REGULATORY ISSUES FACING THE REAL ESTATE APPRAISAL PROFESSION

Unintended Consequences of the Dodd-Frank Law and Potential Remedies

Full Document

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Part 1 – Introduction

The real estate appraisal profession, in recent years, has encountered massive changes. The fallout from the Subprime Mortgage/Financial Crisis of 2007-2008 and the Dodd-Frank legislation that followed have left the profession in disarray. Though the intention of Dodd-Frank was, in part, to protect the independence of the appraiser, it has done little to accomplish that goal. The purpose of this paper is to:

- Present a historical perspective of the relationship between real estate appraisers and the lending industry,
- Review federal rules and regulations affecting real estate appraisers,
- Determine the impact of federal rules and regulations on the real estate appraisal profession, and;
- Highlight specific issues facing the real estate appraisal profession and present potential solutions to these issues.

Part 2 – Historical Context of the Real Estate Appraisal Industry

Setting the Stage

Before the era of the 30-year mortgage, typical mortgage loans were based on terms which required 50% down, interest-only payments, five-year terms and balloon payments of the outstanding mortgage balances at the end of the loan terms. These terms insured the solvency of the lender's portfolio.

In 1934, the federal government passed the National Housing Act in an attempt to revitalize the nation's economy and jumpstart the housing market, both of which were suffering greatly due to the Great Depression. The National Housing Act created the Federal Housing Administration (FHA). FHA's original mission was to insure mortgages originated by depository institutions; however, because lenders were required to hold these mortgages for the entire term of the loan, many institutions were reluctant to issue FHA loans.

In 1938, Congress created the Federal National Mortgage Association (FNMA – commonly known as Fannie Mae), which purchased mortgages from lenders, thus freeing up money the lenders could then relend to other borrowers. Along with Fannie Mae came more fair and efficient mortgage-lending practices. Now that lenders were going to a central funding source, loan terms, interest rates and underwriting guidelines began to be similar from institution to institution. Lenders had to conform to Fannie Mae's guidelines and restrictions if they wanted to sell their loans in the secondary market. In 1944, the Veterans Administration (VA) followed suit with a similar program for veterans and military personnel, who as a result could buy homes without down payments. This action catapulted the housing market.

In the 1950s, 60s and early 70s, most mortgages were 20-30 years loans. In 1968, FNMA was split into the current FNMA (Fannie Mae) and Government National Mortgage Association (GNMA), commonly known as Ginnie Mae. The present-day Fannie Mae is not a government agency, but a federally-chartered corporation owned by private shareholders. The present-day Fannie Mae purchases FHA, VA and conventional mortgages. The present-day Ginnie Mae is a government agency that does not purchase loans, but instead guarantees returns to investors who purchase mortgage-backed securities backed by FHA, VA and other government loans.

Baby boomers, both men and women, entered the workforce in the late 1960s and early 70s, creating double-income families. Boomers wanted larger, more expensive homes to fit their incomes and lifestyles. More mortgages were needed. In 1970, Congress chartered the Federal Home Loan Mortgage Corporation (FHLMC), better known as Freddie Mac, to increase the supply of mortgage funds available to commercial lenders, savings and loan institutions, credit unions and other mortgage lenders.

From the 1930s through the mid-70s, lenders (including thrifts) and residential real estate appraisers shared close working relationships. Lenders relied on the appraiser's knowledge and also his/her reputation. Lenders looked for appraisers who had affiliations with major nonprofit appraisal organizations in the selection process. There were many professional appraisal organizations, including The American Society of Farm Managers and Rural Appraisers – 1929 (AFMRA), The American Institute of Real Estate Appraisers - 1932 (AIREA), the Society of Real Estate Appraisers – 1935 (SRA), the American Society of Technical Appraisers – 1936 (AMSTA), the Technical Valuation Society – 1935 (TVS), the National Association of Independent Fee Appraisers – 1961 (NAIFA), and many others. The AMSTA and TVS merged in 1952 to become The American Society of Appraisers, and the AIREA and SRA merged in 1990 to form the Appraisal Institute. All of these professional organizations were formed to promote education and ethical standards as well as to attract competent appraisers.

Up to the mid-70s, mortgage requirements were generally understood by the average consumer looking to buy a home. To qualify for a mortgage, the applicant generally had to provide a 20 - 25% down payment, and the monthly payment could not exceed 30% of gross income. Lenders used loan officers rather than mortgage brokers for most transactions.
In an effort to prevent redlining and to meet the needs of low- to moderate-income groups, various federal regulations were enacted, beginning with the Community Reinvestment Act of 1977, which measured each financial institution's performance within defined areas. Non-compliance at that time could result in severe consequences.

Savings and Loan Crisis of the 1980s and 90s

Due to spiraling inflation in the late 1970's, the Federal Reserve Bank doubled the interest rate by restricting the growth of the money supply, which in turn caused interest rates to skyrocket. Between June 1979 and March 1980, short-term interest rates rose by more than six percentage points. Low income on the inventory of existing mortgages vs. high interest on short term savings accounts resulted in extraordinary losses by the thrift institutions. In order to curtail the crisis, new federal rules allowed for expanded investment options and eliminated interest ceilings for the thrifts until such time that interest rates returned to normal.

