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FDIC, Federal Reserve and OCC propose to raise “de minimus” - by Shaun Fitzgerald

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Shaun Fitzgerald
Fitzgerald Appraisals

The FDIC, the Federal Reserve and the OCC propose to raise the “de minimus” threshold from \$250,000 to \$400,000. This proposal says that there will be no need for an appraisal if the real estate to be mortgaged has a value under \$400,000. Instead, “evaluations” could be performed. So, what is an “evaluation?” It is something less than an appraisal and it can be prepared by someone without an appraisal license. Most importantly, an evaluation need not comply with the Uniform Standards of Professional Practice (USPAP).

Supposedly, the perspective is that prices have risen so significantly that the de minimus needs to be adjusted. Perhaps. So what is the risk to a lending institution if the mortgage that goes under water is smaller or larger? Let’s consider what mortgages have gone bad in the last three financial crises? The early 1970s gave us the scandal in the Brooklyn neighborhood of Bushwick; the perpetrators fraudulently collected on FHA mortgage insurance in working class neighborhoods. In the 1982 “savings & loan scandal,” it was again mostly the smaller borrowers that had to be bailed out when developers went bust. In the 1987-1992 aftermath of what started in 1982, the I-30 condo case “resulted from soured loans that had been secured through an elaborate array of artificially inflated property values, false financial documents, bribes and kickbacks.” And, of course we are all aware of the most recent 2008 financial crisis which nearly brought down our entire financial system.

None of today’s readers were alive when the Great Depression was preceded by overconfidence in the supposed inevitability of rising prices for real estate, stocks, bonds and everything financial.

Many of these crises were anticipated by or quickly responded to by the appraisal profession. The Massachusetts Board of Real Estate Appraisers (MBREA) was created in 1923 to assure the public trust in real property valuations. The predecessors of the Appraisal Institute were created shortly afterward – both before the start of the depression. The development of USPAP occurred in 1986 just before the worst of the 1987 meltdown; appraisal licensing was instituted in 1992 just afterwards. Congress was instrumental in creating the Appraisal Foundation to assure that standards for appraisers and appraisals were clear, thereby making professional appraisers accountable.

Unfortunately, the progresses of these protective efforts were in conflict with the desire by some to make obscene profits on fraudulently obtained mortgage borrowings. Rules and regulations that banks had to adhere to were circumvented; “mortgage companies” are not considered “lenders,” so many, many mortgages were not impacted by the rules intended to protect the borrowers and the financial system. Some consider the Gramm-Leach-Bliley Act repeal of the 1933 Glass-Steagall Act to have contributed to the 2008 crash because it resulted in banks becoming “too big to fail.”

After the 2008 financial crisis, various governmental efforts attempted to “fix” the appraisal profession. The Home Valuation Code of Conduct (HVCC) attempted to make sure that appraisers were equitably compensated. Instead, it served to commoditize the appraisal; the perspective became that all appraisals are the same and all should be provided at one price. Next came elements of the Dodd-Frank bill that attempted to strengthen the firewall between mortgage originators and mortgage underwriters; this resulted in the formation of Appraisal Management Companies (AMCs). AMCs are middlemen that relieve the mortgage provider of responsibility for hiring a competent appraiser. Some do an excellent job of creating that firewall; others are nothing but paper-pushers who reduce appraiser compensation and behave much like the “Alt-A lenders” that were so much a part of the 2008 meltdown.

Add to all of this the advent of Automated Valuation Models (AVMs). The legitimate versions of these AVMs are computerized systems that provide a reasonably reliable range of values for a given property. But, they do not actually inspect the property and rely on generally available public records data—some of which is as much as ten years old. Then we have Zillow. Zillow has never charged or collected a single dime to anyone for providing their “Zestimates.” Is a service like this reliable if no attempt is made to profit from it? No! Zillow makes all of its profit from advertising.

So, back to the de minimus issue. Despite media reports of “significant price appreciation” and “offers above asking price,” the sales prices of much of the real estate in Massachusetts has yet to reach the levels they were at in 2006-2008. If the de minimus was appropriate back then, shouldn’t it be appropriate today? Moreover, it is being reported in financial publications that 40 million Americans are in danger of defaulting on their auto loans. Lots of people are in significant debt. Regardless of which debt obligation they default on, the entire financial system feels the effect. There is a reliable system in effect to minimize mortgage loan default by minimizing the number of people who get involved in a debt that they cannot possibly repay. In my mind, \$400,000 is still a lot of money, and the banking system still needs some protection against unnecessary default.

Shaun Fitzgerald is the owner of Fitzgerald Appraisals, Easton Mass

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540