

December 3, 2018

Mr. Gerald Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

RE: Proposed Rule Part 722, Real Estate Appraisals

Dear Mr. Poliquin:

The undersigned organizations of professional real property appraisers are responding to the National Credit Union Administration's ("NCUA") request for comment on the Proposed Rule ("proposal") on Real Estate Appraisals. It proposes to quadruple the appraisal threshold for non-residential real estate loans and adopting the rural appraisal exemption found in The Economic Growth, Regulatory Relief, and Consumer Protection Act, among other things.

Non-residential transactions

We are **strongly opposed** to the proposed *quadrupling* of the appraisal threshold level from \$250,000 to \$1,000,000 for non-residential real estate transactions. The proposal marks the first time in history that the NCUA has stepped in front of appraisal regulatory positions established by the federal bank regulatory agencies (the Agencies). Previously, the NCUA maintained generally consistent requirements with those of the federal bank regulatory agencies, with the one exception being qualified business loans (which were subject to a \$250,000 threshold level by the NCUA). However, as you know, significant business lending by credit unions is a relatively new phenomenon and with it, so too are credit union experiences with collateral risk management.

At a macro level, we are deeply concerned the NCUA proposal, if finalized at \$1 million for commercial real estate transactions, will result in a regulatory "arms race" between the Agencies and the NCUA. This would result in the NCUA – the agency with the least direct experience in overseeing business and commercial real estate lending - effectively driving the appraisal policies for the entire financial regulatory system. Further, the NCUA should be aware that other agency loan programs such as the U.S. Small Business Administration 7(a) and 504 loan programs may have updated threshold levels pegged to those established by the Agencies. In our discussions with Congressional staff reviewing pending legislation that would peg the SBA commercial real estate threshold levels to the one established by the Agencies, some believe the threshold level matter should be left to those involved with bank examination on a day-to-day basis. However, should the Agencies move to a second round of commercial real estate threshold level increases in response to a NCUA rule, something far from safety and soundness would be at play. In this sense, this proposal will likely impact not just credit unions and banks, but SBA lenders and risks associated with SBA loans.

These dynamics beg for the NCUA to maintain requirements consistent with the federal bank regulatory agencies. We strongly urge the NCUA to issue a final rule establishing a commercial real estate threshold at \$500,000 and business loans at \$1 million, as the Agencies concluded following their three-year EGRPRA review.

Residential real estate transactions

Consistent with this, we support the NCUA's proposal to maintain the \$250,000 threshold level for residential real estate transactions. The EGRPRA report and analysis correctly concluded that imprudent residential mortgage lending can pose significant risks to financial institutions. Further, as the proposed rule notes, other government agencies and government sponsored enterprises maintain appraisal

requirements to protect against risks associated with real estate lending. Further, we also agree with the proposed rule and the final rule from the Agencies that appraisals can provide added protections to consumers. As the proposed rule notes, these positions were also shared by the staff of the BCFP.

We note that the Agencies just released a proposal for comment to increase the residential threshold level from \$250,000 to \$400,000. However, this, of course, is inconsistent with the EGRPRA report findings and conclusions and faulty in many of its assumptions, including those cited above. We strongly urge the NCUA to maintain the residential real estate transaction threshold level at \$250,000, keeping in mind the final findings of the EGRPRA report.

NCUA analysis

The NCUA does not believe increasing the appraisal threshold for non-residential real estate transactions represents a threat to safety and soundness. The proposed rule explains some of the rationale for this decision, including:

- That credit unions are restricted to holding no more than 1.75 their net worth;
- That commercial loans represent only 5.7 percent of total assets of credit unions granting commercial loans, whereas, banking industry commercial loans represent 25 percent of total assets and 267 percent of tier one capital;
- That while the percentage of transactions exempted from the appraisal requirement would increase from 27 percent to 66 percent, the total dollar volume of loans for commercial properties would only increase from 1.8 percent to 13 percent, covering nearly 90 percent of total dollar volume of such transactions.
- A larger percentage of loans may be subject to an appraisal requirement than when the last threshold level change was made in 2002; and
- That many variables beyond appraisal requirements, including market conditions and various loan underwriting and credit administration practices, affect an institution's loan experience.

We firmly disagree with these assumptions.

1. The proposed rule is written purely through the lens of regulatory relief – not safety and soundness. It ignores the fact that the United States suffered through a financial crisis less than a decade ago. Between 2008-2012, the Federal Deposit Insurance Corporation closed nearly 500 banks, many of which the result of faulty or failed commercial lending. This includes bad business lending, as the financial crisis was not limited to residential lending failures, but instead, also included large segments of failed commercial real estate and business loans. Countless other banks were subject to purchase and assumption agreements, with devastated balance sheets being acquired by larger banks.
2. A large majority of bank failures involved poor or failed appraisal and collateral risk management policies that were a material cause of default of many banks. A review of material loss reports of failed banks conducted by Appraisal Institute staff revealed that a supermajority reported appraisal mismanagement as the cause of failure. It is contrary to the proposed rule, which overlooks or plays down the importance of sound appraisal management by financial institutions.
3. The proposal minimizes the potential impacts of the dramatic increases in transactions, assuming credit unions will not change behavior under new threshold levels. Generally, the figures used to justify the proposed increase illustrate that business lending may be concentrated within larger credit unions, which would help explain why the transaction percentage is higher than the total dollar volume. However, this assumes that less experienced small to mid-sized credit unions would not get more aggressive in business lending.
4. Though pricing in commercial real estate has increased, so have investment risks in commercial real estate. The U.S. is near the end of a long-term economic cycle, with many large institutional investors shying away from further investment in commercial real estate. **If anything, the current market conditions beg for *heightened due diligence* by regulated institutions today -- not a loosening of a fundamental risk management activity.** This is particularly true for credit unions, which our members report are less likely to have robust collateral risk management

