-8339.

SUPPLEMENTARY INFORMATION:

A. Critical Role of Appraisers in FHA-Insured Home Loans

An appraisal is required for every property purchased with an FHA-insured mortgage. The purpose of an FHA appraisal is to determine the property's eligibility for mortgage insurance on the basis of its condition and location, and to estimate the value of the property for mortgage insurance purposes. As stated in a recent Congressional report, "With the high loan-to-value ratio of most FHA loans, an accurate appraisal is critical to minimizing HUD's insurance risk." (Minority Staff of the Permanent Subcommittee on Investigations of the Senate Comm. on Governmental Affairs, 107th Cong., 1st Sess., Property "Flipping": HUD's Failure to Curb Mortgage Fraud 56 (Committee Print 2001)). In recognition of the importance of an accurate appraisal, section 202(e)(1) of the National Housing Act requires FHA appraisals to be performed by "individuals who have demonstrated competence and whose professional conduct is subject to effective supervision." The purpose of this notice is to request comments on establishing a system that will enable FHA to remove poorly performing appraisers from the Roster on the basis of high default and claim rates on loans secured by the properties appraised by such appraisers. As discussed in greater detail in section E, of this notice, HUD is specifically requesting comments on a broad range of issues being considered before a proposed rule is issued. This oversight of appraisal performance will help address the concerns that have been raised about this critical segment of the FHA single family mortgage insurance programs.

B. The FHA Credit Watch Termination Initiative As a Model Approach for Appraisers

The Appraiser Watch Initiative would implement one of several new initiatives to protect FHA. Specifically, HUD proposes to establish an "Appraiser Watch" system, similar to the successful Credit Watch system for FHA lenders. The benefit of following an established system is that it provides for the application of a clear, familiar and consistent approach to these closely related segments of the FHA insurance process. Such an approach would prompt these segments to work more closely and cooperatively to fulfill responsibilities held in common, attain common goals, and avoid common pitfalls.

Approval of a mortgagee by HUD/FHA to participate in FHA mortgage insurance programs includes an Origination Approval Agreement (the Agreement) between HUD and the mortgagee. Under the Agreement, the mortgagee is authorized to originate single family mortgage loans and submit them to FHA for insurance endorsement. Some mortgagees, however, have demonstrated high default and claim rates on their FHA-insured portfolios that, although not signifying violations of FHA requirements, are nonetheless unacceptable. As a result, HUD developed the Credit Watch Termination Initiative to identify mortgagees with unsatisfactory performance levels and take ameliorative action at an early stage.

Under the FHA Credit Watch Termination Initiative, FHA systematically reviews mortgagees' early default and claim rates, that is, defaults and claims on mortgagees' loans during the initial 24 months following endorsement. In cases of severe performance deficiencies, HUD may terminate mortgagees' loan origination approval authority. The Termination of a mortgagee's Agreement is separate and apart from any action under 24 CFR part 25 taken by HUD's Mortgagee Review Board against mortgagees for violations of FHA requirements.

C. HUD's FHA Appraiser Roster

HUD has taken various steps to ensure the integrity of FHA appraisals. On June 1, 1998, HUD launched reforms of the FHA appraisal process through its Homebuyer Protection Plan. The purpose of these reforms is to ensure that a lender and FHA receive accurate and complete appraisals of homes. In keeping with these reforms, HUD has established regulatory placement and removal procedures for the Roster. These procedures are codified in subpart G of HUD's regulations at 24 CFR part 200.

HUD's Appraiser Roster lists those appraisers who are eligible to perform FHA single family appraisals. HUD established the Roster to provide a means by which HUD can monitor the quality of appraisers who perform appraisals on single family homes with FHA single family mortgage insurance and to ensure that appraisers performing appraisals meet high competency standards. The Roster is an important part of the FHA Single Family Mortgage Insurance program because accurate, competent and professional appraisals are vital to the success of the program and HUD's ability to protect the FHA Insurance Fund.

D. Appraiser Watch Initiative

HUD is soliciting comments on using a performance-based Appraiser Watch Initiative similar to the successful Credit Watch system described above for FHA lenders. The Appraiser Watch system would rate appraisers on the performance of loans secured by properties they appraised. Appraisers who are associated with excessive default and claim rates are subject to notification of proposed removal from the Roster within 60 days. Just as a consistently higher level of poor underwriting is reasonably expected to be linked to a consistently higher level of defaults, a consistently higher level of poor appraisals may be associated with a consistently higher level of defaults, regardless of the quality of the underwriting. This is because the appraisal is a key component of the underwriting process, and when this key component is inadequate, the rest of the process is adversely affected from the onset, increasing the probability of default and claims. While poor underwriting practices also increase the probability of defaults and claims, it is reasonable to conclude that at some point, a high enough rate of defaults and claims on loans secured by properties appraised by an appraiser is indicative of inadequate performance.

