



Federal Register

**Tuesday,
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Part III

Department of Housing and Urban Development

24 CFR Parts 25 and 203

**FHA Single Family Mortgage Insurance;
Lender Accountability for Appraisals;
Final Rule**

**DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT**

24 CFR Parts 25 and 203

[Docket No. FR-4722-F-02]

RIN 2502-AH78

**FHA Single Family Mortgage
Insurance; Lender Accountability for
Appraisals**

AGENCY: Office of the Secretary, HUD.

ACTION: Final rule.

SUMMARY: This final rule clarifies HUD's regulations concerning the responsibilities of lenders approved by the Federal Housing Administration (FHA) with respect to appraisals on properties that will be the security for FHA insured mortgages. The final rule clarifies that lenders are accountable for the quality of appraisals on properties securing FHA-insured mortgages. The final rule specifically provides that lenders that submit appraisals to HUD that do not meet FHA requirements are subject to the imposition of sanctions by the HUD Mortgagee Review Board. The final rule applies to both sponsor lenders that underwrite loans, and loan correspondent lenders that originate loans on behalf of their sponsors. The codification of this clarification is designed to ensure lenders are aware of their responsibilities with respect to appraisals, and homebuyers receive an accurate statement of the appraised value of their homes. This final rule follows publication of a January 13, 2003, proposed rule, and takes into consideration the public comments received on the proposed rule. After careful review of the comments, HUD has decided to adopt the proposed rule with minor changes to the regulatory text.

DATES: *Effective Date:* August 19, 2004.

FOR FURTHER INFORMATION CONTACT: Vance T. Morris, Director, Office of Single Family Program Development, Office of Insured Single Family Housing, 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). Hearing- or speech-impaired individuals may access this number via TTY by calling the toll-free Federal Information Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION:

I. Background—The January 13, 2003, Proposed Rule

HUD published a proposed rule on January 13, 2003 (68 FR 1766), to clarify HUD's regulations concerning the

responsibilities of lenders approved by FHA in the selection of appraisers to perform appraisals on properties that will be the security for FHA insured mortgages.

The success of the FHA single family mortgage insurance program, and HUD's ability to protect the FHA Insurance Fund, depends significantly on the quality of appraisals on properties that secure FHA mortgages. Section 203(b)(2) of the National Housing Act (12 U.S.C. 1709(b)(2)) provides the method for calculating the maximum mortgage amount that FHA can insure. The calculations required by the statute are based on the appraised value of the property that is security for the mortgage. If an appraisal is deficient, a mortgagor may be subsequently confronted with unexpected and costly repairs, which could result in default and a mortgage insurance claim. Further, if a mortgagor defaults and the lender conveys property title to HUD in exchange for payment of mortgage insurance benefits, FHA then must manage and sell the property in order to recoup its insurance loss. (Please note that this rule uses the terms "mortgagee" and "lender" interchangeably.) HUD's return on any such sale could be significantly reduced if the appraisal is deficient.

The purpose of the January 13, 2003, proposed rule, was to clarify HUD's regulations concerning the responsibilities of lenders in assuring the quality of FHA appraisals. HUD proposed to codify in regulations that lenders will be held accountable, along with appraisers, for the quality of appraisals on properties securing FHA insured mortgages. HUD also proposed to codify in regulations that lenders that submit appraisals to HUD that do not meet FHA requirements are subject to the imposition of sanctions by the HUD Mortgagee Review Board (MRB).

The January 13, 2003, rule proposed, to enhance accountability of lenders for poor appraisals and thereby protect the FHA Insurance Fund, promote better compliance with appraisal standards, and ensure that homebuyers receive an accurate statement of appraised value. The proposed changes would apply to both sponsor lenders that underwrite loans and loan correspondent lenders that originate loans on behalf of their sponsors. Interested readers are invited to review the preamble of the January 13, 2003, proposed rule, for additional details regarding the proposed regulatory changes.

