APPRAISAL OVERSIGHT: THE REGULATORY IMPACT ON CONSUMERS AND BUSINESSES

HEARING

BEFORE THE

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INSURANCE, HOUSING AND
COMMUNITY OPPORTUNITY

OF THE

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APPRAISAL OVERSIGHT: THE REGULATORY IMPACT ON CONSUMERS AND BUSINESSES

Thursday, June 28, 2012

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INSURANCE, HOUSING
AND COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Judy Biggert [chairwoman of the subcommittee] presiding.

Members present: Representatives Biggert, Miller of California, Capito; Gutierrez, and Sherman.

Chairwoman BIGGERT. This hearing of the Subcommittee on Insurance, Housing and Community Opportunity will come to order. Without objection, all Members' opening statements will be made a part of the record. And I will yield myself as much time as I may consume for an opening statement.

Good morning. I want to welcome our witnesses. Today's hearing is entitled, "Appraisal Oversight: The Regulatory Impact on Consumers and Businesses."

I would just say that timing is everything, and I think that hopefully some of our Members will be here shortly after they find out what is going on in other places.

We are examining how appraisal-related provisions in the Dodd-Frank Act and other regulatory initiatives have affected consumers and the real estate industry. This hearing is a continuation of the subcommittee's oversight work related to the mortgage origination process.

A key element of a vibrant and sound housing market is effective appraisal regulation. Regulation should facilitate robust competition among industry participants; it should ensure transparency and integrity throughout the mortgage origination process, while giving law enforcement officials the necessary tools to weed out bad actors; it should avoid placing unnecessary burdens on businesses; and most importantly, it should benefit consumers.

During today's hearing, we will examine the Federal and State roles in appraisal regulation. We will also explore suggestions to improve the appraisal regulation structure and regulations. For example, can we make more efficient, consistent, and effective appraisal oversight by streamlining regulations and redundant efforts to monitor the appraisal industry?

Finally, some mortgage industry participants have raised concerns about concentration in the appraisal industry as well as the quality and accuracy of appraisals. How could regulations enhance integrity among appraisers and ensure accuracy in appraisal evaluations?

Given the broad interest in the issue of appraisal regulations, I would like to hold at least a second hearing during the 112th Congress on this subject to hear from other stakeholders.

So with that, I look forward to hearing from today's witnesses. I hope that today's hearing will provide members of the subcommittee with a variety of ideas as to how appraisal regulation can be improved for both consumers and businesses.

I would like to recognize our ranking member, the gentleman from Illinois, Mr. Gutierrez, for his opening statement.

Mr. GUTIERREZ. Thank you very much for yielding, Madam Chairwoman, and thank you for holding this hearing.

As we proceed with profound systemic and comprehensive financial system and housing finance reform, it is becoming increasingly clear that we will benefit greatly from a clearly defined, fair, sound, and well-regulated system of property appraisal. In other words, all of the industries involved in the real estate market, from builders to consumers, will benefit from a clear and level playing field in the appraisal system.

I look forward to hearing about the GAO—what the GAO found in its two studies on this issue, specifically the several weaknesses that it identified that have limited the Appraisal Subcommittee's effectiveness in discharging its duties, specifically weak enforcement tools and reporting procedures, and in addition, whether the ASC is fully addressing the requirement to create and operate a national hotline to receive complaints of noncompliance with appraisal independent standards and uniform standards of professional appraisal practices.

I look forward to learning more about the concerns of appraisers and the representative organizations on the impact appraisal management companies are having not only on the ability of experienced appraisers to make a living but on the quality of the appraisals as they impact the housing and financial, specifically consumers.

Madam Chairwoman, it is important to understand the concerns of other stakeholders, such as REALTORS® and mortgagers regarding this and other aspects of appraisal issues. But most important to me and I think to many of our colleagues on this side of the aisle, I want to learn how these appraisal issues are affecting consumers, including whether or not consumers are receiving their money's worth in terms of quality of appraisal they pay for. Are they being fully informed of what they are paying for and are they protected from fraud, and do they have the proper means to address their grievances?

I understand there is much to cover in this hearing and this is only another step in the examination of this critical issue. Therefore, I thank you, and I yield back the balance of my time.

Chairwoman BIGGERT. Thank you, Mr. Gutierrez.

The gentlelady from West Virginia is recognized for 2 minutes.

Mrs. CAPITO. Thank you. Thank you, Madam Chairwoman, and Ranking Member Gutierrez.

I thank everybody for being here today. There is just nothing going on in Congress today, so I am glad we are here to talk about appraisals.

I would like to thank the chairwoman for looking into this. It is important.

And I am going to keep this brief. I wanted to take a few moments to address an issue that I have heard many complaints about in my State of West Virginia.

I believe that the appraisal process is absolutely essential and so important to the mortgage process because, as we know, a sound regulatory structure in which the industry can operate and serve the consumer is of prime importance. I hope to get a better clarification today as to whether the Appraisal Subcommittee can handle this role or whether it would be better left to the States to act as the primary regulator.

My main focus, though, has been to have a marketplace for the consumer that the consumer can access. I represent a State where home values are relatively low. We don't have a lot of foreclosures; we didn't get out over our skis, like a lot of other places.

And so, purchasing a home may appear to be very affordable. It still strains a lot of the home budgets, and I am concerned because I hear of folks who—of rising costs of appraisals and that appraisers in some cases are unfamiliar with the area in which they are making the appraisals—local markets. Even in a small State like West Virginia, it might not sound like much, but if you are coming from Elkins to appraise a home in Charleston, it is a totally different market. It is also 130 miles away.

And so, if this is the case, I know that the AMCs have had an increased market share since 2008 and I am curious to know if this has contributed by putting another layer, a middle layer or a more increased middle layer, has that increased the cost of the appraisal to the consumer? I am really concerned about the cost of the appraisal to the consumer and the accuracy of the appraisal. It is essential.

And so, I am interested to know if Dodd-Frank provisions have absolutely created a more consumer-friendly process or not.

So I appreciate the chairwoman for holding this hearing, and I welcome our panelists to the committee room. Thank you.

Chairwoman BIGGERT. The gentleman from California, Mr. Miller, is recognized for 2 minutes for an opening statement.

Mr. MILLER OF CALIFORNIA. Thank you, Chairwoman Biggert. I want to thank you for having this hearing today. It is extremely important.

The appraisal process was broken, and to some degree, it is still broken. After HVCC passed the Dodd-Frank Act, I remember arguing vehemently about the process and the direction that we are heading, and it proved to be right; it was a disaster and we repealed most of that.

But there is a lot lingering after that process that we are still having to deal with. Out-of-area appraisals are a significant problem we are dealing with. Using distress sales as comparables—it oftentimes creates more problems than it does benefit because an appraiser who is not a local appraiser doesn't understand the difference between the distressed property and the rehab that is necessary to take place to make that a comparable property and a property that is not a rehab, what they are dealing with in those areas.

So there is a lot of confusion and ambiguity and the process, I think, has to be dealt with. New home construction is another good example. You are trying to compare a new home to a piece of property that sold for less than sticks and bricks. They are not comparable; they don't meet the new standards, new compliances required by local agencies and States that pass these mandates on energy efficiency.

Green Home in California is another one that is having to deal with it. Builders are putting costs into homes. Many areas are mandated to do that and they can't even use the cost of those improvements as part of the appraisal.

I would like to enter into the record a letter from the National Association of Home Builders, and a second letter from Leading Builders of America.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. MILLER OF CALIFORNIA. Thank you. But when you talk to different groups and individuals, you don't hire an electrical contractor to bid concrete work, and you don't hire an out-of-town appraiser to do local appraisals. You are getting them in areas sometimes where they don't have any expertise and you can't just necessarily, not knowing an area, go to a computer and pull up an equivalent square footage home and say, "It equates to what we are trying to sell here." It doesn't.

We found out the situation with HVCC when they first passed, and Congressman Kanjorski proposed that, my argument was that perhaps New York is the most problematic State in the Nation, but 49 other States don't have those problems, and we need to allow more local control. Being able to take an appraisal and use it, again, is not available during the old process we had where you required a lender to basically do the appraisal. That appraisal could not be taken to another lender to do the work.

So there are areas that we need to deal with that I don't think we have. We are in a recovering market and we need to do what we can to make sure that the market has an opportunity to recover. And I think until we fix the appraisal process, that is not going to happen. We are not doing a service to people who sell their home nor are we doing a service to people who buy the home, and we are doing a complete disservice to the people who are trying to finance homes and sell homes.

So I thank you for your generous time, and I am looking forward to the testimony.

Chairwoman BIGGERT. Thank you.

The gentleman from Texas, Mr. Green, is recognized for 1 minute.

Mr. GREEN. Thank you, Madam Chairwoman. And I sincerely thank you, Madam Chairwoman, for hosting this hearing.

This is an important hearing and I would like to associate myself, if I may say so, with Mr. Miller's comments. I did not hear them in their entirety, so I won't associate myself with all of them, but what I did hear, I associate myself with.

I would also like to enter into the record a letter from the Houston Association of REALTORS®. This letter is signed by Mr. Shad Bogany, who is the Federal coordinator and also the State chair-elect, as well as Mr. Wayne Stroman, who is the chair of the board for 2012.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. GREEN. Thank you.

Madam Chairwoman, I think that Mr. Miller has made some salient points. We find ourselves with people making decisions that are not entirely familiar with the empirical evidence. I do believe that we have to revisit some of these issues so as to tweak the system that we have in place.

My belief is that this is something that is salvageable, and is something that is doable. I think that we just have to find a way to work on this project and focus on the question before us.

I have had an opportunity to talk to REALTORS® so I have some first-hand information about what is going on in my city—first-hand information. I have talked to many REALTORS® about this concern. I have even gone so far as to talk to people who do the actual appraisals, and they too have some concerns.

So I thank you for hosting this hearing. I am looking forward to hearing much of the evidence—and I have to say much of it because, as you know, there are many things happening today, without getting into all of what is going on, and I am being pulled in many different directions. But I have to be here for this because of the importance associated with it.

Thank you again, and I yield back the balance of my 3 seconds.

Chairwoman BIGGERT. Thank you, Mr. Green.

We are delighted to have our panelists here today. We are going to have two panels, and so we will start with panel number one.

We have: Mr. William B. Shear, Director of Financial Markets and Community Investment for the U.S. Government Accountability Office; Mr. Don Rodgers, President, Association of Appraiser Regulatory Officials; and Mr. James R. Park, Executive Director, Appraisal Subcommittee, Federal Financial Institution's Examination Council.

Thank you all so much for being here. And without objection, your written statements will be made a part of the record. You each will be recognized for a 5-minute summary of your testimony.

We will begin with Mr. Shear.

STATEMENT OF WILLIAM B. SHEAR, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE (GAO)

Mr. SHEAR. Thank you.

Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, I am pleased to be here today to discuss our work on real estate appraisal issues. My statement today is based on information from two reports we issued in response to mandates in the Dodd-Frank Act.

The first, which we issued in July 2011, included an examination of real estate valuation methods, including appraisals, as well as conflict of interest in appraiser selection policies. The second, which we issued in January 2012, included an assessment of the Appraisal Subcommittee's monitoring functions and certain challenges faced by ASC.

In summary, we found that, first, appraisals, which provide an estimate of market value at a point in time, are the most commonly used valuation method for first-lien residential mortgage originations. While data on different approaches for conducting appraisals are limited, we found that the sales comparison approach is required by Fannie Mae, Freddie Mac, and FHA, and is reportedly used in nearly all appraisals. We also found that the cost approach, in which an estimate of value uses data on land value and what it would cost to replace or reproduce a residence, is often used in conjunction with a sales comparison approach.

Second, conflict of interest policies have changed appraisal selection processes and the appraisal industry more broadly. Specifically, the policies have led to increased use of appraisal management companies.

In our July 2011 report, we concluded that setting minimum standards that address key functions AMCs perform on behalf of lenders would enhance oversight of appraisal services and provide greater assurance of the credibility and quality of the appraisals provided by the AMCs. Therefore, we recommended that these regulators consider addressing several key areas, including criteria for selecting appraisers, as part of their joint rulemaking under the Dodd-Frank Act to set minimum standards for States to apply in registering AMCs.

Now, I will briefly discuss our evaluation of the Appraisal Subcommittee. It has been performing its monitoring role under Title XI authority, FIRREA. We found that several weaknesses, which are generally associated with the lack of established policies and procedures and clear definitions, have potentially limited ASC's effectiveness.

We recommended that ASC clarify the criteria it uses to assess States' compliance with Title XI and develop specific policies and procedures for monitoring the Federal banking regulators and the Appraisal Foundation. ASC is taking steps to implement these recommendations.

Chairwoman Biggert and Ranking Member Gutierrez, this concludes my prepared statement. I would be happy to answer any questions.

[The prepared statement of Mr. Shear can be found on page 157 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Mr. Rodgers, you are recognized for 5 minutes.

STATEMENT OF DONALD T. RODGERS, PRESIDENT, ASSOCIATION OF APPRAISER REGULATORY OFFICIALS (AARO)

Mr. RODGERS. Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee, thank you for the opportunity to testify today. I am the executive director of the North Carolina Appraisal Board and I am currently the president of the Association of Appraiser Regulatory Officials, which is comprised of the real estate appraiser licensing agencies.

My testimony today will focus on issues that are particularly relevant to State regulators.

First, lack of resources: State appraiser licensing programs were established as a result of FIRREA to issue appraiser credentials and oversee compliance by appraisers with standards and State laws. Some programs are part of an umbrella agency that handles all occupational licensing of the State. They often use a pool of investigators and assign legal counsel on a per-case basis.

Others are stand-alone agencies that handle appraising and/or real estate. They may have contract or staff investigators and full- or part-time legal assistants.

Finally, there are States such as North Carolina that have an autonomous board set up by State statute. These boards do not receive State funding and typically hire their own staff.

Programs that share staff may lack sufficient resources and may not be able to comply with Federal requirements. State officials do not understand why this program must be given priority when the backlog for other agencies is just as great.