As a result of those risky investments, high interest rates and the transition from traditional mortgages to more risky investments, over 118 savings and loan associations failed in the next three years; and it is estimated that this move ultimately cost taxpayers over $150 billion dollars.[1]

The Creation of FIRREA and Title XI

In the wake of the Savings and Loan crisis, Congress responded by enacting more legislation. It began in 1987 with Congressman Doug Barnard Jr. of Georgia introducing H.R. 3675, the Real Estate Appraisal Reform Act. This bill gave a major role to The Appraisal Foundation and established the Federal Interagency Appraisal Counsel to set real estate appraisal standards and qualifications for transactions in which the federal government has substantial financial or public policy interests. Because Congressman Barnard feared the bill would fail, he decided to use the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) as a vehicle for appraisal reform; and he inserted his bill as a separate amendment known as Title XI in FIRREA.

FIRREA dramatically changed the S&L industry and its federal regulation, including title insurance. Title XI required that appraisals utilized in connection with federally related transactions be performed in writing, in accordance with uniform standards, and by competent individuals whose professional conduct was subject to effective supervision. In addition, it established the Appraisal Subcommittee (ASC)[2] to monitor the activities of the state regulatory agencies and The Appraisal Foundation, which promulgates the generally accepted appraisal standards and qualification standards for state licensed and certified appraisers. FIRREA also upgraded and consolidated the regulations of various federal agencies.

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[1] House Committee on Government Operations*, Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in Secondary Market*, 99th Congress, 2nd session, 1986, H. Rep. 99-891, 4-6.

[2] Responsibilities of the Appraisal Subcommittee (ASC)
The Appraisal Subcommittee (ASC) maintains a National Registry of Appraisers and transmits a report to Congress annually detailing the activities of the ASC. It also provides federal oversight of State appraiser regulatory programs and provides a monitoring framework for The Appraisal Foundation and the Federal Financial Institutions Regulatory Agencies in their roles to protect federal financial and public policy interests in real estate appraisals utilized in federally related transactions.
111th Congress, *Dodd-Frank Wall Street Reform and Consumer Protection Act*.
https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf

We do believe that generally Title XI of FIRREA and the establishment of the Appraisal Subcommittee provided effective regulatory oversight and that The Appraisal Foundation has been an effective, independent organization allowing for standardized rules within the profession.

The Subprime Mortgage/Financial Crisis of 2007-2008

The Housing and Community Development Act of 1992 amended the charter of both Fannie Mae and Freddie Mac to facilitate the financing of affordable housing for low- and moderate-income families. Again in 1999, more pressure was exerted on the financial institutions through the Community Reinvestment Act to expand mortgages and to ease credit requirements. This action adversely resulted in the financial institutions lowering their underwriting standards, offering interest-only loans and floating/adjustable rates (in some cases with little or no documentation to support the consumer's ability to repay the loan.)

These high-risk loans came with higher interest rates; and the financial institutions began a radical move to *mortgage-backed securities* with earnings dependent on volume. The share of subprime mortgages to total originations increased from 9 percent in 1996 to 20 percent in 2006, according to Forbes. Subprime mortgages totaled $600 billion that year; and lenders held very few, if any, of these loans in their own portfolios. They were indeed reaping the benefits of these new high-risk investments without being held responsible for any of the risk.[3]

The secondary mortgage market, which includes collateralized debt obligations (CDOs), soared, and CDOs exploded from $75 billion in 2003 to $450 billion in 2006. These securities were backed by AAA ratings. It appears that rating agencies did not do their jobs and that investors did not do their due diligence.

Regrettably, the relaxed standards for mortgage loans and the movement to mortgage-backed securities led to the Subprime Mortgage/Financial Crisis of 2007-2008 for subprime, Alt-A, CDOs, mortgage, credit, hedge fund, and foreign lending markets. In October 2007, the U.S. Secretary of the Treasury Henry Paulson called the bursting housing bubble that led to the crisis "the most significant current risk"[4] to the US economy. It was a catastrophe caused by many players, including some appraisers. Overall, appraisers contributed

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[3] Ginnie Mae was a main participant in the mortgage crisis of 2008. Ginnie Mae's most important program was and is the mortgage-backed security program in which Ginnie Mae guarantees pools of mortgages accumulated by mortgage originators of "low- and moderate-income households across America by channeling global capital into the nation's housing markets."
Ginnie Mae Home, *Who we are. What we do. Why it makes a difference,* http://ginniemae.gov/pages/default.aspx

[4] Housingwire, *Paulson: Housing a 'Significant Risk' to Economy*, October 16, 2007. http://www.housingwire.com/articles/paulson-housing-significant-risk-economy

relatively little but were assigned a significant amount of the blame.
As a result of the financial crisis, the Attorney General of New York State, Andrew Cuomo, began an investigation into the practices of Fannie Mae and Freddie Mac. Subsequently, Fannie Mae and Freddie Mac signed a settlement with Cuomo, agreeing to abide by new rules which would be embodied in the Home Valuation Code of Conduct (HVCC) that went into effect in May 2009. As part of the agreement, Cuomo's investigation into Fannie Mae and Freddie Mac's practices was terminated. With the co-signing of the agreement by the Office of Federal Housing Enterprise Oversight, HVCC was given federal rule status.