II. This Final Rule

This final rule follows publication of the January 13, 2003, proposed rule, and

takes into consideration the public comments received on the proposed rule. After careful consideration of the public comments, HUD has decided to modify the proposed rule at this final rule stage to clarify that the standard of accountability to which lenders, sponsor lenders, and loan correspondent lenders will be held is the same as the standard used to impose civil money penalties for program violations, and that standard is one of knowing (actual knowledge) or had reason to know.

In the "Summary" of the preamble to the proposed rule (68 FR 1766, column one), and only in the Summary, HUD used the term "strictly accountable." In using this term, HUD did not intend to indicate "strict" liability in the sense that fault or rather no fault would be disregarded when a deficient or inaccurate appraisal was submitted on a HUD-insured property. The proposed rule intended to clarify and emphasize that where an appraisal is deficient or inaccurate, HUD would not look solely to the appraiser as the responsible party for the deficiency. HUD would also look to the lender for the lender's submission of a deficient appraisal and whether the lender knew or had reason to know the appraisal was deficient.

In addition to the clarification of lender responsibility with respect to appraisals codified in this final rule, HUD handbooks and mortgagee letters specify certain actions that a mortgagee should take to help ensure that appraisals comply with FHA requirements. However, the fact that a mortgagee has taken such actions does not automatically mitigate the standard imposed by this final rule if despite compliance with the requirements, the lender is found to have known or had reason to know about the deficient appraisal. HUD will hold both the mortgagee and the appraiser as accountable for the quality of the appraisal in satisfying such requirements. A Direct Endorsement Mortgagee (and any of its loan correspondent lenders) that submits, or causes to be submitted, an appraisal or related documentation that does not satisfy FHA requirements is subject to administrative sanction and civil money penalties by the MRB pursuant to 24 CFR part 25 and part 30.

The following section of this preamble presents a summary of the significant issues raised by the public commenters on the January 13, 2003, proposed rule, and HUD's responses to these issues.

III. Summary of Public Comments on January 13, 2003, Proposed Rule

The public comment period on the proposed rule closed on March 14, 2003. HUD received 34 public comments on the proposed rule. Comments were received from lenders and mortgage companies; private citizens; associations representing realtors, mortgage bankers, home builders, mortgage brokers, and other participants in the FHA mortgage insurance programs; nonprofits; a housing authority; and the state of Colorado.

A. Comments Supporting the Proposed Rule

Comment: Support for proposed rule. Several commenters expressed unqualified support for the proposed rule. The commenters wrote that the proposed rule represents an appropriate step in clarifying and reiterating HUD's policies regarding lender accountability for FHA appraisals. The commenters wrote that it is appropriate that lenders participating in the FHA mortgage insurance programs accept the responsibility of establishing partnerships with reputable appraisers. The commenters wrote that the proposed rule would not establish an undue burden on lenders, since most lenders already exercise care in the selection of appraisers.

HUD response. HUD appreciates the support expressed by the commenters. HUD agrees that the regulatory changes will help to better protect the FHA Insurance Fund and ensure more accurate appraisals with no additional burden imposed on lenders. HUD has modified the proposed rule to clarify that the accountability standard that is being codified through this rulemaking is the standard to which lenders have been held to date.

B. Specific Objections to the Proposed Rule

Comment: Lenders do not have the necessary expertise to be held strictly liable for faulty appraisals. Several commenters wrote that lenders are not trained in the intricacies of the appraisal process and, therefore, would have difficulty reviewing appraisals and catching inaccuracies or readily observable defects. The commenters wrote that it is unfair to hold lenders strictly liable for faulty appraisals or to ask lenders to substitute their opinions for the judgment of the appraiser. The commenters wrote that the obligation of the lender is appropriately limited to selecting a duly qualified appraiser from the FHA Appraiser Roster and to

review, through the lender's underwriter, the appraisal documentation to assure it meets FHA requirements.