Second, appraisal fraud: An appraisal is an opinion of value, which makes it difficult to show that the appraiser intended to deceive someone. For this reason, law enforcement officials often shy away from bringing fraud charges against appraisers. Although State and Federal law enforcement have joined task forces with State regulators, they are often not able to share information due to concerns that their investigations could be compromised.

Appraisers are not usually the originator of fraud schemes but are brought into it with the promise of future assignments instead of large payments, which would provide the smoking gun tying them to the fraud.

Third, appraisal management companies: AMCs have existed for many years. As a result of the Home Valuation Code of Conduct many more AMCs were established. There were, however, no regulations in place defining AMCs or controlling who could own or operate an AMC.

Often appraisers are prohibited from speaking with brokers, builders, or borrowers. This creates consumer frustration directed toward appraisers as consumers are not aware of the role of the AMC in the appraisal process.

Appraisers have their own issues with AMCs, including numerous assignment conditions, requests to go outside of their market, and delays in receiving payment. A frequent problem for regulators is that they must license two entities whose interests are often at odds.

Each group may attempt to change laws and rules that impact the other's ability to function. As complaints increase against AMCs, States may lack the resources to investigate out-of-State companies who have substantial legal resources.

Fourth, alternate valuation services: Broker price opinions and other evaluation products are generally not regulated by appraiser licensing boards. Consumers do not realize the difference and may think they are receiving an appraisal when an appraiser was not involved in the process. There is limited authority to discipline brokers for errors in the development of these valuations and they are not sufficiently regulated.

Fifth, evaluation of the appraisal regulatory system: Some of the cooperative efforts between State boards, the ASC, and the Appraisal Foundation are an investigator training program provided at no cost to the States' task forces on trainee supervision and consistent enforcement. The Foundation issues exposure drafts and requests comments when there are proposed changes to USPAP or the appraisal qualification criteria and schedules meetings to coincide with AARO conferences. The ASC staff attends AARO and Foundation meetings and assists the States in drafting rules and legislation.

There continue, however, to be areas that show the need for improvement. State regulators should be represented on the Appraisal Subcommittee as well as on the Foundation's boards. There should be a national repository for appraiser and AMC records, either through expansion of the national registry or a system similar to the National Mortgage Licensing System.

Current ASC meeting procedures discourage the public from attending. Universal application and complaint forms have been discussed but are difficult to achieve absent a Federal requirement.

The ASC has been in the process of changing its policy statements for several months, but States have not had the opportunity to see a draft or to comment.

The lack of enforcement sanctions was a serious omission from FIRREA and created a situation where derecognition was the only penalty available to the ASC for violations. The Dodd-Frank Act has given the ASC broader enforcement options, the ability to make grants to the States, and oversight of the AMC registration process. It remains to be seen what effects these new tools will have on the oversight of the State appraiser programs.

Thank you for the opportunity to testify before you today. I will be glad to answer any questions.

[The prepared statement of Mr. Rodgers can be found on page 149 of the appendix.]

Chairwoman BIGGERT. Thank you.

Mr. Park, you are recognized for 5 minutes.

STATEMENT OF JAMES R. PARK, EXECUTIVE DIRECTOR, APPRAISAL SUBCOMMITTEE (ASC), FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL (FFIEC)

Mr. PARK. Good morning, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. Thank you for the opportunity to update you on the work of the Appraisal Subcommittee, also known as the ASC.

Title XI of FIRREA created the ASC as an independent agency within the Federal Financial Institution's Examination Council (FFIEC). Title XI was passed following the savings and loan crisis of the 1980s to address weaknesses regarding real property appraisals used in connection with federally-related transactions.

Title XI called for the establishment of State programs to credential and supervise appraisers and created a unique regulatory framework that involves Federal, State, and private entities. At the Federal level, we have the ASC; at the State level, the State appraiser regulatory agencies; and on the private side, the Appraisal Foundation.

The ASC is made up of seven members designated by the heads of the Federal Financial Institution's regulatory agencies as well as

HUD, FHFA, and the CFPB. This past January, the CFPB appointed its first representative to the ASC. Effective April 1st, the FFIEC appointed the HUD representative as the new chairman, who is also a certified appraiser and the first appraiser to chair the ASC.

The member agencies remain committed to fulfilling the ASC's statutory responsibilities. As part of its core responsibilities, the ASC monitors the State appraiser regulatory programs for compliance with Title XI. The ASC completed 27 reviews in 2011 and 31 are planned for 2012.

The ASC also maintains the National Registry, comprised of appraisers eligible to perform appraisals for federally-related transactions. The registry contains just fewer than 105,000 credentials, down almost 14 percent from its peak in 2007. With the registry fee being the ASC's sole source of revenue, the reduction in the number of credentials comes at a particularly challenging time as the scope of responsibility is increasing due to the Dodd-Frank Act.

In monitoring the Foundation, ASC staff attends all public and private meetings of the Foundation boards. For Fiscal Year 2012, the ASC approved a grant of approximately $900,000 to the Foundation. The grant includes funds for the State investigator training program, which has been beneficial to the States.

Through our monitoring, the ASC is aware that the Foundation is currently working on a new strategic plan. The ASC played no role in the development of the strategic plan. However, when made public, the ASC will review and possibly comment on matters related to ASC responsibilities.

The ASC continues to make progress in addressing the Dodd-Frank Act requirements. Last fall, the ASC approved a plan to establish the Appraisal Complaint National Hotline and a great deal of work has been completed towards its implementation.

ASC member agencies are currently working to finalize the details for internal complaint intake and disposition. Launch of the hotline is anticipated before the end of 2012.

The Dodd-Frank Act also required the GAO to conduct a study of the ASC. In its report issued last January, the GAO made three recommendations.

First, GAO recommended that the ASC clarify definitions used to categorize States' compliance with Title XI. In response, the ASC has clarified the definitions, which are now incorporated into all appropriate documents.

The ASC also drafted revised policy statements that have been approved for publication in the Federal Register to solicit public comment. The revisions included new findings and definitions to further address this GAO recommendation.

Second, GAO recommended that the ASC develop specific policies for monitoring appraisal requirements developed by the Federal Financial Institution's regulators. Finally, GAO recommended that the ASC develop specific policies for determining whether the Foundation's grant activities are related to Title XI. Staff is drafting policies for ASC approval to address these last two recommendations.

Other ASC priorities include fulfilling the authority and responsibilities conferred by the Dodd-Frank Act in such areas as State grants and rulemaking. Regarding State grants, many State appraisal programs do not control their funds. Therefore, the ASC will focus on ensuring grant funds are used to support the program.

While the ASC has not yet formally addressed rulemaking, the proposed policy statements would implement the interim sanctioning authority given to the ASC by the Dodd-Frank Act to remove appraisers from the National Registry for up to 90 days. Use of any additional interim sanctioning authority would require rulemaking.

In conclusion, I again appreciate the opportunity to appear before the subcommittee, and I look forward to addressing your questions. Thank you.

[The prepared statement of Mr. Park can be found on page 131 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Park.

This is a time when the members of the committee will ask questions. I will start, and yield myself 5 minutes.

Mr. Shear, do you think that the ASC has made efforts to reform its policies and procedures for determining whether the activities of the Appraisal Foundation are Title XI-related?

Mr. SHEAR. As Mr. Park said, we followed up and we are—we know that they have made progress in this area as far as coming up with a definition—that would be, how do you define Title XI activities? So we know they are making progress in this area.

Chairwoman BIGGERT. So you think that they are moving ahead enough for—

Mr. SHEAR. Yes. We are very glad that they agreed with our recommendation and that they are putting things down in a formal way to address these issues.

Chairwoman BIGGERT. Okay. According to your testimony, and based on your July 2012 report, the Appraisal Subcommittee has not clearly defined the criteria it uses to assess a State's overall compliance with Title XI. Could you expand on this assertion?

Mr. SHEAR. I would be glad to. One thing that we have observed over the years is that the oversight of State compliance with requirements has been enhanced over the years, so we see that and we see the establishment of many policies and procedures that are clearly stated.

But from an internal controls standpoint, we just dealt with a—three different categories that it would bring great clarity and it would provide for more kind of robust oversight if these three categories—or whatever categories they had—were more clearly stated and defined, and we understand that they are making progress in this area.

Chairwoman BIGGERT. Okay. Thank you.

And, Mr. Rodgers, you provide some suggestions on how the appraisal regulatory structure can be improved at the State and national level. Can you describe and explain some of those suggestions for this committee in a little more depth?

Mr. RODGERS. Yes, ma'am. I would be glad to.

In looking at the areas of improvement, as Mr. Park said in his testimony, the policy statements—which are given to the States to follow to show compliance with Title XI—are in the process of being revised. We have not at this point—understand that process has been going on for several months—had any exposure to the States nor do we have the States' comments.

When the Appraisal Foundation makes changes to their—the standards or either the criteria there is a very robust exposure and vetting process and it allows a lot of unintended consequences to get out there. So I would encourage the subcommittee to get those to the States for comment as soon as possible.

Also, we believe that the States should have representation both on the subcommittee as either a member or through some sort of liaison, and they also should have the same representation on the standards and qualifications boards. These boards directly affect policies, rules for each of the States, and for them to understand what impact or what unintended consequences might come by the result of changes to rules or regulations is essential, so we think that is a very essential point.

With regards to the public meetings of the Appraisal Subcommittee, the process is very rigorous to try to attend. You have to register in advance, and have a photo ID. You go through a security process that is more extensive than getting in this building, and you have to be escorted to and from the meeting site.

This is largely because they are held in the offices of the Federal financial institutions, so it is understandable the level of security needed in those buildings. We would suggest that they should be held somewhere the public could come without preregistration or identification. In our State, you come to a public meeting and you can walk right in. And so, we would suggest that, as well. Those are just some of my suggestions.

Chairwoman BIGGERT. Thank you.

I yield myself such time as I may consume for additional questions.

Mr. Rodgers, there seem to be a great number of the appraisal industry participants who claim that real estate appraisal fraud is significantly increasing. As a State regulator, does your appraisal fraud data reflect or dispute this claim?

Mr. RODGERS. Just speaking for my individual State, we have not seen a large increase in appraisal fraud. I think a lot of the flipping schemes that were taking place in the early part of this last decade—they are just difficult to perpetrate given the financial climate we are in now. The rapidly inflated markets made it easier to perpetrate, where now that certainly doesn't take place.

We have heard of issues of what is now called flopping schemes, where it is misrepresented to the lending institution what the property is worth. They short-sell for a low amount and then some of the real estate professionals, in turn, sell the property at a large profit, so kind of a reverse of the flipping scheme.

We have seen some cases in our State which were right in the middle of the transition to the economy falling where there were subdivisions where a lot of promises were made, no money down type investments. A lot of people bought lots for investment type properties and then the market crashed in the middle of it. So some of these were fraud in the fact that they were trying to entice people into making poor investment choices, but the actual market fell out from under them, which was not part of a fraud scheme.

Chairwoman BIGGERT. Thank you.

Then, Mr. Park, it is my understanding that the Appraisal Subcommittee was created in response to the savings and loan crisis in the late 1980s and early 1990s. In light of significant changes over the past 20 years, what is the relevance of the ASC in today's market?

Mr. PARK. The relevance of the ASC is the Federal oversight that we provide for the States as well as the monitoring of the Appraisal Foundation and the grants that are provided to the Appraisal Foundation for the work of the Appraisal Standards Board and the Appraiser Qualifications Board. The original—

Chairwoman BIGGERT. The question is, is the model outdated or do you think you are in the 21st Century, as far as the Federal oversight?

Mr. PARK. Title XI, as originally enacted, had some flaws in it. The Dodd-Frank Act attempted to correct some of those flaws, providing more authority and responsibility to the Appraisal Subcommittee, and while many of those provisions of the Dodd-Frank Act are still being put into place, they should assist the subcommittee in providing greater regulatory oversight for the appraisal regulatory system.

Chairwoman BIGGERT. Mr. Shear, do you think that there should be a complete overhaul of that to make sure that it is in the 21st Century?

Mr. SHEAR. We didn't look at various options for restructuring, so I can't answer your question directly, but we did look at how Dodd-Frank changes the role of the Appraisal Subcommittee and the new authorities and responsibilities, and we think the Appraisal Subcommittee has some huge challenges ahead. As they move forward in implementing our recommendations and taking other actions, I would expect that this committee and others will be taking a very close look to see whether the Appraisal Subcommittee has the resources and the right type of structure to carry out these additional responsibilities, especially pertaining to monitoring the Federal financial regulators.

Chairwoman BIGGERT. Okay.

Mr. Park, obviously the ASC failed to detect a significant amount of appraisal fraud during the financial crisis. A lot of other people made a lot of mistakes too, but do you think because of that, the States could assume some of the role of the ASC?

Mr. PARK. The role of the ASC is not to detect appraisal fraud; that is really the realm of the States. They are the enforcement mechanism of the system.

The ASC's role is to create an environment where fraud can be easily detected and then the States have the ability to enforce disciplinary actions for fraud or lesser offenses—misleading appraisals, incompetent appraisals, and so forth.

Chairwoman BIGGERT. Was there a problem with the environment then, that the ASC created at the time of the financial crisis?

Mr. PARK. The ASC has to work within the confines of Title XI, within the authority that is given. One of the inherent problems with Title XI that Dodd-Frank tried to correct is the fact that the only disciplinary authority that the Appraisal Subcommittee had to use against States that were out of compliance was non-recognition of the State program. Non-recognition of the State appraisal program would, in effect, shut down mortgage lending in the State.

So while it has been addressed with several States, and States know that is a potential outcome of compliance reviews, they also know that it is a very draconian measure.

Chairwoman BIGGERT. The ASC oversees the States, and you said that you don't detect the fraud, but has the ASC put out any information about fraud trends and worked with the States to better address fraud?

Mr. PARK. During the compliance review process, our policy managers who actually conduct the compliance review talk to the States, gather information about what they are doing related to fraud. More and more States, we have found, are getting involved in various mortgage fraud committees and working with the FBI, and Federal and State Government officials to address the problem of mortgage fraud and appraisal fraud.

Chairwoman BIGGERT. Okay.