HVCC was designed to protect appraiser independence and prevent pressure on appraisers to produce a desired property value. It was also intended to protect consumers. Compliance with the rules was required for all loans backed by Fannie Mae or Freddie Mac. Most of the big appraisal organizations initially backed the policy; but by the end of the comment period (45 days) had reversed their stances and submitted commentary much more critical of HVCC than their original comments. The rules stayed in effect and were eventually incorporated, in part, into the next big legislation, the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in July 2010.

While we believe that the reforms enacted by Title XI of FIRREA were good reforms and provide oversight and controls similar to those of many other licensed professions, the rules implemented as a part of the Home Valuation Code of Conduct (HVCC) and incorporated into Title XI as amended by the Dodd-Frank Reform Act have in many cases resulted in unintended consequences. We will discuss these unintended consequences in Part 2 of this document.

Dodd-Frank/Wall Street Reform and Consumer Protection Act

Dodd-Frank was signed into federal law on July 21, 2010, in response to the Subprime Mortgage/Financial Crisis of 2007-2008 and the subsequent Great Recession that followed. The legislation brought the most significant changes to financial regulation in the United States since reforms following the Great Depression. The reforms affected all federal financial regulatory agencies and almost every part of the nation's financial services industry, including appraisers.

How did Dodd-Frank affect the financial services industry, including appraisers?

1. Expanded the functions of the Appraisal Subcommittee (ASC) to include monitoring of State requirements for registration/supervision of operations/activities of appraisal management companies
2. Required the ASC to report to Congress annually regarding activities of the ASC, including results of all audits of State appraiser certifying and licensing agencies
3. Mandated national registry of appraisal management companies registered with and subject to supervision of State appraiser certifying and licensing agencies
4. Set up grants available through ASC for State appraiser certifying and licensing

agencies to support the efforts of such agencies to comply with Dodd-Frank

5. Established that appraisals be subject to appropriate review for compliance with the Uniform Standards of Professional Appraisal Practice
6. Authorized that thresholds established by financial institutions regulatory agencies and The Resolution Trust Corporation concur with Bureau of Consumer Financial Protection to provide reasonable protection for consumers who purchase 1-4 unit family residences
7. Set new rules based on size and complexity of appraisal requiring the services of State certified appraisers
8. Set minimum qualifications for Trainee Appraiser and Supervisory Appraiser through AQB
9. Gave ASC the authority to remove State licensed or certified appraiser from the national registry for a period not to exceed 90 days, pending State agency action on licensing, certification, registration and disciplinary proceedings
10. Established limitations on appraising through reciprocity based on State policy
11. Prohibited discrimination against consideration of appraiser for an assignment based solely on membership in a nationally recognized professional appraisal organization
12. Mandated ASC monitoring of State appraiser certifying and licensing agency for the purpose of maintaining appraiser independence
13. Encouraged States to accept courses approved by AQB Course Approval Program
14. Set up Complaint National Hotline to receive complaints of non-compliance with appraisal independence standards and Uniform Standards of Professional Appraisal Practice (to address improper influence or attempted improper influence of appraisers or the appraisal process)
15. Set requirements for Appraisal Management Companies including registration with State appraiser certifying and licensing agencies
16. Set standards for Automated Valuation Models (AVMs) and limitations on use of Broker Price Opinions (BPOs)
17. Required customary and reasonable compensation for appraisers
18. Mandated additional provisions for high-risk mortgages, including interior inspections of subject properties by licensed or certified appraisers

Part 3 – Challenges, Problems and Proposed Remedies

According to data available from the United States Census Bureau and published in an April 2013 article by the Appraisal Institute, the number of appraisers nationwide peaked in 2007 at 118,657. The ASC lists the current number of appraisers at 100,129 as of April 2015. Although these statistics represent total credentials rather than the actual number of appraisers (i.e. an appraiser may be counted multiple times if he/she is credentialed in multiple states), the trend is clear. There has been a decline in appraiser credentials of more than 15% over the 6-plus year period.

The decline is due in part to age attrition and fewer new entrants into the field. Another reason cited for the drop in appraiser credentials is increased use of alternative valuation products and/or broker price opinions (BPOs) by lenders. These factors, coupled with overall challenging business conditions and convoluted new government regulations, have led to limited growth opportunities in the real estate appraisal profession.