HUD response. HUD has revised the rule at the final rule stage to clarify that lender accountability does not mean a no fault liability. Through this rule, HUD is clarifying and emphasizing that if an appraisal is deficient or inaccurate, HUD will not look solely to the appraiser as the responsible party. HUD will also look to the lender to determine whether the lender acted responsibly in submission of the bad appraisal. HUD does not agree that the regulatory changes made final by this rule, will impose burdensome new requirements on lenders. Rather, the changes made by this final rule clarify, and are consistent with, existing HUD policy regarding lenders' responsibility for FHA appraisals. For example, under the Direct Endorsement process, the lender's Direct Endorsement underwriter (or, in the case of a loan correspondent, its sponsor's Direct Endorsement underwriter) is already required to review the appraisal documentation. Under 24 CFR 203.255(b)(5), when a mortgage is submitted to FHA under the Direct Endorsement process, the application must contain, among other things, "[a]n underwriter certification, on a form prescribed by the Secretary, stating that the underwriter has personally reviewed the appraisal report * * * and that the proposed mortgage complies with HUD underwriting requirements." Consequently, a lender is already required, through its underwriter, to review the appraisal documentation to assure that the documentation meets the FHA appraisal requirements contained in HUD Handbook 4150.2 (entitled "Valuation Analysis for Home Mortgage Insurance") and amendatory issuances. Further, in numerous issuances, including Mortgagee Letters 94-54, 97-22, and 97-45, HUD has stated that mortgagees, in selecting their appraisers, must bear responsibility, along with the appraisers for the integrity, the accuracy, and the thoroughness of appraisals and will be held accountable by HUD. This handbook and these mortgagee letters may be downloaded from HUD's Client Information and Policy System (HUDCLIPS) Internet home page at <http://www.hudclips.org>.

Comment: Rather than imposing new regulations, FHA should more strictly enforce existing requirements. Several commenters wrote that the proposed rule is unnecessary because there already are several existing statutory and regulatory systems in place to safeguard the integrity of FHA

appraisals. For example, the commenters wrote that the licensing of appraisers is currently regulated by the individual states in which the appraisers do business. The commenters also wrote that HUD has several measures to monitor the quality of FHA appraisals and the performance of lenders, such as the FHA Appraiser Roster and the Credit Watch Termination Initiative. These commenters wrote that, rather than imposing additional regulatory requirements, HUD could address its concerns regarding faulty appraisals by more strictly enforcing these existing standards. For example, three of the commenters suggested that HUD could require that appraisers must maintain errors and omissions insurance in order to qualify for placement on the Appraiser Roster.

HUD response. Through this rule, HUD is not imposing new requirements on lenders but is codifying the standards to which lenders have been held to date. In response to some of the specific suggestions of the commenters, HUD notes that few if any states have programs in place that routinely or periodically monitor and review the quality and integrity of appraisals performed by licensed/certified appraisers. Rather, the licensing authority in the individual states typically review or regulate appraisers upon the filing of a complaint against the appraiser. The overall goal of this final rule is to achieve full compliance with FHA appraisal standards and the Uniform Standards of Professional Appraisal Practice. The intent of this rule is to be proactive rather than reactive in maintaining quality appraisals of properties with loans secured by FHA insurance.

Although HUD has other measures to monitor the quality of FHA appraisals and the performance of lenders, this rule will reinforce FHA efforts to ensure accountability in the appraisal process and the performance of lenders. Further, although some lenders may determine that maintaining errors and omissions insurance is advisable, HUD does not believe it would be appropriate to mandate that lenders obtain this type of insurance. Such a requirement will not necessarily ensure a better quality and more accurate appraisal, and might impose an undue financial burden on the FHA appraisers.

Comment: Proposed rule appears to conflict with the purpose of the FHA Appraiser Roster. Several commenters wrote that the proposed rule appears to conflict with the purposes of the FHA Appraiser Roster. The Appraiser Roster lists those appraisers that have the

necessary qualifications to perform FHA appraisals. The commenters wrote that the Appraiser Roster is the best place for ensuring the competency of appraisers. The commenters wrote that placement on the Appraiser Roster constitutes tacit approval by HUD of the appraiser and, therefore, it is not fair or reasonable for lenders to be held liable for faulty appraisals performed by appraisers on the Roster.