Mr. Rodgers, do you think that this is—has this happened in your State? Has this been a help?

Mr. RODGERS. I do agree that there have been efforts both on the level of AARO and with the subcommittee reviews that issues that occur in other States are certainly made available and aware of other States. Again, the joint investigator training that has been alluded to allowed three regulators from each State to attend at no cost and to focus on some of these issues that you may see.

As I pointed out in my testimony, in dealing with law enforcement officials, one thing is they have to have a fairly substantial threshold of financial harm before they can become interested in a fraud perpetration, and when they have participated in a task force, which I think has been useful in helping identify players in some of these mortgage frauds, it is sometimes difficult for the information to be shared both ways because they are in a criminal investigation and sometimes they fear that the advancement of a licensing investigation may compromise their criminal investigation.

Chairwoman BIGGERT. Thank you.

I have exceeded my time, and so there will be some leeway for Mr. Gutierrez. Mr. Gutierrez?

Mr. GUTIERREZ. Thank you so much. You are so kind.

I am in a very generous mood. My prescriptions are ready at the drugstore.

I want to let the panelists know that if you have an appointment, you can keep it. Preexisting conditions will not be counted against you. If you have your kids on health care, it is okay. I guess it is the law of the land now, so I feel pretty good about that. Sorry for that little aside, but I thought you might want to know what the Supreme Court has decided, especially since you were all—I know not on your—

[laughter]

Note, I am not talking to the rest of you, who I know are very well-informed of what happened, but not our three very distinguished and welcomed witnesses here this morning.

So, Mr. Shear, as we continue to look at comprehensive housing finance reform, a key element missing from the debate is comprehensive appraisal reform. I think our goal should be to establish an appraisal system that produces accurate values through all phases of the housing cycle. And the agency guidelines that became effective in December 2010 were a vast improvement over 2004 guidance but the scope was limited.

As we confront the major systemic hurdles to appraisal reform, specifically the fragmented and what some of us consider dysfunctional nature of the appraisal system and regulatory oversight the question is, who has the authority and, more importantly, the ability to coordinate and implement the changes we need to accomplish?

Mr. SHEAR. You raise really good questions and our work can address some of those questions. There is room for improvement with the Appraisal Subcommittee, and in particular, the new authorities and responsibilities provided by Dodd-Frank allow the Appraisal Subcommittee to do a better job of trying to oversee the State regulators.

We also think it is very important and also a huge challenge for the Appraisal Subcommittee to try to come up with a way of monitoring the Federal financial regulators, given their structure and their small size. So there is an awful lot that seems to be riding on what the Appraisal Subcommittee is capable of doing.

But I think the types of questions you ask are very good questions because even if the Appraisal Subcommittee does successfully implement new procedures, implements new authorities, and takes on new responsibilities, there still is the question as far as how comprehensive a system we have. And based on our work, I can say those are very good questions that become very much a part of the whole fabric of mortgage reform under Dodd-Frank.

Mr. GUTIERREZ. Mr. Rodgers, could you help us a little more than—

Mr. RODGERS. Yes—

Mr. GUTIERREZ. —across the country.

Mr. RODGERS. I think there are two questions with regards to what happens on the State level. The question has been raised about dealing with appraisal fraud and joint work with law enforcement. Largely, the complaints and the comments I have heard from the Members here today have more to do with the accuracy of valuation, helping to recover from the housing crisis, and situations like that.

Unfortunately, on the State level you are dealing with a complaint system where the board receives a complaint, then it falls under a due process system. For example, in our State, immediately the respondent has 30 days to respond to the complaint before we even initiate the investigation.

What you are hearing a lot from participants in the marketplace is they need somebody that once an appraisal does not meet their needs they need some sort of ability to appeal or to get it revisited or reviewed. I think that will have to be handled largely in the lending community.

Mr. GUTIERREZ. Mr. Park?

Mr. PARK. Could I ask you to restate your question?

Mr. GUTIERREZ. The effectiveness of the system, and to change and to improve, and to have new effective standards across the country—we have changed them. How do you see those standards changing? Are they changing quickly enough? Are they being adopted quickly enough?

Mr. PARK. The changes to the appraisal regulatory system have occurred very slowly. The Dodd-Frank Act contained the first significant changes since it was enacted back in 1989. So there has been—but the Dodd-Frank Act did install quite a few significant changes that we talked about earlier in terms of the subcommittee's authority—

Mr. GUTIERREZ. But you think they are actually being carried out effectively?

Mr. PARK. Yes. We are in the process of enacting the different provisions that the changes—the amendments to Title XI that were part of the Dodd-Frank Act, and we have already made changes in terms of—for example, the subcommittee did not have the authority other than to comment on but we had no authority during the compliance review process to look at the funding and staffing of a State program. Dodd-Frank gave the subcommittee the authority to do that as part of our compliance review process.

Mr. GUTIERREZ. My time has expired. Thank you so much. We will have more questions for you, and I thank you for the testimony today because maybe it is just my imagination but I have only met two appraisers—I have had appraisers—more than two homes appraised.

But I remember meeting one about 25 years ago, and it is like if your car—you tell the mechanic what you think might be wrong with it, right? Contractor comes over to fix something you might tell him where you—and it was like the last time I had the appraiser come over, I almost felt like I was doing some criminal act by telling her about the beautiful tile, how expensive it was before I installed it and trying to tell her what it was about my home that made my home unique so that she could do a better appraisal, I thought.

When I talk to the mechanic, he kind of listens to me and then does whatever he has to do to fix my car, but he doesn't treat me like a criminal in trying to tell him what I think is wrong or good or bad about my car, and I hope we don't get to the point where you get into an adversarial relationship between homeowners and their most prized possession, right, and what it is we think it is worth. In the end, they are going to make an objective determination but you can still get good information, I think, from the American public as you make a decision about what something is worth.

I thank all of you, and I look forward to the next panel.

Chairwoman BIGGERT. Thank you, Mr. Gutierrez.

And I would like to thank the panel for their expert testimony and for being here. It has been very helpful to us.

With that, we will excuse the panel, but first of all, let me just say that the Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their response in the record.

Thank you very much.

And with that, we will have the second panel come forward.

I would like to recognize the second panel, and thank you all for being here. And let me just go through the list.

We have: Mr. David Berenbaum, chief program officer, National Community Reinvestment Coalition; Mr. David Bunton, president, Appraisal Foundation; Mr. Francois Gregoire, the 2011 chair, National Association of REALTORS® Appraisal Committee; Mr. Don Kelly, executive director, Real Estate Valuation Advocacy Association, REVAA, on behalf of REVAA and the Coalition to Facilitate Appraisal Integrity Reform; Ms. Karen J. Mann, president, Mann and Associates Appraisers, on behalf of the American Society of Appraisers; and Ms. Sara Stephens, president, Appraisal Institute.

Thank you all for being here.

We will now begin with the testimony. Without objection, your written statements will be made a part of the record. You will each be recognized for a 5-minute summary of your testimony, and with that, we will start with Mr. Berenbaum.

You are recognized for 5 minutes.

STATEMENT OF DAVID BERENBAUM, CHIEF PROGRAM OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION (NCRC)

Mr. BERENBAUM. Thank you.

Good morning, Chairwoman Biggert, Ranking Member Gutierrez, and other distinguished members of the subcommittee. My name is David Berenbaum, and I am the chief program officer for the National Community Reinvestment Coalition.

On behalf of our Coalition, I am honored to testify before you today from both the consumer protection and the safety and soundness perspective in order to discuss options for improving the regulatory oversight of stakeholders in the home valuation and housing finance industry. NCRC is an association of more than 600 community-based organizations that promote access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

Today, the U.S. economy is mired in the worst economic crisis in more than half a century and valuation issues remain front and center in the financial reform debate. Our current economy has clearly earned its moniker of a "Great Recession" and this is not an equal opportunity recession.

NCRC calls upon policymakers, the Appraisal Subcommittee, and regulators to act swiftly to enforce Title XI of FIRREA, embrace the reforms included in the Dodd-Frank Act, and implement the following 10 recommendations that will help all Americans, but particularly assist low- to moderate-income communities, communities of color, and communities impacted by the foreclosure crisis who are working to realize or sustain the American dream of homeownership.

To accomplish this end, we propose the following: first, to develop a more modern appraisal reporting process and utilize more robust and uniform reporting that can be tailored to today's needs. The recent changes by the FHFA regarding the uniform appraisal data set have only added further confusion to the already inadequate mandated four.

Second, require full appraisals by licensed appraisal professionals for all residential mortgages above $50,000, regardless of if they are originated or ensured by the private sector or Fannie Mae, Freddie Mac, or the FHA. The current limitations associated with the so-called de minimis value of a quarter of a million dollars are out of touch with today's realities.

Third, the role and impact of appraisal management companies must be critically reviewed by the ASC to ensure that they are not negatively affecting appraisal quality. Congress should immediately investigate the emerging practice of mortgage originators assigning or requiring that AMCs or appraisal professionals they engage with for business assume the buy-back risk from the secondary market or insurer claims related to loan origination.

Fourth, appraisal professionals enhance safety and soundness and protect the interests of all parties to a mortgage transaction, including and especially consumers, and they must be appropriately compensated under any usual and customary fee standard that is developed.

Fifth, the banking regulators—Fannie Mae, Freddie Mac, and FHA—should not escape Appraisal Subcommittee evaluation, safety and soundness review, and enforcement.

Sixth, while automated valuation models serve as a useful and cost-competitive compliance tool and an effective check against fraud, they should never replace the use of appraisal by a licensed appraiser for all mortgages that exceed $50,000.

Seventh, there is a need for more effective consumer protection, transparency, and education, including a dedicated consumer complaint hotline managed by the CFPB in collaboration with not-for-profit organizations.

Eighth, responsible appraisal practices ensure and expand housing opportunities in open society. It is unfortunate today that we still see issues of the age of housing, predominant value, and use of comparables, coupled with subjective remarks with regard to the quality of housing in America's low-income or minority communities.

Ninth, inappropriate appraisal undervaluation is equally damaging to homeowners, communities, the taxpayers, investors, and insurers. We are seeing widespread undervaluation through the use of broker price opinions, and the short-sale process, or general reluctance to recognize that in some communities, the market is beginning to return.

And tenth, States must suspend the inappropriate action of redirecting funds intended for appraisal compliance, professional development, licensing, and oversight to their general funds.

In conclusion, it is imperative for Members of Congress, the CFPB, the prudential regulators, and the Appraisal Subcommittee to work in conjunction with one another to ensure that consumers and industry stakeholders benefit from a system of regulation that helps ensure the independence and integrity of the appraisal process. To accomplish this end, we urge you to consider the recommendations that we have made today.

Thank you.

[The prepared statement of Mr. Berenbaum can be found on page 42 of the appendix.]

Chairwoman BIGGERT. Thank you so much.
Mr. Bunton, you are recognized for 5 minutes.

STATEMENT OF DAVID S. BUNTON, PRESIDENT, THE APPRAISAL FOUNDATION

Mr. BUNTON. Thank you very much, Madam Chairwoman. The Appraisal Foundation greatly appreciates the opportunity to appear before you today to offer our perspective on the regulation of real estate appraisers.

By way of background, I have served as a senior staff member of the Appraisal Foundation for the past 22 years, and prior to that I had the privilege of serving as the chief of staff of one of your former colleagues. I should point out that I am not an appraiser.

There are many misperceptions about the Appraisal Foundation, and let me start off by saying what the Appraisal Foundation is not. It is not a government agency, it is not a regulatory body, it wasn't created by Congress, it is not an appraisal trade association, and we have no individual members.

What are we? We are a 501(c)(3) not-for-profit education organization.

We were founded by eight national appraisal organizations, 25 years ago, before the enactment of FIRREA. We are an umbrella organization composed of over 100 organizations and government agencies with an interest in valuation. We have attached a list of those organizations to our testimony. And we were created primarily to foster professionalism in appraising.

What the Appraisal Foundation is, is the private sector expertise in the real property appraiser regulatory system under Title XI of FIRREA. The Foundation does not have any regulatory authority, but we provide the tools to the regulatory community.

Specifically, we set the minimum education and experience requirements for someone to become a State-certified or State-licensed real estate appraiser. We are the authors of the National Uniform Exam that all 55 States and territories use. And we are the authors of the generally recognized standards of professional conduct known as the Uniform Standards of Professional Appraisal Practice (USPAP), that all State-licensed and certified real estate appraisers must adhere to.

With the work of our boards, we understand the very importance of public trust. In fact, the words "public trust" appear in our mission statement. And we have learned over the years that one way to build and maintain public trust is to promote transparency wherever and whenever possible.

All of our boards conduct public meetings. They adopt their work product in open sessions. They issue exposure drafts, often numerous times. And all comment letters we receive are posted on our Web site. In fact, the people who serve on our boards—we interview them in a public setting.

In addition, as part of our commitment to promoting the public trust, we have worked with several U.S. Government agencies at their request on developing specific recommendations to improve their internal appraisal operations, to assist them in their investigative work regarding valuation, and to assist them in developing new policies and procedures.

As Mr. Rodgers pointed out in the previous panel, the Appraisal Subcommittee, AARO, and the Foundation have had a very close relationship over the past few years. State investigator training, with over 300 State investigators now having been trained. We are producing several training videos. At a time of tight State budgets, State regulators can receive training at their desk without having to fly anywhere.

And then, because all 55 States and territories are using the same document for enforcement, USPAP, we have created something called a voluntary disciplinary action matrix, and what that is, it lists specific violations of USPAP and then recommended disciplinary action. It also lists aggravating and mitigating circumstances. It is completely voluntary; it is simply a tool for States to use.

I have been asked to touch on two internal Foundation issues. One of them is the Foundation's strategic plan. It is premature to get into the details of the plan because it will not be presented to our board of trustees until next month.

Assuming it is accepted by our board, the Foundation will publicly expose the draft plan, as it did with its current plan, to all stakeholders for 90 days. This November, the board of trustees will take into account public comments received and make a final determination on approving the strategic plan.