At the same time the appraisal profession is becoming more challenging for current appraisers, educational requirements are becoming stricter. According to a January 2012 report to Congress from the Government Accountability Office (GAO), "Title XI of FIRREA (as amended by Dodd-Frank) created a complex regulatory structure that relies upon the actions of many state, federal and private entities to help ensure the quality of appraisals and the qualifications of appraisers used in federally related transactions."[5]

One of the primary barriers facing appraisers entering the appraisal profession as of January 2015 is increased educational requirements, including

- For Licensed Residential appraisers, increasing formal education requirements from no degree requirement to "an Associate's degree or higher (in any field) from an accredited college, junior college, community college , or university"[6]

- For Certified Residential appraisers, increasing formal education requirements from "Associate's degree" to "Bachelor's degree or higher (in any field) from an accredited college or university"[7]

Listed below are the requirements already in effect for licensed and certified appraisers:

[5] Government Accountability Office, *Highlights of GAO-12-147, a report to congressional committees*, January 2012, page 8.
[6]The Appraisal Foundation, *New! Summary of Changes to the Real Property Appraiser Qualification Criteria (effective January 1, 2015).*
https://netforum.avectra.com/eweb/DynamicPage.aspx?Site=taf&WebCode=RPCriteria
[7] Government Accountability Office.
https://netforum.avectra.com/eweb/DynamicPage.aspx?Site=taf&WebCode=RPCriteria

For a Licensed Residential appraiser:

- 2,000 hours of experience obtained in no fewer than 12 months
- 150 creditable class hours (7 courses) in appraisal-specific subjects
- passing a standardized Appraisal Qualifications Board (AQB) exam and
- 28 credits of appraiser-specific continuing education every two years.

For a Certified Residential appraiser:

- 2500 hours of experience obtained in no fewer than 24 months
- 200 creditable class hours (10 courses) in appraisal-specific subjects
- passing a standardized Appraisal Qualifications Board (AQB) exam and
- 28 credits of appraiser-specific continuing education every two years

While there may be some rationale for higher educational requirements, the additional requirements listed above have made the process of becoming an appraiser more burdensome. (See footnote.[8])

Throughout the rest of this paper we will explore various factors that have influenced the decline in credentials and give recommendations of how to improve the attractiveness of the profession to new entrants while protecting consumers.

Problem 1 – Trainees Face Training Hurdles

In today's market, for federally related transactions, lenders and AMCs do not typically accept work from anyone other than licensed or certified appraisers. This practice leaves appraisal trainees with no way to earn the work experience required by law. This structure discourages established appraisers from hiring Appraiser Trainees. The profession must take on the responsibility for training new entrants; otherwise, there will be too few appraisers remaining to assume responsibility from those retiring.

A survey done in June 2013 by the Appraisal Institute showed that trainee hiring will remain relatively weak for the next one to two years, based mainly on lenders/AMCs resistance to

[8] The basis for this change (higher educational requirements) is that individuals with higher educational levels have typically tested better on the AQB-approved examination. Test results also indicate that individuals with Bachelor's degrees or higher perform better on the exam than those with Associate degrees or without degrees. (The previous statements have been supported by demographic information on candidates sitting for exams in January 2010).
Appraiser Qualifications Board, *Proposed Revisions to the Future Real Estate Appraiser Qualification Criteria*, October 28, 2010.

having trainees do any work. Of those surveyed only 9 percent of residential appraisers plan to hire more trainees during this period.[9]

Recommendation:

The Appraisal Qualifications Board (AQB) currently has in place qualification criteria for Appraiser Trainees that gives clear guidelines for trainees and the supervisory appraisers who oversee them. Quality training programs need to be designed and implemented to support and link the educational and experience requirements for appraising.

In one model, appraisal students could spend the first two years of a four-year degree program learning general and appraisal-specific concepts, followed by two years of a combined education/work experience program, thus allowing students to graduate with the qualifications necessary for becoming a certified appraiser.

We feel that it is important to also encourage lenders and AMCs to adopt policies regarding trainees and supervising appraisers and not insist that trainees be accompanied on inspections beyond the point where they are considered competent by their supervising appraisers.

Problem 2 – Lack of Mandatory State Licensing in All States

A reported issued in 2012 by the Government Accountability Office (GAO) to Congress stated that "Under authority granted by Title XI, the federal regulators also have adopted regulations that exempt federally related transactions of $250,000 or less from appraisal requirements"[10] (meaning that the services of a licensed or certified appraiser are not required). Fannie and Freddie were also deemed exempt.

The fact that licensed or certified appraisers are not required for the majority of mortgages leaves consumers at risk. The GAO in January 2012 found that "more than 70 percent of residential mortgages made from 2006 through 2009 were $250,000 or less."[11]

As previously discussed, a residential appraisal license/certification takes years of training, education and experience to acquire. Lenders, in order to save money and meet federal requirements, are using alternatives to appraisals to obtain values on homes. Many utilize Broker Price Opinions (BPOs) in part for refinances.

It should be noted that real estate salespersons and brokers in New York State, as an example, have no formal education requirements (whereas certified appraisers will require a bachelor's

[9] Appraisal Institute, *2013 Appraisal Outlook*, June 28, 2013

[10] Government Accountability Office, *Highlights of GAO-12-147, a report to congressional committees*, January 2012, page 23.

[11] Government Accountability Office, *Highlights of GAO-12-147, a report to congressional committees*, January 2012.

degree in 2015), no work experience requirements for salespersons and only two years' work experience as a salesperson to qualify as a broker (certified residential appraisers require 2,500 hours experience in no less than 24 months). Salespersons and brokers are not required to complete any appraisal related coursework or appraisal continuing education (certified residential appraisers require 200 hours of appraisal related coursework and 28 hours of appraisal continuing education every two years).

