

REGULATORY ISSUES
FACING THE REAL
ESTATE APPRAISAL
PROFESSION

*Unintended
Consequences
of the Dodd-
Frank Law and
Potential
Remedies*

Summary
Document

Regulatory Issues Facing the Real Estate Appraisal Profession

Executive Summary

The real estate appraisal profession has experienced massive changes in recent years. The fallout from the Subprime Mortgage/Financial Crisis of 2007-2008 and the Dodd-Frank legislation that followed 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 highlight significant issues facing the real estate appraisal profession and present potential solutions to the issues. Although the paper is focused on issues in the residential profession, we recognize that many of these problems could also affect other categories of appraisal.

This document addresses only the main problems as perceived by the appraisal profession and our proposals for addressing those issues to the benefit of consumers and the profession as a whole. A more detailed white paper has been prepared by this group that provides a wider view of the historical aspects that underpin current conditions in the appraisal profession and the impact these conditions have on consumers. We would strongly urge the reader to refer to that document in conjunction with these recommendations.

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There needs to be recognition of the dwindling appraiser population, and steps must be taken to encourage entry into the appraisal profession

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; 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.

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

1. The appraisal profession and users of professional appraiser services must create an environment that encourages Appraiser Trainees

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.

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 two years of a 4-year program dedicated to 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 for becoming certified appraisers.

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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.

2. Consumers would benefit from added transparency in the valuation process

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.

3. The federal de minimis appraisal threshold should be reduced to encompass more valuation assignments

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)¹.

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 "lower- to middle-income consumers needed the same protections as those seeking HPMLs."² When the final rule was issued, the de minimis for HPMLs was set at \$25,000, or 1/10 that established for all other

¹ 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."

² Federal Register, Vol. 78, No. 248, December 26, 2013. 78529.

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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 \$175,000.³ 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 \$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 Financial Protection. Reducing the de minimis threshold would increase the number of transactions requiring professional appraisals, giving more consumers access to more reliable valuations.

4. More must be done to enforce the customary and reasonable fee requirements established by Dodd-Frank

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.

One of the mandates of Dodd-Frank is the requirement for State appraiser certifying and licensing agencies to 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.”⁴

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.

³ <https://research.stlouisfed.org/fred2/series/SPCS20RSA>

⁴ http://www.reab.state.la.us/AMC_license_law.html

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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.

Another suggestion has been to use the Veteran Administration's (VA) fee schedule as a guideline, as it 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.

5. Lenders should critically analyze the value and condition of the property as well as the borrower's ability to pay

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".⁵ 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 state that the following are exempt from these appraisal requirements:

- Qualified Mortgages
- 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.

Recommendation:

To protect the homebuyer and ultimately the taxpayer, we argue that lenders should critically analyze the value of the property, the condition of the property and the borrower's ability to repay the loan. Ideally, lenders would be held responsible for failed loans within a reasonable time period (e.g. five years). Furthermore, lenders and not the AMCs should be held accountable for ordering these appraisals. This approach will contribute to ensuring that low cost and fast turnaround are not the basis for choosing qualified appraisers.

⁵ Bureau of Consumer Financial Protection, *Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act (Regulation Z)*, January 10, 2013.

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6. More is needed to educate consumers on the role of appraisers in the mortgage origination process

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.

7. Lenders need more flexibility in estimating 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.

It is not difficult to estimate the cost of services such as credit reports, flood certifications, tax services, etc. since they are fairly well standardized; however, that is not true of an appraisal. In most cases, location, complexity of the valuation and scope of work cannot be immediately determined. Nonetheless, in order to comply with the 2014 TILA-RESPA rules, lenders are forced to quickly obtain and guarantee a fee. Time simply does not allow either the lender or a management company to analyze and determine a reasonable and customary fee for work undertaken by the most competent and experienced appraiser in such a short amount of time.

Recommendation:

To solve this problem, lenders should be given more flexibility in estimating the appraisal fee within the three day period and not be held to such strict requirements pertaining 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.

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Additional thoughts:

Appraisers and underwriters should be allowed and encouraged to communicate with one another directly

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 AMC's to either the underwriter or the appraiser. A more efficient process would benefit the consumer.

Conclusion

The real estate appraisal profession is currently experiencing several challenges affecting both appraisal professionals and consumers. We believe that the declining attractiveness of the appraisal profession to new entrants could be addressed by:

1. Creating a more effective training structure for Appraiser Trainees to perpetuate the appraisal profession and support growth in the number of professionals in the market
2. Lowering the de minimis threshold, thereby increasing the amount of work available for appraisers and providing consumers, at all levels, the opportunity to benefit in their decision making process by providing a professional, unbiased opinion of value
3. Enforcing payment of *customary and reasonable* fees to maintain a fair environment for appraisers while discouraging further declining appraisal quality

Additionally, we believe that consumers would ultimately benefit from:

1. Increased transparency with respect to the role an AMC plays in the appraisal process, including a breakout of fees paid to AMC's for this role
2. A lower de minimis threshold, covering more transactions and providing consumers with access to a valuable tool in determining risk
3. Access to consumer education and educational products relating to the appraisal process