I was also asked to comment on the Appraisal Practices Board. There is a lot of misinformation about this newest board that was constituted in July 2010. This essentially is the how-to board, if you will. How do I appraise it with foreclosed properties, and short sales, and things like that?

There are four things I want to mention about the APB. First, the Appraisal Practices Board does not have any congressional authority. Adherence to the guidance is strictly voluntary.

Second, the APB does not operate with any public funds or any grant money.

Third, the APB valuation advisories do not establish new valuation methods or techniques. They rather are a compilation of existing ones into one place.

And fourth, the APB valuation advisories are available to anyone at no cost.

Earlier, we heard from the Government Accountability Office, and over the past decade, there have been 16,000 disciplinary actions, 2,300 revocations, and 1,800 suspensions. The States have been very active.

Title XI, while certainly unique without its flaws, is the glue that holds these 55 jurisdictions together and, it is important to remember, without the use of any appropriated funds.

Madam Chairwoman, the Appraisal Foundation stands ready to assist in any way you believe the subcommittee can help this effort. Thank you.

[The prepared statement of Mr. Bunton can be found on page 71 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Mr. Gregoire, you are recognized for 5 minutes.

STATEMENT OF FRANCOIS K. GREGOIRE, PRESIDENT, GREGOIRE & GREGOIRE, INC., ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS® (NAR)

Mr. GREGOIRE. Good morning. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee for the opportunity to testify on behalf of the National Association of REALTORS® about appraisal and the regulatory impact on consumers and businesses. NAR represents more than 1 million real estate professionals, including approximately 30,000 licensed and certified appraisers.

My name is Francois K. Gregoire. I go by Frank. I do not speak French.

I am a REALTOR® but I earn my living as a real estate appraiser. My qualifications are fully detailed in my written testimony.

NAR believes a strong and independent appraisal profession is important to consumers and the real estate industry and vital to restoring faith in the mortgage origination process. Appraisals are one of the most critical components necessary for the housing market recovery.

There is no question about the importance of appraisals in real estate and mortgage transactions. A credible valuation by a competent, licensed or certified professional provides benefits to the lender, borrower, and secondary markets. Public trust in the real estate profession is enhanced.

There are obstacles to preventing the realization of these benefits. Among the obstacles is weakened appraiser competency.

Despite good intentions, litigation, legislation, and regulation has diminished the importance of appraiser competency as criteria for appraiser selection and retention. The insertion of appraisal management companies between loan originators and appraisers results in a focus on fee and turnaround time rather than appraiser competency and experience.

The most common concern expressed by our members, whether a broker or an appraiser, is knowledge of the local market or geographic competency. The Uniform Standards of Professional Appraisal Practice requires appraisers to have competency or to acquire competency to understand the nuances of a particular market.

The current AMC model tends to disregard this necessary focus on competency. Appraiser competency may be enhanced with education and communication.

Communication between appraisers and real estate agents and their clients is not prohibited and should, in fact, be encouraged. Of course, efforts to intimidate, bribe, or coerce an appraiser are and should continue to be prohibited.

Some AMCs provide legitimate services for reasonable fees but many contribute to problems in the appraisal business and the overall housing market. Contrary to their claims, there is evidence that appraiser independence is often compromised by the AMC.

Assignment conditions, such as unreasonable turnaround times and unrealistic scope of work for reduced fees, interferes with the decision-making process necessary for a credible appraisal. Experienced appraisers refuse these assignments. Instead of selecting the best appraiser for the job, the assignment is often awarded to the appraiser who responds first to a mass e-mail—not the best selection method.

The independent judgment of appraisers is compromised when AMC reviewers unreasonably question comparable sales selection. Non-appraiser AMC staff with only a cursory knowledge of valuation interfere by insisting that specific information be included or excluded from appraisal reports.

The altered business relationships between appraisers and their clients, unreasonable completion time requirements, diminished fees, and interference in the appraisers' independence all contribute to the failure to recognize positive movement in prices and values in many market areas.

NAR did not support the Dodd-Frank language that regulates AMCs on two different tracks. We believe exempting some AMCs from State registration has aggravated the problems. NAR believes that all AMCs should be registered with State regulatory agencies.

Additional appraisal challenges include limitations of the current standard forms, the reporting format, lagging market information, discrepancies in market definitions, privacy concerns, the funding structure of appraisal programs, and the declining number of appraisers. NAR is the only real estate trade association able to speak with authority on appraisals and alternative valuation products. We have long been proactive in ensuring credible valuation of real property for our industry and embrace an all-encompassing approach.

Appraisals are certainly the gold standard for mortgage origination but there is a role for broker price opinions, comparative market analyses, and automated valuation models. Through our subsidiary, REALTORS® Property Resource, and our valuation committee, NAR is able to provide comprehensive data sets and tools to assist in determining credible home values.

Thank you for holding this hearing to examine an issue which is paramount to restoring confidence in the U.S. housing market. NAR is dedicated to the idea that homeownership matters. It contributes to our Nation, benefitting individuals, families, and communities. Our efforts are directed at ensuring that the dream of homeownership is available to the next generation.

We look forward to working with the committee on this issue, and I am anxious to answer your questions.

[The prepared statement of Mr. Gregoire can be found on page 85 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Gregoire.

Mr. Kelly, you are recognized for 5 minutes.

STATEMENT OF DONALD E. KELLY, EXECUTIVE DIRECTOR, REAL ESTATE VALUATION ADVOCACY ASSOCIATION (REVAA) ON BEHALF OF REVAA AND THE COALITION TO FACILITATE APPRAISAL INTEGRITY REFORM (FAIR)

Mr. KELLY. Thank you, Madam Chairwoman. I am delighted to be here again. It is good to see you. I believe that you and your staff have hit a homerun here. If you look at the panels that have been put together here, a tremendous amount of experience, so many of us have known each other in this business for so long—

and I won't say how long, just to protect the innocent here. And despite some of our disagreements, I must say that on behalf of REVAA and the FAIR Coalition, I will say that personally, I love appraisers. I have been working with appraisers for 30 years and they have tremendous professionalism and it has been a delight to work with them.

My members love appraisers as well because without good appraisers, there would be no appraisal management companies.

Allow me to summarize my testimony. First, regarding appraisal management company operations, REVAA and FAIR members provide necessary services to financial institutions as well as benefits to appraisers and consumers in the course of a mortgage transaction.

Second, in regard to regulation, we are working proactively with the Federal Government and the States to implement the regulatory requirements of the Dodd-Frank Act and State legislation. Third, we encourage the Consumer Financial Protection Bureau to continue to rely on the reasoning utilized by the Federal Reserve Board for payment of customary and reasonable fees.

To my first point, our members manage the production and the delivery of real estate valuation products. They have been responsible for advancements in technologies that benefit mortgage investors, servicers, originators, appraisers, and ultimately consumers.

AMCs typically operate national networks of employee-based and independent contractors for the completion of appraisal reports. Because mortgage lending is a national undertaking, AMCs act as a centralized resource for mortgage lenders and servicers that operate nationwide.

There are approximately 315 AMCs in operation today, owing to the diversity of the lending industry and the competitive marketplace. AMC has worked to match assignments with qualified local appraisers. The average appraiser utilized by an AMC has 15 years of experience and typically travels less than 13 miles on any given assignment.

AMCs perform extensive administrative and quality control functions on behalf of both the appraiser and the lender to ensure delivery of high-quality reports. Member companies rely on competent and qualified appraisers and work diligently to ensure quality.

As part of the selection criteria, our members typically confirm the physical location of the appraiser's office. That location is what they call "geo-coded" and used to calculate the distance to subject properties and other metrics. In addition, objective metrics are applied to an appraiser's performance and appraisals are reviewed by quality assurance teams who specialize in product development and review.

Contrary to what some have suggested, appraisers directly benefit by working with an AMC by having an advocate to ensure appraisal independence, to make sure that no attempt is made to improperly influence the appraisal process. In addition, AMCs provide significant value-added services to appraisers, such as quality control, review, marketing, insurance, technical support, and billing processes.

With loan rate lock-ins and time-sensitive negotiations, AMCs help consumers by reducing the time required for appraisal delivery.

To my second point regarding regulation, AMCs are subject to new regulatory requirements under Dodd-Frank, and prior to passage of the Act, several States had begun the process of enacting laws to require registration of AMCs. We have been actively involved with the States from the inception of these registration laws and have long supported transparency and independence in the appraisal process.

We believe it is important to work towards consistency and uniformity in State laws and regulations to ensure that AMCs can effectively operate on a national basis. We believe the Appraisal Subcommittee and the relevant banking agencies can and should contribute to ensuring a consistent set of national requirements in this regard.

Finally, Dodd-Frank requires that lenders and their agents, AMCs, compensate appraisers at a customary and reasonable rate for appraisal services. We believe the Federal Reserve Board acted appropriately and logically to implement the congressional intent in this provision.

The board has recognized that appraisal services are not one-size-fits-all and has created a compliance structure for fees that reflects market realities and ensures that the appraisal cost borne by consumers will remain competitive and fair. While the board's interim final rule remains effective without further finalization, we believe the CFPB should maintain the criteria articulated by the Federal Reserve Board. To reconsider the issue could result in additional confusion and even lead to setting a fixed fee which may not reflect local market and industry conditions.

Since we last met, States have been active in establishing registration programs for AMCs. By and large, States have been diligent with consistently required registration for a set fee, background checks for AMCs and employees, surety bonds, minimum education requirements, and built-in protections for appraisers engaged by AMCs.

However, because mortgage lending is national in scope, we believe it is important to work towards greater consistency and uniformity in State AMC laws and regulations. We support reasonable and appropriate laws and standards to improve the appraisal industry as a whole, but we also believe the Federal banking agencies should provide clarification and guidance for the industry.

Thank you for the opportunity to testify. I look forward to your questions.

[The prepared statement of Mr. Kelly can be found on page 103 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Kelly.

Ms. Mann, you are recognized for 5 minutes.

STATEMENT OF KAREN MANN, PRESIDENT, MANN & ASSOCIATES, ON BEHALF OF THE AMERICAN SOCIETY OF APPRAISERS (ASA) AND THE NATIONAL ASSOCIATION OF INDEPENDENT FEE APPRAISERS (NAIFA)

Ms. MANN. Thank you very much.

Good morning, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. My name is Karen Mann, and I am an appraiser. I have been an appraiser for 32 years and I am currently the president of my firm, Mann and Associates, in Northern California.

Today, I am here to testify on behalf of the American Society of Appraisers, ASA, and the National Association of Independent Fee Appraisers, NAIFA. I am speaking on their behalf today.

The current appraisal regulatory structure is a dramatic improvement over what was in place prior to the savings and loan debacle. Prior to that, you could own a clipboard, you get a business card, get a tape measure, and you go out and call yourself an appraiser. The problem is it became like the Wild West where people thought that they could be an appraiser at any time.

Thanks to the implementation of Title XI, we found that there were rules and regulations that appraisers had to follow, and it was good. That doesn't mean we always wanted to follow the rules, but we had to, and that makes a more organized society. It is very important.

The role of the appraiser had to recognize that the appraisal industry had changed over the years. As a result of that, we needed something that was a foundation for us, a basis.

So now we have a standard of accountability, and this standard of accountability was—the basis was Title XI, and now with augmentation of the Dodd-Frank Act, we will have a fine-tuning of that original standard format.

We also believe that the Appraisal Foundation has been and continues to be an indispensible and positive factor in the growth of the appraisal profession. Currently, some 65 percent of practicing appraisers are not a part of a professional appraisal organization for guidance. The Appraisal Foundation has been an important element for these appraisers.

Professional appraisal organizations have been around since the 1930s. However, the presence of approximately 65,000 licensed and certified appraisers relying on some source of a foundation requires the use and the implementation of the Appraisal Foundation guidance.

It is important to note that the Foundation decisions involving standards, best practices, and qualifications are made in a transparent manner and are open for comment, review, and recommendation by appraisers and stakeholders.

Improving the current system is currently in process with the proposed implementation of the appraisal portion of the Dodd-Frank Act. The current regulatory system is adequate, however, we recognize, like anything that is being developed, one must tweak it, one must go in and improve it.

So we agree with the 2012 GAO report regarding the need for greater effectiveness at the Appraisal Subcommittee. However, we also believe the Appraisal Subcommittee is showing improvement. They are trying to increase their skill sets and to be more effective and more efficient.

We have several issues facing appraisers in today's environment: first and foremost, as an appraiser, customary and reasonable fees. With the implementation of the AMCs—we don't disagree that having an AMC is appropriate or could be appropriate, but the problem is that the experienced appraisers don't want to work for the AMCs because the fees are so low.

The AMCs typically will charge—and it is customary for the V.A. to publish that fees for appraisers are approximately $450. The AMCs keep between 30 and 40 percent, which means that the remainder goes to the appraiser. The appraiser then has a lower fee. In today's business practice, having a lower fee when your expenses are the same or increasing, makes it very difficult to stay in business.

A lot of the newer and less experienced appraisers are choosing to work for the AMCs, which is not a good thing for consumers because the consumers may not be getting necessarily the most qualified appraiser. I hear this every day from homeowners who contact me and say, "This person came from Fresno and they are appraising a property in San Francisco." That is 400 miles and that is a long distance. Completely different markets.

The next item we have to recognize is that the Dodd-Frank reform has not yet fully been implemented. So the fact that it hasn't been fully implemented—we are working on the presumption that it is going to happen, but once it is implemented we anticipate that the improvement to the entire process will be accelerated immensely.

The good faith estimate and settlement form mortgage disclosures do not disclose that the appraisal fee paid by the consumer is actually two pieces. One piece is what goes to the AMC and the remainder goes to the appraiser.

The homeowner—the property owner—should really know which part goes to which because they think that—when we go out there they say, "We paid you $500 for this appraisal," and when they find out that the appraiser is only getting $300 of it, the homeowner feels deceived and they wonder what is going on with the process.

One other factor that has been a bone of contention for appraisers for years is eliminated the—and reducing the de minimis. Currently, the de minimis means that properties with a price—a value less than $250,000 for residential properties and a million dollars for commercial properties do not necessarily need a—the typical appraisal and other types of valuation products may be used. We firmly believe that that compromises the system and it compromises the homeowner—the consumer—of properties worth less than $250,000, which is a considerable amount when you consider the average price of the home in the United States.