HUD response. HUD has not revised the proposed rule in response to these comments. In the past, FHA performed the required appraisals for properties securing FHA-insured mortgages. In response to statutory changes over the years, responsibility for selecting appraisers was transferred from FHA to the mortgagees. To ensure that appraisers selected to appraise FHA-insured properties meet minimum standards and have experience with FHA-insured mortgages, however, a mortgagee's selection is limited to appraisers listed on the FHA Appraiser Roster. A mortgagee may select any appraiser on the FHA Appraiser Roster.

The FHA Appraiser Roster, established in 1994, presents mortgagees with a list of appraisers who meet minimum qualification standards. These minimum standards include (1) an appropriate state licensure/certification with credentials based on the minimum licensing/certification criteria issued by the Appraiser Qualifications Board (AQB) of the Appraisal Foundation in the individual state where the appraiser practices, and (2) knowledge of and familiarity with FHA appraisal requirements, policies, and regulations as evidenced by passing the FHA Appraisal Exam. Placement on the FHA Appraiser Roster means that an appraiser is eligible to perform FHA appraisals. It does not mean that the appraiser is approved by FHA nor does it provide a guarantee or warranty that the appraiser's work will meet FHA standards. The lender who selects the appraiser must ensure that the appraiser is complying with FHA requirements when conducting appraisals for HUD-insured properties. Consequently, the FHA Single Family Appraiser Roster is not in conflict with this rule; it provides the lender a list that denotes appraisers have met FHA's minimum eligibility requirements.

Comment: HUD lacked the legal authority to issue the proposed rule. Several commenters questioned HUD's legal authority for issuing the proposed rule. The commenters wrote that the National Housing Act (12 U.S.C. 1701 *et seq.*) does not explicitly provide HUD with the authority to hold lenders strictly liable for the quality of appraisal

reports. The commenters also wrote that the proposed rule conflicts with the intent of Congress in enacting those provisions of the National Housing Act concerning FHA appraisal requirements, such as sections 1708(c) and (e), 1709, and 1735f-14. The commenters also questioned HUD's authority to issue the proposed rule pursuant to the general rulemaking authority granted by section 7(d) of the Department of Housing and Urban Development Act (42 U.S.C. 3535(d)). The commenters also wrote that the proposed rule conflicts with agency law principles. The commenters wrote that, as a general rule, an employer using an independent contractor, such as a third-party appraiser, is not liable for the wrongdoing of the contractor or the contractor's employees because the employer does not have the right to control the contractor's work.

HUD response. As discussed earlier in this preamble, through this rule HUD is clarifying that mortgagees accept the same responsibility for the quality of appraisals submitted to HUD to which they have been held responsible to date. To the extent there remains disagreement among mortgagees with HUD's authority to impose this standard of responsibility on mortgagees, HUD advises that its legal authority is based on the National Housing Act and the general rulemaking authority provided to HUD under section 211 of the National Housing Act and HUD's rulemaking authority under section 7(d) of the Department of Housing and Urban Development Act. Further, HUD has determined that issuance of this rule is consistent with Congressional intent as reflected in the provisions of the National Housing Act.

Section 211 of the National Housing Act grants the Secretary of HUD with broad rulemaking authority "to make such rules and regulations as may be necessary to carry out the provisions of this title." Section 211 provides statutory authority for HUD's issuance of rules to implement substantive provisions of the National Housing Act (see below), which would provide for the imposition of liability upon mortgage lenders for faulty appraisals.

Under section 203(a) of the National Housing Act, the Secretary establishes terms and conditions under which a mortgage loan will be endorsed for insurance. HUD's regulations at 24 CFR 203.5(e)(1) provide that the Direct Endorsement (DE) mortgagee, in originating mortgage loans under the DE process, will have the property appraised in accordance with "such standards and requirements as the Secretary may prescribe." HUD is

issuing this rule pursuant to section 211 to ensure a mortgagee is aware of its responsibility for the accuracy of the appraisals that they are required to submit pursuant to 24 CFR 203.5(e).

