

administrative sanctions against a lender who submits such a false certification in connection with any FHA insured mortgage transaction. The responsibilities of a lender in ensuring the quality of FHA appraisals are also emphasized in the guidance issued by HUD through Mortgagee Letters. For example, Mortgagee Letter 94–54, issued on November 7, 1994, provides that “mortgagees that select their own appraisers must accept responsibility, equally with the appraisers, for the integrity, accuracy, and thoroughness of the appraisals, and will be held accountable by HUD” (this guidance was reiterated by FHA Mortgagee Letter 97–45, issued on November 25, 1997). Further, Mortgagee Letter 97–22, issued on May 20, 1997, reminds lenders “that if the appraiser they selected provides a poor or even fraudulent appraisal which leads the Department to insure a mortgage at an inflated amount, the lender is held equally responsible with the appraiser for the violation.” Copies of these Mortgagee Letters may be downloaded from HUD’s Client Information and Policy System (HUDCLIPS) internet website at <http://www.hudclips.org>.

II. This Proposed Rule

A. Need for Proposed Rule

FHA has found that most appraisers perform appraisals in accordance with FHA standards. There are some instances, however, in which some lenders tacitly require appraisers to make the appraisal computations match the sales price to ensure that a home sale and mortgage loan closes for the appraiser to obtain additional business. Other instances have occurred, including recent episodes of predatory lending activity in several areas of the country, whereby lenders, realtors, investors, and others have participated in so-called property “flipping” schemes to inflate home prices and perpetuate sales that generate fees and charges to participants in the transaction. There are additional examples of fraudulent activity that could have been prevented if the underwriters had properly reviewed the appraisal reports.

This proposed rule would clarify and strengthen HUD’s regulations concerning the responsibilities of lenders in assuring the quality of FHA appraisals. The proposed rule will ensure accountability of lenders for poor appraisals and thereby protect the FHA Insurance Fund, ensure better compliance with appraisal standards, and help to ensure that homebuyers receive an accurate statement of

appraised value. The proposed changes would apply to both sponsor lenders, who underwrite loans, and loan correspondent lenders, who originate loans on behalf of their sponsors.

There are numerous tools that lenders may use to determine whether an appraisal satisfies FHA requirements. Reviewing appraisal documentation and performing quality assurance reviews are two such methods. New technology is available, such as Automated Valuation Model (AVM), which can be used to determine whether the value derived by an appraiser is within reason. A lender may wish to do business only with appraisers who carry errors and omissions (E&O) insurance. Such coverage may help in reducing possible schemes that result in fraud. There are numerous other steps that lenders can take to ensure that an appraisal package satisfies FHA requirements. The purpose of this proposed rule is not to mandate that lenders must follow a specific course of action to ensure compliance with FHA appraisal requirements. Each lender has the discretion to choose the means by which it will ensure such compliance. The purpose of the proposed rule is to require that a lender act to ensure appraisal quality and to emphasize that the lender will bear responsibility if an appraisal does not satisfy FHA requirements.

B. Proposed Changes to FHA Regulations

The proposed rule would make the following changes to the existing FHA regulations:

1. *Mortgagee Review Board (§ 25.9).* The proposed rule would clarify that a mortgagee is subject to administrative action by HUD’s Mortgagee Review Board for submitting to HUD an appraisal that does not satisfy FHA appraisal requirements in connection with an insured mortgage transaction. Specifically, a new § 25.9(ee) would be added to explicitly include the obtaining and submitting of appraisals that do not satisfy FHA appraisal requirements among the list of actions subject to administrative sanction. As provided in § 25.3, which contains the definitions applicable to Mortgagee Review Board proceedings, the term “mortgagee” includes both underwriting and loan correspondent lenders.

2. *Lender accountability for appraisal (§ 203.5).* The proposed rule also would codify HUD’s policy that lenders must ensure that the appraisals satisfy FHA appraisal requirements and are responsible, equally with appraisers, for the quality of appraisals on properties that secure FHA insured mortgage loans.

The proposed rule would amend § 203.5, which describes the Direct Endorsement process, to specify that a lender must ensure that appraisals satisfy FHA requirements and is responsible for the quality of the appraisals. A Direct Endorsement mortgagee, and any of its loan correspondent lenders, that submit, or cause to be submitted, an appraisal or related documentation that does not satisfy FHA requirements may be sanctioned by the Mortgagee Review Board. The proposed rule would also amend § 203.5 to re-emphasize that a lender must select an appraiser listed on the FHA Appraiser Roster.

III. Issue Highlighted for Public Comment

While HUD invites public comment on all aspects of this proposed rule, it is particularly interested in comments regarding the possible consequences of the rule on the majority of FHA lenders and appraisers who comply with FHA standards. HUD believes that the proposed regulatory changes are necessary to ensure the accountability of lenders for poor appraisals and thereby protect the FHA Insurance Fund, ensure better compliance with appraisal standards, and help to ensure that homebuyers receive an accurate statement of appraised value. However, HUD recognizes that the proposed changes may also have unintended negative consequences on those lenders and appraisers who already comply with applicable FHA regulations and policies. Accordingly, HUD invites interested members of the public to submit their comments on such possible unintended impacts, as well as to offer suggestions on less burdensome methods to accomplish the stated goals of the proposed rule.

IV. Small Business Concerns Related to Mortgagee Review Board Actions Against Lenders

As discussed below in this preamble, HUD has determined that this rule will not have a significant economic impact on a substantial number of small entities. However, the proposed rule may nonetheless result in HUD’s Mortgagee Review Board imposing an administrative sanction on a small lender or appraiser due to a submitted appraisal that is inconsistent with FHA requirements, or taking other appropriate enforcement action against a small lender or appraiser. With respect to such compliance efforts, HUD is cognizant that section 222 of the Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) (referred to as “SBREFA”) requires the