Finally, we have other issues with day-to-day operations, but we don't think that your subcommittee should worry about our minor little issues. We will try to endeavor to participate and encourage and to try to develop processes that work and help the committee and each other improve our system so that we have a professional appraisal group of professional appraisers for every single consumer.

Thank you for allowing me to represent my organizations.

[The prepared statement of Ms. Mann can be found on page 118 of the appendix.]

Chairwoman BIGGERT. Thank you, Ms. Mann.

Ms. Stephens, you are recognized for 5 minutes.

STATEMENT OF SARA W. STEPHENS, PRESIDENT, THE APPRAISAL INSTITUTE

Ms. STEPHENS. Thank you.

Chairwoman Biggert, Ranking Member Gutierrez, my name is Sara W. Stephens and I am president of the Appraisal Institute, the largest association of real estate appraisers in the United States, representing 23,000 professionals and more than half of all professionally designated appraisers in the United States.

In 2007 Chief Justice Roberts, writing for a unanimous U.S. Supreme Court stated, "Valuation is not a matter of mathematics. Rather, the calculation of true market value is an applied science, even a craft. Most appraisers estimate market value by employing not one methodology but a combination. These various methods generate a range of possible market values, which the appraiser uses to derive what he considers to be an accurate estimate of market value based on careful scrutiny of all data available."

These words are so true. Appraisal methods and techniques require judgment by the appraiser. The choice of methods and techniques are the responsibility of the appraiser.

For instance, in valuing a parcel of residential and commercial real estate, appraisers are trained to decide whether or not to use replacement cost and when and how to adjust for seller sales concessions. These decisions by the appraiser are dependent on the actions of the marketplace and should not be mandated. Sadly, this tenet is at risk.

Established under a false premise that timely guidance on appraisal methods and techniques does not exist, the Appraisal Practices Board of the Appraisal Foundation is attempting to assert itself as the authority over appraisal methodology, a move that flies in the face of the decision of the Supreme Court case that I just quoted. Despite having no authorization from Congress in this area, proponents of the Appraisal Practices Board are attempting to dictate appraisal methodology.

In fact, even though the Appraisal Foundation maintains that the guidance documents are voluntary, the Appraisal Foundation is now encouraging States to adopt them as compulsory. Furthermore, the Appraisal Foundation has professed to reference them in the latest document edition of the Uniform Standards of Professional Appraisal Practice, essentially codifying them into State law.

We believe that Congress should exercise oversight over this insidious attempt to confuse the public by subtly abusing existing congressional authority. The appraisal process is not aided by more rules. Instead, the appraisal profession is at risk of having innovation curtailed.

Furthermore, the Appraisal Institute supports realigning the appraisal regulatory structure with those of other industries in the real estate and mortgage sectors. As a model, we believe Congress could turn to the national mortgage licensing system for mortgage loan originators, which is mandated by the SAFE Act and is overseen by the Consumer Financial Protection Bureau.

This is not a self-regulatory organization but one that is owned and operated by the State bank regulators. We see several benefits to a realignment of the appraiser and certification system, including enhanced communication among regulators and reduced red tape for appraisers.

Congress saw reason to authorize this body to assist others within the real estate sector. So, too, can it be for appraisers and appraisal regulators.

Congress also should remain engaged on the issues involving appraisal procurement and appraisal management companies, including the payment of customary and reasonable fees and consumer disclosure of fees paid to appraisal management companies. We often hear from real estate agents, homebuilders, and others that poorly performed appraisals are killing deals and/or holding back economic recovery. These accusations are unfounded and misguided, as appraisers do not make the market; they report the market.

The purpose of an appraisal is not to support a contract sales price but instead is an integral part of lender risk management. Any crisis of confidence regarding appraisals is a direct result of the way in which lenders under the oversight of bank regulatory agencies procure appraisals today.

Here, the predominant factors in the appraisal hiring decision are often price and turnaround time of the appraisal, not quality of service or geographic or market competency of the appraiser. The dumbing down of appraisals cannot continue and we ask Congress for its continued oversight.

Lastly, we know nothing is perfect. The regulatory system that appraisers operate with today is 20 years old and we believe it is time for a fresh look.

Appraisers do not need a set of arbitrary rules. As the Supreme Court has stated, "The careful scrutiny of data should be at the forefront of the appraisal process and is essential to maintaining its integrity." We ask for your oversight of these matters. I thank you very much for the opportunity to be here and I would be glad to answer your questions.

[The prepared statement of Ms. Stephens can be found on page 180 of the appendix.]

Chairwoman BIGGERT. Thank you, Ms. Stephens.

We will now proceed to questions, and I will yield myself 5 minutes.

The Appraisal Subcommittee is in the process of developing the new standards or rules as required by the Dodd-Frank Act, and Dodd-Frank was enacted in 2010, almost 2 years ago. This question is for all of you: Do you believe that the Appraisal Subcommittee has been effective by taking more than 2 years, and counting, to comply with the Dodd-Frank Act?

Let's start with you, Mr. Berenbaum, and just go down the line.

Mr. BERENBAUM. Thank you. I think that is a very important question. We are anxious for the Appraisal Subcommittee to move ahead very quickly in this phase, particularly with regard to monitoring the activities of the other prudential regulators. We have raised issues such as flopping, such as the quality of appraisal compensation, such as issues with regard to expanded use of automated valuation models to, in fact, the prudential regulators.

And despite the lessons that should have been learned in this financial crises, it appears to us, working with consumers across the country, that the prudential regulators are not acting quickly enough. And so, the ASC will and should be playing a critical role in that space as well as, frankly, working with the FHA, as well.

Chairwoman BIGGERT. Thank you.

Mr. Bunton?

And please be brief, because I have some other questions, too.

Mr. BUNTON. I think they are doing much better. The Appraisal Subcommittee today is a far different organization than it was just 7 months ago. I believe 4 of the 7 members were not serving 7 months ago. They are new; they are higher level policy people. For the first time, you have a Chair who is an appraiser.

I attend every one of their public meetings and the difference between it then and now is night and day.

Chairwoman BIGGERT. Thank you.

Mr. Gregoire?

Mr. GREGOIRE. The National Association of REALTORS® does not have a specific policy related to your question. However, I can tell you that unlike a lot of other Federal agencies, the ASC operates without an appropriation; they operate on an appraiser tax. So they don't have the flexibility or the funds to move in the same way that a lot of Federal agencies do.

And I believe that has to be taken into account. The folks who are funding the operation of the Appraisal Subcommittee are actual licensed and certified appraisers, and as Mr. Park testified, that number of folks is diminishing.

Chairwoman BIGGERT. Thank you.

Mr. Kelly?

Mr. KELLY. Thank you. We would like to see the ASC move a little quicker. As I testified, States are already proceeding with registration and other standard development, and so I believe that the ASC could be helpful with moving along with their agenda.

Chairwoman BIGGERT. Ms. Mann?

Ms. MANN. Thank you. There is a pressing need for speedy implementation by rulemaking of many of the Dodd-Frank appraisal provisions, which have yet to be addressed.

These provisions involve enormously important issues, including supervision, registration of AMCs, development of quality control standards for AVM, that is automated valuation models, establishment of an appraisal complaint hotline, and the CFPB's consideration of whether the banking agencies' existing dollar threshold, or the de minimis, is adequate. So we look forward to this.

Chairwoman BIGGERT. Okay. Thank you.

Ms. Stephens?

Ms. STEPHENS. Yes, I think that one of the biggest problems we see is that the current structure really assumes that the States are not capable of administering this entire process of certification and entire process of overview. We would like to see that changed. And that is one of the reasons we make the suggestion that a good look be taken at the way that our whole entire system is set up.

Chairwoman BIGGERT. Thank you.

Now, I have two questions that are just a yes-or-no answer, so the first one is—and we will start with you, Ms. Stephens, and go the other way. Is the Appraisal Subcommittee effective?

Ms. STEPHENS. In my opinion, no.

Chairwoman BIGGERT. Ms. Mann?

Ms. MANN. I believe it is, and it is going to get better.

Chairwoman BIGGERT. Mr. Kelly?

Mr. KELLY. Yes.

Chairwoman BIGGERT. Mr. Gregoire?

Mr. GREGOIRE. Somewhat.

Chairwoman BIGGERT. Mr. Bunton?

Mr. BUNTON. It needs improvement.

Chairwoman BIGGERT. Mr. Berenbaum?

Mr. BERENBAUM. [Off mike.]

Chairwoman BIGGERT. Okay.

Now, another question, yes or no: Should Congress consider a complete overhaul of appraisal regulations and improve it for consumers and businesses alike?

Mr. Berenbaum?

Mr. BERENBAUM. I think there is a serious need to look at how—

Chairwoman BIGGERT. Yes or no?

Mr. BERENBAUM. Yes or no? There is a need to look at it.

Chairwoman BIGGERT. Mr. Bunton?

Mr. BUNTON. [Off mike.]

Chairwoman BIGGERT. Mr. Gregoire?

Mr. GREGOIRE. [Off mike.]

Chairwoman BIGGERT. Okay.

Mr. Kelly?

Mr. KELLY. We should continue to look at it, yes.

Chairwoman BIGGERT. Okay.

Ms. Mann?

Ms. MANN. Improve the existing system.

Chairwoman BIGGERT. Okay.

Ms. Stephens?

Ms. STEPHENS. Yes.

Chairwoman BIGGERT. Okay, thank you.

All right. My time has expired.

Mr. Sherman, from California, is recognized for 5 minutes.

Mr. SHERMAN. Thank you, Madam Chairwoman.

Mr. Gregoire, the GSEs have created this new uniform appraisal database, the UAD, which is used on all GSE appraisals, also for the FHA. How is it all working out?

Mr. GREGOIRE. Fortunately, because of the work that I do, I have not had to complete one of those reports. However, I have heard from dozens if not hundreds of appraisers about their experience, and also from consumers. The UAD method of reporting was not implemented to enhance the quality or the credibility of an appraisal report. What it does enhance is data-gathering.

It does not improve an appraiser's performance or ability to accurately or credibly estimate an opinion of value. And in fact, I believe that it makes the appraisal report more confusing and less useful to the consumer.

Granted, the consumer is not an intended user of an appraisal that is completed for mortgage finance transaction. However, the wording in the form clearly anticipates that the borrower will be placing some credence in that, and the report, according to Federal law, is required to be provided to the borrower prior to the closing of the transaction.

That UAD does not improve the usefulness of that report to the consumer.

Mr. SHERMAN. So at a very minimum, we need to change how it is presented so that the consumer can understand it?

Mr. GREGOIRE. I believe that the reporting format that is instituted by the GSEs is not designed to result in a more accurate estimate of value; it is designed for the convenience of the GSEs. And things that make things more useful to consumers are very often excluded from the report due to the manner in which the report is delivered to the GSEs.

And there are also privacy concerns. The GSEs are now insisting on a whole slew of interior photographs and the borrower and the seller and the lender don't control the distribution of that appraisal report, and a lot of our members are very concerned about privacy.

Mr. SHERMAN. The only thing I have been told about real estate is that it has something to do with location, and location, and location. What can we do to make sure that the appraisers actually understand the neighborhoods that they are appraising, Mr. Gregoire?

Mr. GREGOIRE. Thank you, again. Unlike some of the discussion here concerning geographic competency, I don't believe that geographic competency is determined solely by the appraiser's proximity to the property that is being appraised. Geographic competency is determined by the appraiser's knowledge of a particular market or knowledge of a particular neighborhood or of a particular location. It is also determined by the appraiser's knowledge of a particular property type.

And competency can be—it is not absolutely, positively necessary at the time the appraiser accepts the assignment as long as the appraiser takes the steps necessary to acquire the competency. But you don't acquire competency in a manner of minutes or hours, and I believe that appraisers are fully capable of gaining the necessary competence if they are given the appropriate and the necessary time to spend in a market, interview the folks necessary to gather market information, and given the time necessary to appropriately complete the appraisal report.

Mr. SHERMAN. But even a very competent appraiser who is given just one job in some community he doesn't know, he is only paid a few hundred dollars so he can't spend hours and hours studying everything. That competent appraiser, if he is only going to do one appraisal in that neighborhood is probably going to miss some things.

Mr. GREGOIRE. I agree, and I think that the Uniform Standards for Professional Appraisal Practice provides the appraiser guidance as what to do in such a circumstance, and that is to decline the assignment. And I believe that we have to hold appraisers to that standard. They have to know when it is appropriate for them to accept an assignment and when it is appropriate for them to decline the assignment.

Mr. SHERMAN. If I can squeeze in one more question, how are appraisals and valuations affecting the housing recovery, or what we hope to be a housing recovery?

Mr. GREGOIRE. That is a pretty broad question, but I believe the concern of the National Association of REALTORS® is that there is interference in an appraiser's independence to call things the way they see it. I have plenty of anecdotal evidence of appraisers—and I work and appraise in Pinellas County, Florida. It is a county which is not monolithic. There are areas that are improving—some dramatically, some not so much—and areas that are stable. There are appraisers who have identified improving areas, and as a result of their data and analysis in reaching an opinion that an area is improving have reported that to their clients, and they have made the appropriate positive adjustments to comparable sales to make sure that those comparable sales are adjusted to reflect what they would have sold for on the effective date of the appraisal. The result that has been reported is that you better rethink those date-of-sale time adjustments. That is interference with an appraiser's independence and it results in a misleading appraisal report and an appraisal report that does not reflect a current and an improving market in a specific area.

Chairwoman BIGGERT. The gentleman yields back.

The gentleman from California, Mr. Miller, is recognized for 5 minutes.

Mr. MILLER OF CALIFORNIA. Thank you, Madam Chairwoman.

So the problem I have, and I guess this panel really doesn't—we really don't have a mortgage broker on here; we don't have—these problems, but the data I have seen, 80 percent of all the appraisals being done are refinances, so let's put those in one category. That is just somebody refinancing their home, whatever.