The amount of FHA mortgage insurance is based upon the value of the property that will be the security for a mortgage loan and the creditworthiness of the borrower. Sections 203(b)(2)(B)(ii)(I) through (IV) of the National Housing Act provide the formulas, based upon the appraised value of a property, for calculating the maximum mortgage amount that FHA is statutorily authorized to insure. Consequently, it is imperative that appraisals be accurate in order to comply with this statutory requirement. In addition, the mortgagee, not the appraiser, submits an appraisal to FHA as part of a mortgage insurance application package. The mortgagee selects an appraiser, and pursuant to 24 CFR 203.255(b)(5), certifies to HUD that its underwriter has reviewed personally¹ the appraisal report and credit application and that the proposed mortgage complies with HUD underwriting requirements.

Section 202(c)(1) of the National Housing Act provides that the mortgage lender may be sanctioned by the MRB for "engaging in activities in violation of Federal Housing Administration requirements." Nothing in the National Housing Act would prohibit FHA from establishing a requirement that mortgage lenders submit only appraisals that comport with FHA appraisal requirements. In fact, as noted above, section 203(a) provides the Secretary with broad authority to insure mortgage loans under such terms and conditions as he may provide, and under section 211, to make such rules and regulations as may be necessary to carry out the provisions of Title II of the National Housing Act.

FHA can insure only those mortgage loans that are made to, and held by, a mortgagee approved by the Secretary as "responsible" (see section 203(b)(1) of the National Housing Act). FHA believes this final rule is consistent with appraisal standards used in the conventional marketplace. FHA also believes that responsible mortgage lenders will take appropriate steps to ensure that appraisals of properties that will be security for FHA-insured mortgage loans conform to FHA requirements.

¹ Section 203.255(b)(5) contains an exception to this requirement for an underwriter to review personally a credit application when FHA's TOTAL Scorecard has determined that the application represents an acceptable risk under FHA terms and conditions.

C. Possible Effects of the Proposed Rule

Comment: The proposed rule will increase costs to FHA homebuyers. Several commenters wrote that the proposed rule would force lenders to incur the cost of hiring appraisal experts to review and evaluate all FHA appraisals "a cost that would inevitably be passed on the FHA consumers and make FHA products unattractive when compared to other loan products on the marketplace.

HUD response: HUD does not agree with the commenters. As noted above in this preamble, Direct Endorsement lenders have had a long-standing requirement to provide appraisal oversight and review for all FHA-insured loans. This final rule does not place any additional burden upon FHA lenders who, by FHA policy and guidance, have been performing appraisal review functions. It only codifies and reinforces existing policy. Consequently, promulgation of this regulation is not expected to increase costs to FHA homebuyers.

Comment: The proposed rule will discourage lenders from participating in the FHA loans programs. Several commenters wrote that the imposition of strict liability on lenders for faulty appraisals would cause lenders to question whether originating FHA mortgages presents an unacceptable business risk and lead them to abandon the FHA market. The commenters wrote that the burden of the increased risk would be particularly difficult for small lenders, who have less ability to fully attest to the quality of independent third-party contractors and to absorb the additional risk and cost the rule would impose on them. The commenters wrote that even if some lenders are able to incur the added costs, low-income consumers might not be able to afford the increased expenses and thereby lose a valuable source of credit.

HUD response: As discussed in this preamble, this final rule does not impose a no fault liability on the lender, but rather emphasizes and reinforces that lenders are being held to the standard that HUD has held them to date, one of known or had reason to know. With this clarification, HUD does not agree that this final rule will reduce lender participation in the FHA programs. As noted elsewhere in this preamble, this final rule does not impose any additional burdensome requirements on lenders. Therefore, HUD does not expect any lender to withdraw from the FHA-insured mortgage program as a result of this rule.