policies, practices and procedures. While most large banks with established commercial lending operations have internal appraisal departments that are staffed by qualified appraisers and appraisal reviewers, our members report that credit unions pay far less attention to risk management and collateral valuation.

5. Those closest to this issue and assisting risk management activities within regulated financial institutions (what the NCUA calls “staff appraisers” in the proposed rule) do not support increasing the appraisal threshold levels. A recent survey indicated that an overwhelming majority believe that the appraisal threshold levels should have remained at \$250,000. Specifically, 76.6 percent of chief appraisers/appraisal managers strongly or somewhat disagrees with raising the \$250,000 threshold level; 87.5 percent of chief appraisers/appraisal managers strongly or somewhat disagrees with raising the \$1,000,000 owner-occupied commercial real estate threshold level. Further, an overwhelming majority (89.1 percent) of chief appraisers/appraisal managers strongly or somewhat agrees that raising threshold levels could increase risk to lenders.

The final rule should not limit itself to rosy and filtered economic analysis, but instead look more closely at risks associated with commercial real estate and business lending, including the experiences of failed banks during the financial crisis.

Existing Extensions of Credit

The propose rule replaces long-standing nomenclature around existing extensions of credit (refinancings, renewals, etc.), which we believe may create widespread confusion and inconsistency between financial institutions. Currently, the NCUA and the Agencies subscribe to exempting existing extensions of credit provided there was “(i) no advancement of new monies, other than funds necessary to cover reasonable closing costs; or (ii) there has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the credit union’s real estate collateral protection after the transaction, even with the advancement of new monies.” The NCUA proposed rule would provide, instead, that an existing extension of credit would not require an appraisal or written estimate of market value if the transaction is not considered a new loan under Generally Accepted Accounting Principles (GAAP).

While we agree there is a level of subjectivity to the current standard and a substantial need for guidance, a change like this should be undertaken by an Interagency work group – not the NCUA alone. We strongly urge this be struck from the final rule and for the NCUA to engage the Agencies in discussions about providing additional guidance to the existing framework or an entirely new protocol such as the proposed GAAP solution.

Rural Appraisal Exemption

The proposed rule includes some implementing language relating to the rural appraisal exemption included in S. 2155 enacted by Congress earlier this year. The proposed rule notes the provision is self-implementing, meaning it can be taken immediately by credit unions.

Left out of the proposed rule are important elements to sound implementation of this exemption (or allowance). This includes whether an evaluation (written estimate) is required for all rural exemptions and whether other consumer lending regulations still apply, such as the Equal Credit Opportunity Act requirement for any and all appraisal or valuations shall be disclosed to the borrower at least three days prior to closing. We encourage the NCUA to include an evaluation requirement in the final rule and affirm the applicability of consumer lending requirements when the rural exemption is taken by a credit union.

Other Provisions

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- We are generally supportive of the incorporation of independence requirements in the credit union regulations. This will be more important as evaluations play a larger role in credit union lending.
- We urge the NCUA to clarify that appraisers can provide evaluations (written estimates). The current proposal implies that evaluations can only be performed by non-appraisers, when appraisers may be the preferred source for such streamlined or limited services.
- We urge the NCUA to not include a de minimis amount for written estimates. Like the proposed GAAP solution, the NCUA should engage the Agencies in an Interagency work group to address issues like this.

Thank you for the opportunity to comment on the NCUA's proposed rule on real estate appraisals. Should you have any questions or need additional information, please contact Bill Garber, Director of Government and External Relations, Appraisal Institute, at 202-298-5586 or bgarber@appraisalinstitute.org, or Brian Rodgers, Manager of Federal Affairs, Appraisal Institute, at 202-298-5597 or brodgers@appraisalinstitute.org.

Sincerely,

Appraisal Institute
Appraisers' Coalition of Washington
Coalition of Appraisers of Nevada
Coalition of Pennsylvania Real Estate Appraisers
Collateral Risk Network
Illinois Coalition of Appraisal Professionals
Louisiana Real Estate Appraisers Coalition
Mississippi Coalition of Appraisers
National Association of Appraisers
New York Coalition of Appraiser Professionals
North Dakota Appraisers Association
Professional Appraisers Association of South Dakota
Real Estate Appraisers Association
Real Estate Appraisers of Southern Arizona
Rhode Island Real Estate Appraiser Association
South Carolina Professional Appraisers Coalition
Tennessee Appraiser Coalition
Utah Coalition of Appraisal Professionals