HVCC was so efficient at changing the landscape that even though Congress came back and said, "No, we don't like that," FHFA and FHA never listened. They are still implementing the concept of HVCC, which was a disaster. There was a time, like ordering an appraisal when a mortgage broker, now called an originator, could do something.

But they are excluded from participating in the appraisal process as they were in the past, and many times trying to represent a client—a REALTOR® comes in with a client, mortgage broker, they try to figure out what the house is going to sell for, how the buyer is going it buy it, and they could do an appraisal and they could go out and go to a lender, if the lender's appraisal didn't come in the same line they could say, why are there differences in the appraisals? Is there an error in the appraisal? Are there different issues we need to consider here?

Those are off the table, and in Dodd-Frank I made sure the language included in there that said appraisal would be portable, but they are not. They are just not being done. You go to one lender and they do an in-house appraisal, and they are not giving their appraisal to the other lender. So now somebody has to go back and pay for two appraisals or three appraisals when it could have been done the first time by understanding what the house is really worth based on somebody's understanding of what an appraisal should be and who should do an appraisal.

And, geography, should that matter? I think it does if an—and I think appraisals are wonderful. I have no problem with that. But if he is 2 hours away, and he has one appraisal in a neighborhood, that makes it really tough. And when you are dealing with a marketplace that is tough, is an appraiser likely to say, "I think I should forego taking this job when I can go on a computer and come up with something and present an appraisal?"

So I think there is an inherent conflict in the industry when you put that onus on the individual to say, "No, I am going to turn the work down." It has been a bad market. It has been tough. People are trying to grow their businesses back.

But portability is huge, and it is not taking place. And a problem I have is, especially in the industry today you are appraising many distressed homes at a value and unless the appraiser is out there on site looking and making sure he knows it is distressed versus when it is not distressed they really don't know. So you have to actually drive up to the door and actually look and understand what you are dealing with.

And especially when it applies to new marketplace today, when—I don't believe this country's economy is going to come back until the housing industry comes back. I just don't believe it. There is nothing showing me that it is going to happen until the industry comes back full swing and this economy turns around.

So you have builders in communities that are buying lots basically through this down marketplace in the recent years for less than it costs to do the improvements. So you have an appraiser who is going out there appraising it on values less than it would cost to do the improvements today and buy land today. Land is supposed to be free but it is not, and even all the new requirements placed on them aren't being considered in appraisal value.

And I am not impugning appraisers. I don't mean that at all. It is just very tough and you have to have somebody local who understands it, understands the issue, understands the market and can come up with a realistic value of that home based on current market conditions.

And if that doesn't happen, you are going to continue to distress the marketplace. New product can't be built today unless you are using realistic values of what fair market value is for that home in today's market.

But when you have a buyer willing to buy and a seller willing to sell and the appraiser comes down here everybody is looking at each other scratching their heads saying, "What do we do?" And that is where the problem is today.

You need to be able to say, "I think you made some mistakes in your appraisal here," but you are excluded from that now. You can't do that. It is a conflict of interest almost, the way they are looking at it.

You have to get back to some realistic approach to the concept of value at market rate and putting a lender together with that buyer and seller to be able to move forward in the marketplace. And I think we are hurting ourselves and hurting this economy by not realistically looking at that.

I guess when you look at the State appraiser expected to be selected from individuals assigned based on completely the performance of an appraisal, knowledge of an areas, and type of a product, Ms. Stephens, is that happening? If not, what steps are being taken to make sure that appraiser understands what they are looking at?

And I am not impugning appraisers. I am just saying that we restricted it through HVCC and that we have not come full circle in correcting it.

Ms. STEPHENS. We are hearing from many of our appraisers and many of their clients that this is not happening, that we are not sending people into an area who are familiar. And one of the big problems is, again, that most of the function of today's residential lending market is vested in hiring people based on fee and turnaround time.

We are not saying that all of the AMCs that are working out there are not doing a good job, but we are saying that there are instances where people are traveling great distances to work on a residential assignment when there are qualified people—professional people—in the area who would do that job if the fee were commensurate with their—

Mr. MILLER OF CALIFORNIA. And the problem with traveling that great distance is it is a cost factor for the appraiser. They are traveling; they are not doing something else. It is time lost in the car when they could do two appraisals somewhere else.

And I think the inherent conflict being placed on the industry today is that nobody wants to turn a job down, and I don't blame them. But there is not adequate compensation based on the impact associated with what they have to do to get the appraisal done to expect a reasonable approach to the appraisal process.

And I know you have been generous, Madam Chairwoman, and my time is way up. I had eight more questions, but I yield back. Thank you very much.

I ask unanimous insert to insert into the record a written statement by William Kidwell, president of Impact Mortgage Management Advocacy and Advisor Group, IMMAAG.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. MILLER OF CALIFORNIA. Thank you, Madam Chairwoman.

Chairwoman BIGGERT. Mr. Miller, I am going to ask a few more questions, so if you would like to—

Mr. MILLER OF CALIFORNIA. I can finish. Yes I would love—

Chairwoman BIGGERT. All right.

Mr. MILLER OF CALIFORNIA. Mr. Gregoire, an out-of-area appraiser is one of the most common complaints. I know I just said that. But what can be done, in your opinion, to fix that problem?

The chairwoman gave me the time. Go for it.

Mr. GREGOIRE. I just had an e-mail forwarded to me from a Tallahassee appraiser. This appraiser is in Tallahassee and he wanted to let me know about an assignment that he was given yesterday. They are a nationwide appraisal management company, has a conventional 1004 MC appraisal for a purchase located on a property in Karo, Georgia. I don't know where Karo, Georgia is, but it is in Georgia, not in Florida.

"If you are interested in working with us on this and future appraisals please reply to this e-mail with your estimated turnaround time and fee."

This appraiser is licensed—actually, is certified in Florida, not in Georgia. That is an example. And I don't know how many other appraisers in Florida received the same e-mail.

That is a primary driver of a lot of AMCs' determination as to who gets the assignment—the turnaround time and the fee. No question here whether or not he even is certified in Georgia or what his qualifications are, whether or not he is a designated appraiser. The—

Mr. MILLER OF CALIFORNIA. And the problem with that—and I do like appraisers. I am not impugning anybody. Please don't anybody mischaracterize. What I am saying is everybody shopping for business today, and when a lender receives an estimate from this appraiser that says, "We will do your appraisals for this amount of money," and the lender says, "That is a good deal," it doesn't matter if they are 800 miles away.

Mr. GREGOIRE. Thank you.

Now, as to how it can be corrected, first off, I believe that consumers should be entitled to an appraisal report that is commensurate with the fee that the consumer pays for the appraisal report. They are not getting that now.

They are getting only a fraction of what they are paying for because the bulk of the fee is going to a party other than the person who is completing the assignment. The bulk of the fee is going to an organization, a company, that adds no value to the transaction.

They are strictly a broker, strictly a middleman, and despite all the claim of the quality control and the adherence to the appraiser's qualifications, in most cases it is not. It is simply a means of siphoning off money. Very often, the appraisal management company is associated with or affiliated with the lender, and it is a means for the lender to increase his bottom line.

Mr. MILLER OF CALIFORNIA. Done on a contract basis?

Mr. GREGOIRE. Yes.

Mr. MILLER OF CALIFORNIA. Yes.

Mr. GREGOIRE. So we have to think that the consumer needs to get what they are paying for, and if the lender wants to use the services of an appraisal management company to broker these valuation services—the AMCs claim that they are operating as an agent for the lender. Well, by golly, let the lender pay for that service, don't make the appraiser pay for it or don't make the consumer pay for it. The lender is the one that is getting the benefit; make the lender pay for that benefit.

Mr. MILLER OF CALIFORNIA. I agree.

I guess I am admitting I am getting old, but I have been in the real estate and building industry for over 40 years and I really have tremendous respect for appraisers, especially when I used to make application to a bank to build a subdivision and they relied on their usually in-house appraiser to go out and give a fair market appraisal because they were taking a risk lending me the money, so—and the individual actually went out and did what I considered a fair market appraisal. They did a good job.

And when we would buy or sell the house they would take and go and appraise the individual house and they based it on—they appraised the house the block away and they appraised the house a mile down the road, and they really understood the area. And what we did with HVCC was overturn the apple cart to such a degree that nobody has figured out, even though we have directed them, how to put it back the way it was.

Government doesn't change rapidly. For some reason, they did with HVCC, but coming back the other way, it has not done a good job.

I think it has done a disservice to the appraisers in this country who do excellent work. It has hurt them. It has created a situation where the lenders are no longer having appraisals to compare with theirs and they can't deal with the issues of errors like we could in the past, having multiple appraisals, and the appraisal can't be used somewhere else because one person has already paid for it and it is proprietary.

And we have created a situation where they are putting out and they are bidding these things on a bulk basis and whoever gives them the best price is going to get all of them, irrespective of the letter you read to me about geography.

I took notes on what you said earlier, and you talked about geography, you talked about fully capable, and you talked about guidance. Every one of them was followed with an if, and proximity doesn't matter if, fully capable if, provide guidance if. The problem is defining if. I had—Bill Clinton of what the definition of is is, but "if" opens up a huge problem that we started and we have to correct.

Now, the REALTORS® are out trying to provide a service to a buyer and seller. The mortgage brokers are trying to provide a service to the buyer, seller, REALTOR®. And the appraisers are trying to provide service to everybody. And we have put them in such a difficult situation that it is just not working, and we have put them in a situation where it is, I believe, in some fashion stifling the ability of the economy to recover because we have decimated value in homes out there with this downturn in the economy that we are not doing what is necessary that we have hit a bottom to start building it back up or letting it come back on a natural basis.

We are stepping it steps and we are stopping it right there because we have mandated things that don't work. And now I hope somebody is starting to listen that, "Hey, we are not happy with what we did; we messed up. But we are also not happy with you not listening to us wanting you to correct what we did wrong," and that is a problem today.

We have to fix it. It has to be done, and somebody needs to listen.

And, Madam Chairwoman, you have been more than generous. I would yield back my time twice. Thank you.

Chairwoman BIGGERT. Thank goodness.

Mr. KELLY. Madam Chairwoman?

Chairwoman BIGGERT. Mr. Kelly?

Mr. KELLY. Might I just respond quickly to Congressman Miller's—I appreciate your summary and the description of the plight and I agree with much of what you said. However, I don't believe that you should consider legislating on the basis of anomalies or hearsay.

I have heard the stories, too, about—

Mr. MILLER OF CALIFORNIA. And I didn't mean to do that—

Mr. KELLY. I know you wouldn't, and I appreciate that. But AMCs—there are 350 of them in the country. Are they all the best and good? No. Are there good and great ones? Yes, there are, and I think they are associated with my association. But they do, indeed, provide real value to the process, and the reputable AMCs indeed do help protect the appraiser but they also allow for the types of transactions that you are talking about to be facilitated.

We mentioned in our testimony earlier that BPOs, ABMs, and other methodologies can be utilized to either check appraisals or to give a sense of what the trends are in any given neighborhood or any given property, and those sorts of tools are very much available and in use in today's world.

I was delighted to see my friend Karen Mann using an iPad to give her testimony today. And as you know from your real estate experience, the big technology of the day back in our day was the memory card in a Selectric typewriter.

So things have changed. Things are, indeed, available—

Mr. MILLER OF CALIFORNIA. Sure.

Mr. KELLY. —today that can help, I think, go to the issues that—

Mr. MILLER OF CALIFORNIA. Ms. Stephens, what is your opinion on what he just said?

Ms. STEPHENS. I think that there are a couple of things that are incumbent on all of us and that we need to make sure change, and one of those is that lenders are held accountable for these appraisals and for the opinions and for their actions. But we also need to make sure that people who are regulating this industry, who are the regulators who are coming in, are well-versed and that we have a sufficient staff to take care of the problems that are coming and to make sure that what is happening in the appraisal business is well-maintained and understood as they try to do their job.

Mr. MILLER OF CALIFORNIA. Madam Chairwoman, if you give me 1 second—Mr. Kelly, I agree with—I am not disagreeing with what you said. What I was saying is we all make mistakes. We did. Congress did. And we came back and tried to correct that.

But what we did was exclude everybody from being able to be involved and participating in this appraisal process—use matching appraisals dealing with areas we think that were done wrong, errors that might have been made. And they happen in appraisals. They just do. Happens in every business.

But we have taken and excluded that ability to be competitive, comparative, and being to deal with mistakes that just occur. And that is what I am saying is where we have messed up. It is not impugning any appraiser anywhere. It is saying, let's get back to a system of accountability and portability and reliability.

And that was all I was saying, so if anybody in any way took any statement impugning anybody it was never intended to be that way. I am saying we goofed up. And other people make mistakes, too. Let's get back to a system where we can correct those mistakes and come up with something that is really good for everybody.

And thank you, Madam Chairwoman.

Chairwoman BIGGERT. Thank you.

I will recognize myself for 5 minutes.

In that line of thinking, Ms. Stephens, you have offered an alternative regulatory structure for real estate appraisers. How would this structure differ from the one we have today?

Ms. STEPHENS. Let me start by emphasizing that what the Appraisal Institute is speaking about and what we are proposing is not a self-regulatory organization, like some have mentioned. Self-regulatory organizations involve industry, whereas the national mortgage licensing system is owned and operated by bank regulators, in this case State bank supervisors.

Those are the fundamentals of the State appraiser certification and licensure and adherence to enforceable Uniform Standards of Professional Appraisal Practice would remain unchanged. At a high level, as I alluded to before, the current regulatory structure assumes that States are not capable of administering a system of certification, creating a specific agency to intervene with the process. The mortgage licensing system assumes that a State can assume the responsibility and administer State certification, maintaining a Federal presence out of a last resort.

For many years, Congress and others have sought a way to advance regulator communication, and this mortgage licensing system has developed a solution. We understand that they are offering the system to State regulators outside the mortgage loan origination business, and as there are common problems that all State regulators face. So it would not be elite appraiser regulators to participate in this system.

Thank you.

Chairwoman BIGGERT. Thank you.