Comment: The proposed rule may have the unintended consequence of having appraisers be less concerned with the quality of appraisals, since the appraiser can rely on the lender to ensure that the appraisal meets FHA requirements. Two commenters wrote that the proposed rule might create this unintended disincentive for appraisers to meet FHA requirements.

HUD response: The appraisal industry is a regulated profession with established education and experience criteria and continuing education requirements. HUD expects all FHA Appraisers to abide by the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation and FHA requirements. Those FHA appraisers who fail to abide by USPAP and do not meet FHA requirements are subject to administrative actions by the Department. It is also expected that FHA mortgage lenders will not select FHA appraisers that are not knowledgeable in the property type appraised or do not adequately perform their trade.

D. Other Comments and Recommendations

Comment: HUD should establish a single Web site for posting all procedures and policies regarding FHA appraisals. Two commenters made this suggestion. The commenters wrote that it is currently very difficult for lenders and appraisers to locate all of the relevant FHA policies since they are scattered throughout several Web sites and sources.

HUD response: HUD's home page <http://www.hud.gov> contains links to Web pages that enable appraisers and lenders to obtain information on FHA requirements and to keep abreast of changes. In addition, information can be found at Web page <http://www.hudclips.org> (Client Information and Policy System), which enables the user to search for all of HUD's official policies, procedures and directives, including notices, handbooks, Mortgage Letters, **Federal Register** publications, the Congressional Record, and the U.S. Code.

Comment: HUD should establish a system to consider complaints from appraisers alleging inappropriate lender pressure to inflate the appraised value of a property. Two commenters made this suggestion. The commenters wrote that such a procedure should inform the appraiser of the information that must be submitted to HUD as part of the complaint, and whether HUD will hold the appraiser's identity in confidence during the investigation. The commenters also suggested that HUD

should establish a "hotline" or designate a single point of contact for these complaints.

HUD response: HUD currently has a system in place where complaints may be channeled. Each HUD Homeownership Center can be contacted through a toll-free telephone number, e-mail, or written correspondence. Each Homeownership Center has a Technical Support Branch to handle complaints and a Customer Service Division, which can also receive complaints and make referrals to the Inspector General's hotline. Contact information for the Homeownership Centers may be found on HUD's Home page at <http://www.hud.gov>.

Comment: HUD should require lenders to inform State appraisal licensing agencies when problems with a particular appraiser are identified. One commenter made this suggestion. The commenter wrote that removing an appraiser from the Appraiser Roster without providing information to the State-licensing agency protects HUD, but does not protect the public.

HUD response: HUD will not impose an additional burden on lenders by mandating that they inform State appraisal licensing agencies when problems with a particular appraiser are identified. However, FHA will continue to make referrals to State certification and licensing boards.

Comment: Care must be taken in the use of AVMs to conduct appraisal reviews. Two commenters wrote that the use of Automated Valuation Models (AVMs) does not constitute an effective appraisal review program. The commenters wrote that AVMs are not appraisals, but a form of computerized statistical modeling. According to the commenters, AVMs fail to consider the unique characteristics of properties, as they rely primarily on public records and proprietary databases for information. The commenters recommended that if a lender chooses to use AVMs, a qualified appraiser employed by the lender should conduct the AVM appraisal review.

HUD response: HUD agrees with the commenters that AVMs do not constitute an effective stand-alone check on the quality of appraisals. An AVM can be a useful tool, however, when used in conjunction with more traditional appraisal review techniques to preliminarily assess the credibility and accuracy of an appraisal, as well as assess the probability of ancillary concerns such as the probability of property "flipping".

Comment: Lenders should be held strictly liable only for substantive appraisal defects. One commenter

suggested that the final rule should clarify that lenders will be held strictly liable only for substantive defects in an appraisal. The commenter wrote that the goal of the rule should be to prevent bad appraisals, not to punish lenders for insignificant errors. The commenter further suggested that the final rule should specify the appraisal elements that would be considered significant enough to trigger strict liability.