Under a rule similar to Credit Watch, an appraiser may be subject to removal from the Roster if the rate of defaults and claims on closed mortgages secured by properties with appraisals performed by the appraiser exceeds the normal rate in the area of a HUD field office by a specified amount, and exceeds the national default and claim rate for closed mortgages. In the case of Credit Watch, lenders are subject to removal if the rate exceeds 200 percent of the normal rate in the field office area. Such an objective, performance-based standard allows for the most efficient use of HUD's limited resources to conduct across-the-board monitoring of appraisers.

Upon receiving notification of proposed removal under Appraiser Watch, an appraiser may request an informal conference to present HUD with relevant reasons and factors, including factors beyond the appraiser's control, that may have contributed to the excessive default and claim rates. HUD may withdraw the removal notice based upon the informal conference.

Consistent with the goals of the Administration regarding the increased use of technology in government, the Appraiser Watch system being considered would allow for electronic monitoring. HUD's electronic Neighborhood Watch system, available via the FHA Connection, would be used for this purpose. Specifically, HUD would, on an ongoing basis, review the FHA mortgage default and claim rate on loans secured by properties appraised by an appraiser in the geographic region served by a HUD field office and according to the type of appraisal conducted (i.e., single family, or 2- to 4-unit, or rehabilitation). An appraiser's performance would be determined relative to the performance of other appraisers in the same geographic area conducting the same type of appraisal over the same period of time. HUD would make this information available to appraisers and the public on an ongoing basis through the Neighborhood Watch system.

To keep the public informed of the status of appraisers, HUD believes it is appropriate for any system that is adopted to provide for publication of the names of appraisers removed from the Roster pursuant to Appraisal Watch. Further, to prevent delays and disruptions in any transactions already in progress, HUD believes the appraiser should be permitted to complete any appraisal already contracted for, but not be permitted to take on any additional appraisals as of the date of removal from the Roster. Appraisers should also be permitted to apply for reinstatement. Appraiser watch is proposed to be a procedure separate and apart from the Appraiser Roster Placement and Removal procedures contained in 24 CFR part 200 subpart G. Any rule promulgated as a result of this ANPR would clearly provide that Appraiser Watch removal is in addition to and independent from any other remedies and actions available to HUD under applicable law.

E. Additional Considerations and Request for Comments

HUD seeks to establish a clear, consistent and familiar standard and procedure for an appraiser to maintain status on, or be removed from, the Roster. Because it is HUD's goal to promulgate a rule that will promote, in a fair, reasonable, and efficient manner, the highest standard of conduct and

professionalism among FHA Appraisers, thereby minimizing the risk of loss to the FHA, HUD is requesting public comment on all aspects of promoting and maintaining the excellence and integrity of appraisers listed on the Roster. In particular, HUD requests comments on the following issues:

1. Whether HUD should establish a minimum number of appraisals as a threshold for any action, and if so, what number would be appropriate.

2. Whether HUD should specify the age of loans secured by appraised properties that would be considered under a standard, and what loan age would be appropriate (e.g., appraisals for loans not more than one, two or three years old, measured from the time of origination).

3. Whether a higher or lower rate than the 200 percent used in Credit Watch would provide an adequate measure of appraiser performance and level of protection for FHA.

4. What period of time over which appraisals are conducted should be used for evaluation purposes (e.g., performance over 12 months, or 18 months, or 24 months)?

5. What factors in addition to the rate of loan defaults and FHA insurance claims should HUD consider in evaluating appraiser performance?

6. Should the severity of loss be considered as a factor in evaluating an appraiser's performance?

7. If included as a factor, how should severity of loss be considered in evaluating performance?

8. What kinds of factors should be considered as mitigating for an appraiser with higher than normal default and claim rates (e.g., factors beyond the appraiser's control)?

9. How much time should be provided for an appraiser to request an informal conference after receiving notification of proposed removal (e.g., 15, 30, or 45 days)?

10. What is an appropriate period of removal from the roster before a reinstatement is permitted?

11. What are appropriate procedures and factors to consider for reinstatement?

Dated: July 17, 2002.

Sean Cassidy,

*General Deputy Assistant Secretary for
Housing-Federal Housing Commissioner.*

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