And then, just one last question. Ms. Mann, on page 2 of your testimony, you call a Federal Reserve rule on customary and reasonable fees as required by Dodd-Frank, "stunning and completely inappropriate," and you also mention that this rule creates a loophole. Could you expound on these points?

Ms. MANN. Let me catch up with you here.

Chairwoman BIGGERT. Okay. Page 2.

Ms. MANN. It creates a loophole whereas the AMCs were allowed to go out and check customary fees, but within the scope of their investigation they used AMC fees as part of the equation, as part of the array. We feel that customary fees should be outside of the AMC realm and it should be from the general marketplace.

For instance, V.A., FHA, appraisals done for other purposes, whether it be for dissolution or for estate work, just to get an ideas as to what the customary fee is for an independent appraiser in the field trying to make a living in their small business.

Chairwoman BIGGERT. Okay.

Mr. Kelly, do you have a response to that?

Mr. KELLY. Yes, I do. We believe that appraisers should be paid appropriately. Fees for appraisers—compensation for appraisers—has always been set by the market. It is a supply and demand equation, quite frankly. Appraisers indeed deserve a reasonable, customary fee to be paid for the services that they provide.

The notion that AMCs are somehow driving down fees for appraisers I think is really mistaken. We don't set fees for appraisers; we work for lenders. We are the agents of the lender. We are doing the risk assessment pieces of what the lenders have traditionally done. We provide, as I indicated in our testimony, services for lenders and for appraisers.

One of the things that I have been told in all the years that I was with the Appraisal Institute is that one of the largest costs for appraisers was marketing. That in addition to the risk—no insurance and warranties and those types of things are real costs for appraisers, say, doing retail assignments.

Much if not all of that has been offloaded to the AMCs, and so there is a sharing of that compensation. That risk and those duties are no longer done by the traditional appraiser and the consequent fee that they get is one that they agree to and have been negotiated with to say, "Will you go do this assignment on 123 Maple? It is a 1004, etc., etc. What is your fee?" They say it is $300 or whatever it might be, and you strike an agreement.

So there may be anomalies on that, just like we have talked about anomalies on traveling, but those are truly anomalies, as far as I can tell. I haven't seen any evidence of that—

Chairwoman BIGGERT. Thank you.

Would anyone else like to comment on that?

Mr. Berenbaum?

Mr. BERENBAUM. Thank you very much.

I think it is very important to distinguish the importance of what has happened over the past 8 years. At the height of the market, 60 percent of mortgages were originated by mortgage brokers, the majority of whom were professional lenders.

However, we all know that we saw many problematic nontraditional, subprime loans. We also saw issues where appraisers were working exclusively with companies such as Ameriquest or brokers and they were overvaluing properties.

The intent of the Home Valuation Code of Conduct was to ensure that arm's length transaction, which was part of USPAP. We agree it should be changed.

The reality today, jumping forward to today, is some of the unintended consequences of efforts to improve performance in the marketplace. Appraisers tell us, when we ask them about valuations given to consumers, with regard to accuracy issues, in the past they would have a day or more to produce an appraisal for a lender. Today, AMCs expect them to do two to three appraisals in the same time period.

The fact of the matter is, appraisers are leaving the practice, the profession, in droves because they can't make ends meet. That is not a product of quality. These appraisers are committed to providing quality products.

But it is a product, unfortunately, of a changing marketplace, and what we are not seeing, and I hope we do see, back to the purpose of this hearing, is that we do see, in fact, the subcommittee working with the CFPB, working with the prudential regulators, to ensure safety and soundness and the return of robust lending.

Thank you.

Chairwoman BIGGERT. Thank you.

I ask unanimous consent to insert the following material into the record: a June 28, 2012, statement from the National Association of Home Builders; a June 28, 2012, statement from the American Enterprise Institute; a June 28, 2012, statement from the American Guild of Appraisers; a June 28, 2012, statement from the Mortgage Bankers Association; a June 28, 2012, statement from the Dallas-Fort Worth Association of Mortgage Brokers; and a June 28, 2012, statement from the Leading Builders of America.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

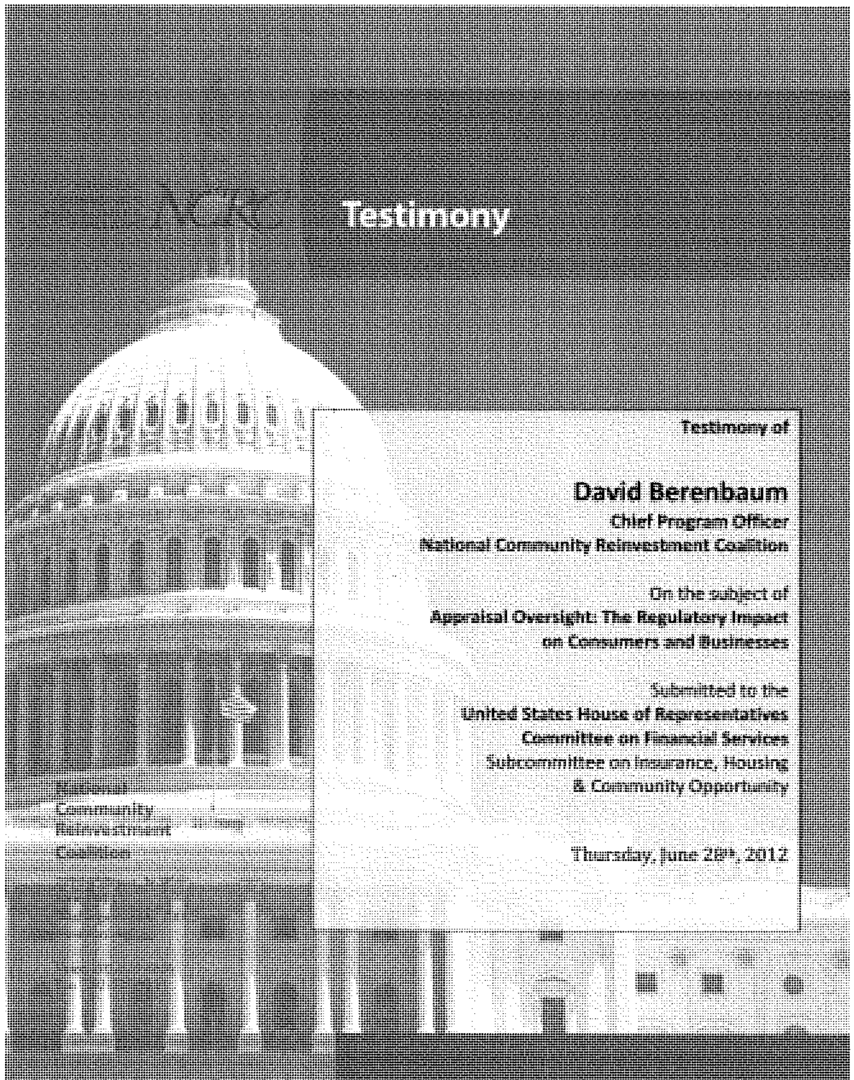
With that, I would really like to thank you for your expertise that you have brought to this panel, and for helping us as we move forward. And so, I thank you all for being here.

And with that, this hearing is adjourned.

[Whereupon, at 12:06 p.m., the hearing was adjourned.]

A P P E N D I X

June 28, 2012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NATIONAL
COMMUNITY
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Room 2128
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Thursday, June 28th, 2012

Introduction

Good morning Chairman Biggert, Ranking Member Gutierrez and other distinguished Members of the Committee. My name is David Berenbaum and I am the Chief Program Officer for the National Community Reinvestment Coalition (NCRC). On behalf of our coalition, I am honored to testify before you today from both a consumer protection and a safety and soundness perspective in order to discuss options for improving the regulatory oversight of stakeholders in the home valuation and housing finance industry.

NCRC is an association of more than 600 community-based organizations that promote access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

Members of the Committee, today the U.S. economy is mired in the worst economic crisis in more than a half century and valuation issues remain front and center in the financial reform debate. And while few would conclude the current economic environment is comparable to the Great Depression, today's economy has clearly earned its moniker, the Great Recession. Our housing markets are currently experiencing a self-perpetuating cycle wherein (1) foreclosures drive down home values; (2) sinking home values erode bank assets and household wealth; (3) loss of wealth leads to lower consumer spending and less lending activity by banks; (4) this, in turn, leads to lower productivity; (5) that creates more unemployment; and (6) more unemployment causes more foreclosures. The most dispiriting aspect of the current crisis is that we have yet to meaningfully address the cause of the foreclosure crisis, the core problems that caused the financial system to implode and drove the economy into a ditch.

This is not an equal opportunity recession. Although the national unemployment rate is an uncomfortable 8.2 percent as of May, that rate for African Americans exceeds 13.6 percent, and for Latinos unemployment is now 11 percent. The unemployment rate for non-Hispanic whites, by comparison, remains at 7.4 percent.[1]

Because African Americans and Latinos have comparatively few savings, they are poorly positioned to survive a lengthy bout of unemployment. The median wealth of white households is 20 times that of black households and 18 times that of Hispanic households, according to a Pew Research Center analysis from 2009. As a result, potentially millions of African-Americans and Latino households could find themselves falling out of the middle class by the time the economy recovers. This has been compounded by the dual lending market and valuation issues that have infected every residential community in America but have, in particular, metastasized in African American, Latino and low to moderate income communities.

Moreover, African Americans and Latinos were targeted disproportionately for deceptive high cost loans and non-traditional toxic prime option ARM loans coupled with home equity lines of credit at 110 to 120 percent loan to value. The result is that blacks and Latinos are over-represented in the foreclosure statistics. Pew Research analysis found that, in percentage terms, the bursting of the housing market bubble in 2006 and the recession that followed from late 2007 to mid-2009 took a far greater toll on the wealth of minorities than whites. From 2005 to 2009, inflation-adjusted median wealth fell by 66% among Hispanic households and 53% among black households, compared with just 16% among white households.[2]

[1] United States Department of Labor Bureau of Labor Statistics, May 2012

[2] Kochhar, Fry & Taylor "Wealth Gaps Rise to Record Highs between Whites, Blacks, Hispanics," Pew Social & Demographic Trends. July 26, 2011. www.pewsocialtrends.org

Equally troubling are the following statistics:

- Roughly 11 million homes, 22.5% of homeowners, are currently mortgaged for more than they are now worth. [3]
- According to Zillow, the number is even higher – 15.7 million people, or one in three Americans owe more then their home is currently worth. Collectively this is 1.2 trillion dollars in debt. [4]
- Approximately 3.5 million homeowners are behind on their payments (RealtyTrac)
- Nearly 1.5 million homes are already into the foreclosure process (RealtyTrac)
- 3.6 million foreclosures will take place over the next two years[5]

The time has come for members of Congress, the prudential regulators, the Appraisal Subcommittee and the Consumer Financial Protection Bureau to work collaboratively to ensure that consumers and all the industry stakeholders involved in the home buying and refinance process will benefit from a system of regulation that helps ensure the independence and integrity of the appraisal process. These efforts will promote equal access to responsible and sustainable credit and a robust mortgage marketplace that meets our nations immediate housing finance needs.

In June 2005, the National Community Reinvestment Coalition released our report "Predatory Appraisals - $tealing the American Dream" exposing appraisal overvaluation as both a significant consumer protection and safety and soundness issue. While appraisal professionals did not appreciate the use of the word "predatory," the report brought sunshine to a previously

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[3] Corelogic Reports Negative Equity Increase In Q4 2011, March 1st, 2012. See www.corelogic.com/about-us/researchtrends/asset_upload_file360_14435.pdf

[4] Zillow Negative Equity Report, May 24th, 2012. See http://www.zillow.com/blog/research/2012/05/24/despite-home-value-gains-underwater-homeowners-owe-1-2-trillion-more-than-homes-worth/

[5] William C. Dudley, President & CEO, Federal Reserve Bank of New York, Remarks at the New Jersey Bankers Association Economic Forum, January 6th, 2012. See http://www.newyorkfed.org/newsevents/speeches/2012/dud120106.html

unexposed issue and brought significant public policy attention to the underlying valuation issues impacting on loan origination, securitization and consumers alike. To quote from the studies executive summary – "...appraisal practices, combined with consumer protection loopholes and the absence of meaningful industry standards, is facilitating the theft of equity from homeowners nationwide, and, in the process, threatening the safety and soundness of the market. Further, these predatory appraisals destroy entire communities, leave the secondary market in extreme risk and endanger the marketplace as a whole. These abuses must end before the American dream of homeownership is stolen from the entire nation." Despite NCRC's repeated calls upon the prudential regulators, the Federal Financial Institutions Examination Council (FFIEC), Appraisal Subcommittee (ASC), the not for profit Appraisal Foundation and related state regulatory agencies to use the full force of their authority under Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), USPAP and related Federal and state laws to address the significant issues in our report, our requests for broad reform and enforcement were largely ignored.

In 2006, NCRC founded The Center for Responsible Appraisals and Valuations, representing borrowers, appraisers and responsible financial service providers. The Center's mission was to encourage mortgage finance professionals to adopt an official "code of conduct" pledging to ensure fair and accurate appraisals for borrowers and to advocate for public policy on the federal and state level. The Center eventually created a national Code of Conduct as a voluntary industry best practice for all industry participants. In order to curtail the valuation abuse, each "signatory" agreed to comply with the guidelines of FIRREA as well as other local, state and federal rules and regulations. The Center Code of Conduct was devised in an effort to avoid conflicts of interest for loan officers and others who would have an interest in inflating real estate values.

NCRC staff, including myself, personally met with over one hundred public and private sector leaders to request that they voluntarily accept the best practices that we had developed in cooperation with the appraisal, mortgage finance, and securitization industry.

Despite our best efforts, only a handful of responsible appraisers, AMC's and lenders joined the effort. Many industry trade associations actively pushed back against our efforts and preferred to support the status quo that was producing routine overvaluations that often were more than 20% above the actual value. The work of The Center concerning the Code of Conduct was ultimately superseded by the adoption of the Home Valuation Code of Conduct, which has been generally acknowledged by the New York State Attorney General's Office and the other parties to the agreement to be inspired by the NCRC Center's Code of Conduct.