HUD response. In this preamble, HUD already has thoroughly addressed the issue of strict liability but notes that HUD Handbook 4000.4 ("Single Family Direct Endorsement Program") details the procedures for an underwriter's appraisal review, which include verification that factual information is correctly reported in the appraisal; assessment of the plausibility and consistency of conclusions based upon data presented in the report; determination of consistency of reported conclusions with other data conclusions reported in similar cases recently processed; and compliance with HUD underwriting instructions. If the underwriter concludes that the appraisal report findings are inconsistent, or otherwise unacceptable, the appraiser may be contacted or the report returned for reconsideration. In addition, HUD Handbook 4060.1 REV-1, dated September 30, 1993, and Handbook 4330.1 REV-5, dated September 1994, provide guidance on a mortgagee's quality control plan. Given this existing policy guidance and the fact that this final rule codifies and clarifies HUD's existing policy regarding lender review of appraisals, HUD does not consider any additional clarification necessary. Copies of the handbooks referenced above may be downloaded through the HUDCLIPS Web site: <http://www.hudclips.org>.

Comment: Lenders should not be permitted to select appraisers. Two commenters wrote that the proposed rule demonstrates that the system of permitting FHA lenders to select their own appraisers has been a mistake. The commenters suggested that HUD return to the system of HUD selecting the appraisers, on a rotation system, from an approved list of independent appraisers.

HUD response. The change requested by the commenters is outside the scope of the January 13, 2003, proposed rule. Lender selection of the appraiser is statutorily mandated. There are no plans to recommend changes to the existing regulations.

Comment: Rule should provide greater clarity regarding liability. One commenter wrote that the proposed rule was unclear regarding how HUD would allocate liability for a faulty appraisal

between the lender and appraiser. The commenter requested that HUD clarify this matter in the final rule.

HUD response. This final rule states that the lender and appraiser shall both bear responsibility for the quality of the appraisal. To that end, if an appraisal is determined to be faulty and/or non-compliant with FHA requirements, HUD may seek administrative sanctions against either or both of the parties, depending upon the particular circumstances of the case. This final rule clarifies the authority of the MRB to sanction lenders for deficient appraisals. HUD Handbook 4150.2 details administrative and civil sanctions as well as criminal penalties available against appraisers who have violated FHA regulations and/or the USPAP.

IV. Small Business Concerns Related to MRB 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. The final rule does clarify that HUD's MRB may impose administrative sanctions on small lenders for submitting appraisals that are inconsistent with FHA requirements, and for which the lenders knew were inconsistent or had reason to know were inconsistent. With respect to such enforcement 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 Small Business and Agriculture Regulatory Enforcement Ombudsman to "work with each agency with regulatory authority over small businesses to ensure that small business concerns that receive or are subject to an audit, on-site inspection, compliance assistance effort, or other enforcement related communication or contact by agency personnel are provided with a means to comment on the enforcement activity conducted by this personnel." To implement this statutory provision, the Small Business Administration has requested that agencies include the following language on agency publications and notices that are provided to small businesses at the time the enforcement action is undertaken. The language is as follows:

Your Comments Are Important

The Small Business and Agriculture Regulatory Enforcement Ombudsman and 10 Regional Fairness Boards were established to receive comments from small businesses about federal agency enforcement actions. The Ombudsman will annually evaluate the enforcement activities and rate each agency's responsiveness to small business. If you wish

to comment on the enforcement actions of [insert agency name], call 888-REG-FAIR (888-734-3247).

As HUD stated in its notice describing HUD's actions on the implementation of SBREFA, which was published on May 21, 1998 (63 FR 28214), HUD intends to work with the Small Business Administration to provide small entities with information on the Fairness Boards and National Ombudsman program, at the time enforcement actions are taken, to ensure that small entities have the full means to comment on the enforcement activity conducted by HUD.