Lack of consistency in state licensing requirements leaves consumers vulnerable to comparability and reliability issues. Presently, only 37 licensing jurisdictions require mandatory licensing, and the rest are either voluntary or mandatory for federally related transactions only. Another issue associated with transparency is the lack of disclosure about the components covered by the appraisal fees, such as lender fees, fees paid for AMC services, and direct appraisal fees.

Recommendation:
We propose mandatory licensing rules be put in place and enforced in all states, requiring the use of licensed or certified appraisers for any services for which an opinion of value for real property is developed. Mandatory licensing in all states would improve the comparability and reliability of appraiser valuations nationwide, supporting consumer's need for better information during the home buying process. It is also our opinion that each component of the appraisal fee should be listed separately when disclosed to the client, so that consumers know fully where their money goes as part of the overall mortgage transaction.

Problem 3 – The Federal De Minimis Limit is Set Too High

The de minimis appraisal threshold, the dollar level set by the federal financial regulators to exempt real estate loans made by federally insured financial institutions from statutory appraisal requirements, was increased in 1994 from $100,000 to $250,000 as a way to reduce regulatory burden and encourage economic growth. Though many groups have lobbied to reduce the de minimis since that time, none have been successful except in one type of mortgage loan, the Higher-Priced Mortgage Loans (HPML)[12].

Mortgage loans are HPMLs if they are secured by a consumer's principal dwelling and have annual percentage rates (APRs) that exceed the Average Prime Offer Rate (APOR) by 1.5 percentage points or more (see footnote for reference to additional criteria[13]). In other words, HPMLs are high-interest loans.

[12] TILA Regulation Z defines HPML's as: "a consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for loans secured by a first lien on a dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling."
Consumer Financial Protection Bureau, *TILA Higher-Priced Mortgage Loans (HPML) Appraisal Rule*, January 13, 2014, http://files.consumerfinance.gov/f/201401_cfpb_tila-hpml_appraisal-rule-guide.pdf
[13] Consumer Financial Protection Bureau, http://files.consumerfinance.gov/f/201401_cfpb_tila-hpml_appraisal-

It is important to note that in December 2012, the Federal Register discussed HPMLs and established a $25,000 de minimis for these loan types. In January 2013, after the Final Rule was issued, a consumer advocacy group expressed the view that "LMI (lower- to middle-income) consumers obtaining or refinancing loans secured by lower-value homes may have a particular need for the protections of the HPML."[14] When the final rule was issued, the de minimis for HPMLs was set at $25,000, or 1/10 that established for all other federally related transactions. The de minimis for all other mortgage loans has remained at $250,000.

Data analyzed for this paper, taken from the S&P Case-Shiller 20-City Home Price Index for the period 2009-2015, indicate that the average price for homes in surveyed markets ranged between $140,000 and $175,000.[15] The data show that, at a minimum, most residential real estate transactions are below the de minimis, thereby nullifying the federal requirement for an appraisal. Thus, many consumers are effectively being denied the right to professional appraisals in a significant amount of mortgage transactions.

Recommendation:
We propose that the existing de minimis threshold of $250,000 for all federally related mortgage transactions be lowered to the $25,000 HPML Appraisal Rule passed by the combined efforts of the Department of the Treasury, Board of Governors of the Federal Reserve System and the Bureau of Consumer Protection. Reducing the de minimis threshold would increase the number of transactions requiring professional appraisals, giving more consumers access to more reliable valuations.

Problem 4 – Lack of Regulation Concerning Customary and Reasonable Fees

The level of fees paid to appraisers is clearly one of the most important issues facing the profession. Declining fees currently being paid by AMCs to appraisers have discouraged new entrants from coming into the profession.

Dodd-Frank requires that lenders and their agents compensate fee appraisers at a rate that is *customary and reasonable* for appraisal services – customary as it pertains to the market area and reasonable as it pertains to the complexity of the specific appraisal. The law allows for two alternatives approaches when determining rates: 1) that the rate be "reasonably related to recent rates paid for comparable appraisal services performed in the geographic market of the property being appraised" or 2) that the rate be established "by relying on information about rates that Is based on objective third-party information, including fee schedules, studies, and surveys prepared by independent third parties such as government agencies, academic

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[14] Federal Register, Vol. 78, No. 248, December 26, 2013. 78529.
[15] Federal Reserve Bank of St. Louis, *S&P Case-Schiller 20 City Home Price Index*, 2014. https://research.stlouisfed.org/fred2/series/SPCS20RSA, January 2000.

institutions, and private research firms."[16]

In our research we found little actual data indicating that AMCs are paying *customary and reasonable* fees. Instead, many appraisers have stated that AMCs shop the marketplace for rock-bottom prices. The process is as follows: an AMC sends an email blast to all appraisers within a given area, detailing the property and offering a certain fee for the completion of the assignment within a prescribed time frame. The email may or may not even discuss assignment elements that an appraiser must consider in order to make an appropriate scope of work decision for the assignment. Time frames offered are many times less than what the appraisal actually entails. Appraisers receiving the email are left with one choice: accept the assignment as-is, at the fee being offered, in the time-frame being given. If an appraiser tries to counter with a higher fee, invariably the AMC has already hired someone else based on the original fee and timeframe requested.

Another concern is whether or not AMCs are addressing the "reasonable" aspect of *customary and reasonable*, the things that make an appraisal more complex and time consuming than the average, things like location, size, driving distance, availability of comparable data, and access to sales contracts and other information supplied by third parties.

To help address these problems, Dodd-Frank requires that State appraiser certifying and licensing agencies register and oversee AMCs. At least one state, Louisiana, has gone a step further in dealing with the *customary and reasonable* debate. In May, 2012, Louisiana passed its *Louisiana Appraisal Management Company Licensing and Regulation Act*. The law requires that AMCs "compensate appraisers at a rate that is *customary and reasonable* for appraisals in the market area of the property being appraised, consistent with the presumptions of compliance under federal law."[17]

To determine what constitutes *customary and reasonable* fees, Louisiana authorized a statewide survey done by the Southeastern Louisiana University Business Research Center. The survey focused on fees being paid by lenders, not AMCs, to determine *customary and reasonable* fees for specific assignments in specific areas. The survey also included appraiser input for comparison. The final results of the survey set the standard for customary rates in various regions of Louisiana. Although AMCs operating in Louisiana are not bound to the rates prescribed, they are required to provide extensive documentation on how the rate used was developed if audited.

The question relating to the proper methodology to determine *customary and reasonable* fees has been an issue since they were mandated by Dodd-Frank. In a Division of Consumer and Community Affairs report dated October 28, 2010, appraiser representatives and one state legislator argued that creditors and AMCs rely on published fee studies such as Veterans

[16] http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf
[17] Louisiana Real Estate Appraisers Board, *AMC Licensing and Regulation Act,* Acts 2009, No. 502, §1, eff. Jan. 1, 2010, http://www.reab.state.la.us/AMC_license_law.html

Administration fee schedules to determine how much to pay appraisers. Creditors and AMCs argued that VA fees were too high for "average appraisals." We disagree with the creditors and AMCs.[18]

It has been suggested that the Veteran Administration's (VA) fee schedule fairly reflects, at a minimum, fees associated with the work involved in appraisal development and reporting, as well as time frame (7 to 10 days in most markets), and other requirements to develop and report credible and USPAP-compliant appraisals.

Recommendation:
We suggest that all states follow the Louisiana AMC law and begin regulating AMCs as Dodd-Frank mandates. Furthermore, states should follow the Louisiana model and conduct their own independent studies to determine what *customary and reasonable* fees should be for their geographic areas. Where studies have not yet been developed, we suggest the use of VA rates as an alternative.

Problem 5 – Lack of Communication between Clients and Appraisers

The lack of understanding regarding communication between the client and the appraiser became even more prevalent after the enactment of Dodd-Frank. Lenders quickly promoted AMCs as middlemen, and AMCs quickly and happily accepted this new and growing business. Actually, Dodd-Frank never restricted communication between the client and the appraiser; instead, its intent was to protect the independence of the appraiser and the appraisal process.

In addition, Dodd-Frank, TILA, GSE Servicing guidelines and USPAP all address appraiser/agent communications. None prohibit appraisers from speaking with real estate agents during the appraisal process. Agents may talk with appraisers and provide additional property information, including a copy of the sales contract for purchase transactions. Of course an agent must not intimidate or bribe an appraiser, and an appraiser must not disclose confidential information at any time. (See footnote for Dodd-Frank language on this topic.[19])

Once an appraisal assignment is completed and sent to the client, USPAP prohibits an appraiser from discussing the results of the report with anyone other than the client or parties designated

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[18] Federal Reserve Board Staff, *Docket No. R-1 3 9 4 - Valuation Independence Interim Final Rule (12 CFR 226.42),* October 28, 2010.

[19] "The requirements of subsection (b) shall not be construed as prohibiting a mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, consumer, or any other person with an interest in a real estate transaction from asking an appraiser to undertake 1 or more of the following:

- Consider additional, appropriate property information, including the consideration of additional comparable properties to make or support and appraisal.
- Provide further detail, substantiation, or explanation for the appraiser's value conclusion.
- Correct errors in the appraisal report."

111th Congress, https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf by the client. At this point no one except the client can ask for corrections or request consideration of additional data. (See footnote for USPAP Ethics Rule language on this topic.[20])

Recommendation:

We believe that it is important that underwriters who are responsible for verifying credibility and USPAP compliance of appraisal reports be allowed and encouraged to communicate directly with the appraiser. This would eliminate much of the confusion and promote efficient time usage in the appraisal process by reducing the amount of information and questions passed through AMCs to either the underwriter or the appraiser. A more efficient process would benefit the consumer.