V. Findings and Certifications

Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866, *Regulatory Planning and Review*. OMB determined that this rule is a "significant regulatory action" as defined in section 3(f) of the order (although not an economically significant regulatory action under the order). Any changes made to this rule as a result of that review are identified in the docket file, which is available for public inspection in the office of the Regulations Division, Office of General Counsel, Room 10276, 451 Seventh Street, SW., Washington, DC 20410-0500.

Environmental Impact

This final rule does not direct, provide for assistance, or loan and mortgage insurance for, or otherwise govern or regulate, real property acquisition, disposition, leasing, rehabilitation, alteration, demolition, or new construction, or establish, revise, or provide for standards for construction or construction materials, manufactured housing, or occupancy. Accordingly, under 24 CFR 50.19(c), this final rule is categorically excluded from the requirements of the National Environmental Policy Act (42 U.S.C. 4332 *et seq.*).

Regulatory Flexibility Act

The Secretary has reviewed this final rule before publication, and by approving it certifies, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), that this final rule will not have a significant economic impact on a substantial number of small entities. The final rule will not establish, or substantively modify, HUD policy and procedures regarding lender accountability for FHA appraisals. Rather, the regulatory changes will clarify HUD's existing policy of holding lenders responsible along with

appraisers for the quality of such appraisals. Further, the regulatory changes are designed to ensure the integrity of appraisals on properties securing FHA-insured mortgages. To the extent that the regulatory amendments have an economic impact, it will be on those lenders and appraisers who submit appraisals that are inconsistent with FHA requirements.

Executive Order 13132, Federalism

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on State and local governments and is not required by statute, or the rule preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This final rule will not have federalism implications and would not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments, and on the private sector. This final rule will not impose any Federal mandates on any State, local, or tribal governments or on the private sector, within the meaning of the Unfunded Mandates Reform Act of 1995.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance Numbers for the programs affected by this final rule are 14.117 and 14.133.

List of Subjects

24 CFR Part 25

Administrative practice and procedure, Loan programs—housing and community development, Organization and functions (Government agencies).

24 CFR Part 203

Hawaiian Natives, Home improvement, Indians—lands, Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

■ Accordingly, for the reasons described in the preamble, HUD amends 24 CFR parts 25 and 203 as follows:

PART 25—MORTGAGEE REVIEW BOARD

■ 1. The authority citation for 24 CFR part 25 continues to read as follows:

Authority: 12 U.S.C. 1708(c), 1708(d), 1709(s), 1715b and 1735(f)–14; 42 U.S.C. 3535(d).

■ 2. Amend § 25.9 by redesignating paragraph (ee) as paragraph (ff) and adding a new paragraph (ee) to read as follows:

§ 25.9 Grounds for an administrative action.

* * * * *

(ee) Submitting, or causing to be submitted, with an application for FHA mortgage insurance an appraisal, valuation condition sheet, or any other

documentation relating to an appraisal that does not satisfy FHA requirements.

* * * * *

PART 203—SINGLE FAMILY MORTGAGE INSURANCE

■ 3. The authority citation for 24 CFR part 203 continues to read as follows:

Authority: 12 U.S.C. 1709, 1710, 1715b, and 1715u; 42 U.S.C. 3535(d).

■ 4. Amend § 203.5 by adding a sentence at the end of paragraph (e)(1) and adding a new paragraph (e)(3) to read as follows:

§ 203.5 Direct Endorsement process.

* * * * *

(e) * * *

(1) * * * A mortgagee must select an appraiser whose name is on the FHA Appraiser Roster, in accordance with 24 CFR part 200, subpart G.

* * * * *

(3) A mortgagee and an appraiser must ensure that an appraisal and related documentation satisfy FHA appraisal requirements and both bear responsibility for the quality of the appraisal in satisfying such requirements. A Direct Endorsement Mortgagee (and any of its loan correspondent lenders) that submits, or causes to be submitted, an appraisal or related documentation that does not satisfy FHA requirements is subject to administrative sanction by the Mortgagee Review Board pursuant to 24 CFR part 25 and part 30.

Dated: July 12, 2004.

Alphonso Jackson,
Secretary.

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