Problem 6 – New Regulations Dilute the Appraisal's Importance in Loan Underwriting

New regulations enacted by the Consumer Financial Protection Bureau, entitled *Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z)* state that "The act (Appraisals for Higher-Priced Mortgage Loans {HPML Act}) contains special appraisal requirements with respect to higher-risk mortgages"[21]. The HPML regulations contain language regarding a $25,000 *de minimis* and include very specific appraisal standards for higher-priced mortgage loans. It is troubling that the Qualified Mortgage regulations further imply that the following are exempt from these appraisal requirements:

- Qualified Mortgages (Unclear what, if anything, is required);
- Higher-priced mortgages with a debt-to-income ratio of 43 or less;
- Loans with a higher debt to income ratio that are purchasable by the GSAs or insurable by FHA (this is presumably a temporary provision).

The above three exclusions effectively remove the preponderance of loans from any defined appraisal requirements.

With this in mind, the Qualified Mortgage regulations conclude that "The impact of this reduction in the scope of appraisal requirements is relatively muted for first lien mortgages because of the small number of high-risk mortgages to begin with and the fact that most lenders already do a full interior appraisal and share the results with the consumer".[22]

[20] "An appraiser must not disclose 1) confidential information or 2) assignment [appraisal] results to anyone other than the client, persons specifically authorized by the client, state appraiser regulatory agencies, third parties as may be authorized by due process of law, or a duly authorized professional peer review committee except when such disclosure to a committee would violate applicable law or regulation."
111th Congress, https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf

[21] Bureau of Consumer Financial Protection, *Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z)*, January 10, 2013..

[22] Bureau of Consumer Financial Protection, *Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z)*, January 10, 2013.

Recommendation:

It is our opinion that in underwriting a loan, the parties responsible for underwriting the loan should critically analyze the value of the property, the condition of the property and the borrower's ability to repay the loan. Historically, when lenders wrote mortgages they considered all three aspects very carefully since they were responsible for the property if a loan defaulted. Ideally, lenders would be held responsible for failed loans within a reasonable time period (e.g. five years). This would ensure a critical review of all three criteria. However, this option was considered and not implemented by Dodd-Frank. In the absence of this alternative, it is imperative to ensure that lenders are responsible for ensuring that all loans in excess of the *de minimis* be held to the same standards as the higher-priced mortgages with regard to property valuation/condition. It is not acceptable to simply state that "most lenders already do a full interior appraisal …." If this standard is not applied to each and every mortgage written, consumers and ultimately taxpayers are placed in jeopardy. Furthermore, lenders and not the AMCs must be held accountable for underwriting the risks associated with these loans, including the accuracy of appraisals. This approach will contribute to ensuring that low cost and fast turnaround are not the basis for choosing qualified appraisers.

Problem 7 – How the Appraiser is Viewed by the Consumer and the Public Generally

Though consumers have a vague understanding of the appraisal process, they do not understand that one of the appraiser's main roles in the loan process is to protect the consumer. Appraisers have been unjustifiably blamed for "killing the deal" if the value comes in too low to satisfy the loan requirements.

Recommendation:

There are numerous pamphlets and flyers that explain the appraisal process to consumers; however, they are not being distributed widely. While The Appraisal Foundation is working closely with a public relations firm to promote the profession, federal and state governments must also participate in this educational process; financial institutions should be required to disseminate this information when accepting loan applications; and professional appraisal organizations could also support consumer education with wider distribution of educational and informational materials.

Problem 8 – Poor Implementation of AMC Regulation and Oversight

We believe that, while Dodd-Frank put heavy regulation on appraisers, there is insufficient regulation of the middlemen, the appraisal management company (AMC)

The FDIC, in its Interagency Evaluation and Appraisal Guidelines, talks about third party arrangements in which a lender engages a third party (AMC) to perform real property valuation-related services, such as selecting an appraiser to perform an appraisal. In those cases it is the responsibility of the lender to understand and manage the risks associated with the arrangement. The Guidelines caution that an institution should have the resources and expertise necessary for performing ongoing oversight of third party arrangements. They go on to say that "An institution also is responsible for ensuring that a third party selects an appraiser or a person to perform an evaluation who is competent and independent, has the requisite experience and training for the assignment, and thorough knowledge of the subject property's market."[23]

But the question is, "Are lenders doing their due diligence in overseeing AMCs; and if not, are the States?" Some States have undertaken the task of regulating AMCs, but not enough has been done in this area. While this will be addressed through the requirements placed on states to regulate AMCs under Dodd-Frank, the laws of each state will go a long way to determining how effective AMC regulation will ultimately prove.

We also recommend that lenders be held to their new responsibilities as created by Dodd-Frank. If lenders remain in charge of the lending and appraisal process, they will be less likely to rely on AVMs and BPOs and will instead look for quality appraisals done by licensed or certified appraisers.

[23] Federal Deposit Insurance Corporation, *Interagency Appraisal and Evaluation Guidelines,* https://www.fdic.gov/regulations/laws/rules/5000-4800.html

Problem 9 – Unreasonable Timeframe for Lenders to Estimate Appraisal Fees

There has been a change in the interpretation of the three-day requirement for estimates by lenders as a part of a 2014 TILA-RESPA Integrated Disclosure Rule that has made it very difficult for the lenders to select the most qualified appraiser at a reasonable and customary fee.

The problem is that the 1974 law entitled RESPA stated:

> "(c) Estimate of charges
> Each lender shall include with the booklet a good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary.
>
> (d) Distribution by lenders to loan applicants at time of receipt or preparation of applications
>
> Each lender referred to in subsection (a) of this section shall provide the booklet described in such subsection to each person from whom it receives or for whom it prepares a written application to borrow money to finance the purchase of residential real estate. Such booklet shall be provided by delivering it or placing it in the mail not later than 3 business days after the lender receives the application, but no booklet need be provided if the lender denies the application for credit before the end of the 3-day period."[24]

The 2014 TILA-RESPA Integrated Disclosure Rule replaced the 1974 RESPA language shown above, and while still stating that the "creditor is required to provide the consumer with good-faith <u>estimates</u> (underline added for emphasis) of credit costs and transaction terms in Section 5.1 of the Small Entity Compliance Guide, it states that "Creditors generally may not issue revisions to Loan Estimates because they later discover technical errors, miscalculations, or underestimations of charges." [25] Furthermore, In Section 7.1 of the document it is made clear there is little tolerance for revision of the "estimate" where the rules state that:

> Generally, if the charge paid by or imposed on the consumer exceeds the amount originally disclosed on the Loan Estimate it is not in good faith, regardless of whether the creditor later discovers a technical error, miscalculation, or underestimation of a charge.

It is not difficult to estimate the cost of such services as routine credit reports, flood certifications, tax services, etc. since they are fairly well standardized; however, this is not true of an appraisal. In most cases, location, complexity of the valuation and scope of work cannot

[24] HUD website, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/res/resp2604
[25] ConsumerFinance website, http://files.consumerfinance.gov/f/201403_cfpb_tila-respa-integrated-disclosure-rule_compliance-guide.pdf

be immediately determined. However, in order to comply with the 2014 TILA-RESPA rules, lenders are forced to quickly obtain and guarantee a fee. An easy way to do this is to utilize the services of an appraisal management company that sends out email requests and generally accepts the lowest bidder providing the fastest turnaround. Time simply does not allow either the lender or the appraisal management company to analyze and determine a reasonable and customary fee done by the most competent and experienced appraiser in the time allowed.

Recommendation:
To solve this problem, the lenders should be given more flexibility in estimating the appraisal fee within the three day period, and not be held to such strict requirements as it pertains to upward adjustments in the cost of the appraisal. Where a state has performed an appraisal fee study, lenders may be better situated to provide more accurate estimates; as such, it is imperative that states engage in fee studies not only for the benefit of appraisers, but for consumer confidence in the estimated fee.

Part 4 – Conclusion

Unfortunately, a small number of real estate appraisers played a role in the Subprime Mortgage/Financial Crisis of 2007-2008; however, their part was not commensurate with the heavy toll the appraisal profession took legislatively. Some of the legislation, while well intentioned, had negative consequences that are affecting the livelihoods of appraisers, especially residential appraisers, and threatening the future of the profession in general. More importantly, consumers are paying the price as well.

Many appraisers are leaving the profession due to heightened regulations, undue interference by AMCs, low pay, and other factors not necessarily discussed in this paper. New entrants are not coming in due to a variety of reasons, including new and heightened educational standards that went into effect on January 1, 2015.

Lenders are relying more heavily on third parties (AMCs) in overseeing the appraisal process. Dodd-Frank puts lenders in charge of managing the risks associated with AMCs, including the lender's obligation to insure that AMCs hire appraisers based on competence, independence, and thorough knowledge of the subject property's market. If lenders understand and accept their obligations in this area, they may be willing to rely less on BPOs or AVMs performed by non-appraisers and ask for quality appraisals by licensed and certified appraisers instead.

Lenders should be held responsible for loans that they underwrite and process even where the loan is sold to third parties such as Fannie Mae and Freddie Mac. If a loan fails within the first five years, the lender should be held responsible for the full amount of the balance of the loan. If this is required, lenders will insist on reasonable underwriting standards and quality appraisals.

AMCs have to be regulated consistently state to state, not haphazardly as is now the case. Appraisers should not be the only party who has to abide by the rules of USPAP. All parties participating in federally related mortgage transactions should adhere to the same ethical standards as appraisers.

Some AMCs have created communication wedges between lenders and appraisers due to lack of understanding of the rules. This lack of communication has hurt the appraisal process in general. The resistance of lenders and AMCs to allow appraiser trainees to perform work is another barrier. Low fees and illogical turnaround time requirements for work performed by residential appraisers have further compromised the appraisal process and quality of the product.

Mandatory state licensing would go a long way to alleviate some of the problems created by Dodd-Frank and Title XI. It would require the use of licensed and certified appraisers for all federally related mortgage transactions involving appraisals and appraisal reviews, in lieu of brokers/salespersons and others who are not as knowledgeable or experienced. Lowering the de minimis to $25,000 would also be beneficial.

In the end, the consumer pays the ultimate price. This fact cannot be overemphasized. The entire reason for Dodd-Frank was to protect the consumer, as well as the independence of the appraiser. Due to unintended consequences, the law has done neither. It is the responsibility of all parties involved in the mortgage lending process - legislators, regulators, lenders, AMCs, nonprofit appraisal organizations, and appraisers – to understand and correct the current deficiencies in the law.

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