Prior to 2008, 60% of all appraisals were ordered by mortgage brokers.[6] Because of this, in 2007, the New York Attorney General's Office began conducting investigations into whether lenders had been asserting undue influence on real estate appraisers to encourage them to inflate home values. Attorney General Cuomo believed that there may have been collusion between lenders and appraisers, for which they could be prosecuted. In late 2007, Cuomo expanded his investigation to include the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), the two giants of the secondary mortgage market. The purpose of the investigation was to determine whether or not these two corporations were complicit with other financial institutions in illegally inflating home values. Though neither corporation ever admitted to any wrongdoing, on March 3rd, 2008 an agreement was struck between the NY AG, Fannie Mae/Freddie Mac and their primary regulator, the Office of Federal Housing Enterprise Oversight (OFHEO). The NY AG agreed to end its investigation into Fannie Mae and Freddie Mac in exchange for these two industry giants agreeing to a new policy of only purchasing mortgages from banks that would abide by a new set of appraisals standards known as the Home Valuation Code of Conduct (HVCC).[7]

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[6] Testimony of Sara W. Stephens, MAI, CRE. "Mortgage Origination: The Impact of Recent Changes on Homeowners and Business." July 13, 2011. House Committee on Financial Services, Subcommittee on Insurance, Housing & Community Opportunity

[7] Ted C. Koshiol, "Should the HVCC Settlement Be Treated As An Agency Rulemaking?" April 2009. http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=ted_koshiol

The purpose of the HVCC was to prevent Fannie Mae and Freddie Mac from purchasing loans from sellers that had not adopted the code with respect to single-family mortgages (except government-insured loans) originated on or after May 1, 2009. This regulation prevented banks' staff and mortgage brokers from directly overseeing the appraisal process. The HVCC was devised in an effort to avoid conflicts of interest for loan officers and others who would have an interest in inflating real estate values.[8]

Under the HVCC agreement, lenders were not allowed to use in-house staff for initial appraisals and are prohibited from using appraisal management companies that they own or control. The HVCC encouraged banks to engage third-party appraisal management companies (AMC's), in an effort to keep the appraisal process independent from mortgage brokers, banks, etc. The HVCC also required GSEs to set up a complaint hotline for consumers and industry alike and funded the creation of a new "institute" known as the Independent Valuation Protection Institute (IVPI), to study the issue further. Though Fannie and Freddie implemented the HVCC, as a result of the GSE's failure and conservatorship the "institute" was never funded. This is unfortunate, because the Institute was originally envisioned and intended to address many of the issues that the House Financial Services Committee Subcommittee on Insurance, Housing & Community Opportunity is examining today.

Unfortunately, the issues and related "contagion" of greed and malfeasance that inspired the creation of the HVCC at the height of the market, including appraisal independence, valuation fraud, rampant industry pressure upon appraisal professionals, open blacklisting or cherry picking of valuation professionals, and the absence of arms length transactions - coupled with the use of inaccurate and growing reliance on automated valuation systems in refinance lending – continue to infect our markets today even during a time of declining values and conservative underwriting. Instead of "flipping," the practice of overvaluing properties, we

[8] Ibid.

now have "flopping," a deceptive practice in which there is instead widespread pressure to undervalue by real estate agents and many Appraisal Management Companies are implicit in the process. In addition, there has been an over reliance on foreclosures as "comps" or the use of broker price opinions. Further, the appraisal industry is in crisis, with respected and expert licensees leaving the trade due to inadequate compensation for the critical valuation services they provide. The answer that many suggest – use inaccurate AVM's and/or create a national valuation database to compensate for the shortage of qualified and licensed appraisers. Compounding this is the fact that a majority of states are diverting revenues that are sorely needed to recruit and train valuation professionals to their general funds. Of course, many of these factors are market driven, but most, if not all, could have been addressed by FFIEC Subcommittee and the prudential regulators if they fulfilled their mandate.

Another core issue that has yet to be addressed is the fact the lenders and specifically end investors, such as Fannie Mae and Freddie Mac, provide the definition of Market Value that the appraiser must use in fulfilling an assignment for loans directed to them and presented on the GSE mandated form. This definition is based on providing a point-in-time value in current market conditions. Meaning what the house is selling for today makes sense in current conditions. Many professional appraisers have continued to offer counsel that a more prudent definition would be lending value. And, that this lending value, drawing on long standing principals in valuation, includes a consideration of market rents, carrying costs and other economic factors besides just comparable sales to determine if the property can sustain the collateral burden represented by the proposed loan. Appraisers either accept the assignment as presented by the lender client and fulfill to those requirements, or pass on the assignment. The lending value approach is helpful as many homes being sold as a result of foreclosure or short sale are now being rented by former homeowners or working families who are opting to rent rather then purchase and this approach will help sustain the tax base and comparable values in our nations communities.

The National Community Reinvestment Coalition calls upon policy makers to act swiftly to enforce Title XI of FIRREA, embrace the reforms included in the Dodd-Frank Act and implement the following ten recommendations that will help all Americans, but particularly assist low to moderate income communities, communities of color, and communities impacted by the foreclosure crisis, who are working to realize or sustain the American Dream of homeownership.

1. *Review and define a more modern, robust appraisal reporting process and not accept the Uniform Residential Appraisal Report form by the GSEs but rather to call on the industry to define more robust and standardized reporting that can be tailored to the lending situation. The recent changes by FHFA regarding the Uniform Appraisal Dataset have only added further confusion to the already inadequate mandated appraisal form.*

2. *Require full appraisals by licensed appraisal professionals for all residential mortgages above $50,000 regardless if they are originated or insured by the private sector or Fannie Mae, Freddie Mac, or Federal Housing Agency.*

3. *The role and impact of Appraisal Management Companies (AMC) must be critically reviewed by the ASC to ensure that they are not negatively affecting appraisal quality and further Congress should immediately investigate the emerging practice of mortgage originators assigning or requiring that Appraisal Management Companies and/or appraisal professionals they engage for business assume the buy-back risk from the secondary market or insurer claims relating to loan origination.*

4. *Appraisal professionals enhance safety and soundness and protect the interests of all the parties to a mortgage transaction—including consumers—and they must be appropriately compensated under any usual & customary fee standard that is developed*

5. *The banking regulators, Fannie Mae, Freddie Mac and the FHA should not escape Appraisal Subcommittee valuation safety and soundness review and enforcement.*

6. *While Automated Valuation Models (AVM's) serve as a useful and cost competitive compliance tool and an effective check against fraud, they should never replace the use of an appraisal by a licensed appraiser for all mortgages that exceed $50,000.*

7. *There is a need for more effective Consumer Protection, Transparency & Education.*

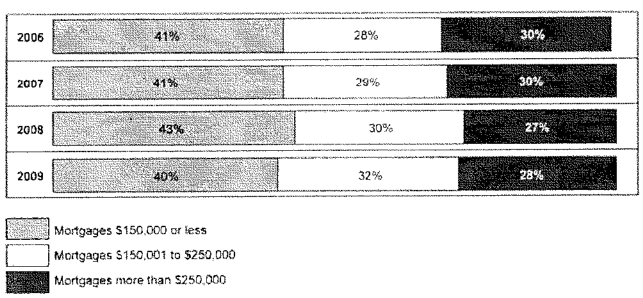
8. *Responsible Appraisal Practices Ensure and Expand Housing Opportunities in an Open Society.*

9. *Inappropriate appraisal undervaluation is equally damaging to homeowners, communities, the tax base, investors & insurers.*

10. *States must suspend redirecting funds intended for appraisal compliance, professional development and licensing, to their general funds.*

<u>Requiring Professional Appraisals Regardless of What Institution Originated the Loan:</u>

The United States Government Accountability Office (GAO) found in its 2012 report to Congress entitled, "Real Estate Appraisals – Appraisal Subcommittee Needs to Improve Monitoring Procedures" that more then seventy percent of the residential mortgages made from 2006 through 2009 were $250,000 or less (See Report Chart 4, reproduced below) – the current regulatory threshold at or below which appraisals are not required for transactions involving Federally regulated lenders.[9]



Source: GAO analysis of HDMA data.

[9] "Real Estate Appraisals—Appraisal Subcommittee Needs to Improve Monitoring Procedures." The United States Government Accountability Office (GAO). 2012.

Mae, Freddie Mac, and the Federal Housing Administration have voluntarily required ıals for mortgages both above and below the threshold. However, since these appraisals ndated on the forms they defined, they are still limited and self-serving. A more robust rd for defining the appraisal requirement suitable for specific lending situations could be ɘd by broad industry and consumer cooperation.

:hese entities currently dominate the mortgage market, many of the proposed Federal vate sector plans to scale them back could lead to a more privatized market, and ɘr this market would impose similar requirements is unknown. Therefore, it is NCRC's nendation to the House Financial Services Committee that valuations conducted by d appraisal professionals should be required for all real estate guaranteed loans – public ıte – for transactions above $50,000. This will ensure meaningful consumer protection educing risk to all of the parties involved with originating, servicing, insuring or teeing the mortgage transaction.

, the National Community Reinvestment Coalition agrees with the position of the an Guild of Appraisers, which notes in its recent petition to the Federal Reserve Board CFPB that the real estate appraiser is the only participant in a loan transaction who is a ested expert and whose only incentive is to provide as accurate as possible an estimate of the property.[10] Appraisals, when performed competently and honestly, are a against problematic and irresponsible lending practices that victimize borrowers and ely burden the American taxpayer when financial institution safety and soundness is lized.

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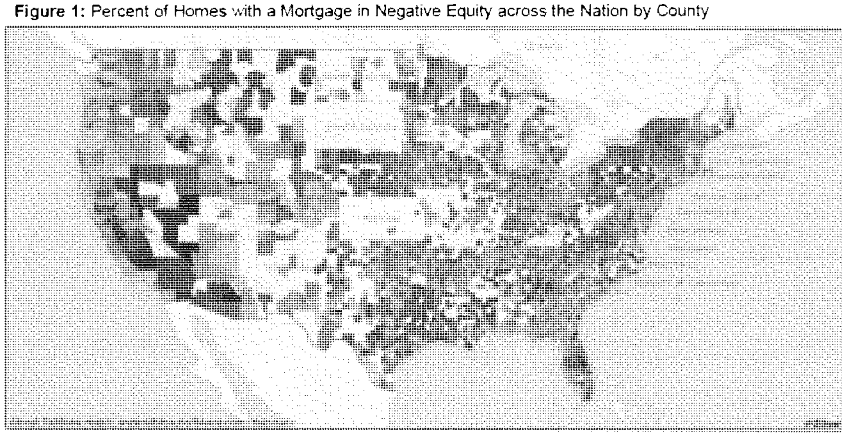
can Guild of Appraisers Petitions Federal Reserve Board." February 28, 2012.
w.opeiu.org/Home/tabid/37/ctl/ArticleView/mid/1886/articleId/300/American-Guild-of-Appraisers-Petitions-eserve-Board.aspx

In contrast, the Guild notes real estate agents, lenders and mortgage brokers are all incentivized by the size of the loan and sale price of the property, which in some cases may prompt participants to advocate that the consumer buy more home then they can afford. Similarly, consumers are encouraged by mortgage or real estate professionals who are more interested in a personal gain than ethical professional practice, to apply for a larger mortgage, refinance, or obtain a reverse mortgage for a larger amount then they need. Of course, we acknowledge that most industry participants are ethical and professional, yet millions of Americans are now upside down in their home due to irresponsible practices across the nation, as is evidenced by the chart below.

Figure 1: Percent of Homes with a Mortgage in Negative Equity across the Nation by County



Percent of Homes with Mortgages in Negative Equity. Color scale is centered at 31.4%, the national average. Blue counties have fewer underwater homes than the national average, while red counties have more underwater homes.

2.5% — 84.6%

[11]

This incentive may also lead some of the stakeholders to attempt to influence the appraisal. This undermines the very purpose of an independent, objective and accurate valuation. For the marketplace, investors and insurers, determining the true market value is critical to sustain safe & sound lending. As incentivized players advocate for an inflated value – or, often in the case

[11] Zillow Negative Equity Report, May 24, 2012. See http://www.zillow.com/blog/research/2012/05/24/despite-home-value-gains-underwater-homeowners-owe-1-2-trillion-more-than-homes-worth/

of short sales or REO today, lower values to move properties off the books of servicers, this leads to riskier lending and compromised protection for the consumer or where there is no equity in the real estate leading to higher loan losses. Alternatively, it also lowers property values in impacted communities and undermines the tax base. The unintended consequences of this tampering behavior are readily observable in that as Congress has found time and again it leads to price bubbles, crashes, increased loan losses, loss of confidence and a weakened, unsustainable system. This is not a blue, red or purple issue – it has affected all Americans and communities and Congress must act to ensure that stakeholders enforce and are accountable to the law.

Role and Impact of Appraisal Management Companies:

Greater use of AMCs has raised serious questions about oversight of these firms and their impact on appraisal quality. Title XI of FIRREA was enacted to protect federal financial and public policy interests in real estate related transactions by requiring that real estate appraisals be performed by individuals having demonstrated competency in the profession. However, the regulatory framework that developed as a result of the Dodd Frank Act has become more complex, inconsistent from state to state, and is in need of a thorough review by the ASC and the CFPB. In particular, there are growing concerns about the role of national AMC's and how they are conducting business under existing prudential regulators – both Federal and State – and how some may be negatively impacting upon FIRREA, USPAP, and the Dodd-Frank legislations mandate.

Despite NCRC's well-intentioned effort of making the appraisal industry truly autonomous, our Center's Code of Conduct and the subsequent HVCC received heavy criticism from industry trade associations and other governmental agencies. Critics of the HVCC were concerned that the HVCC imposed significant changes on the mortgage industry as a whole but still would not lead to an increase in appraiser independence.[12] Today, we must acknowledge that while the HVCC has realized many of its goals to ensure responsible underwriting, some of the concerns may have been warranted as there were a number of unintended consequences as a result of the HVCC including the emergence of AMC's that are owned by lenders and title companies, as well as, expanded use of Broker Price Opinions (BPO's) by mortgage servicers, which will be addressed later in this testimony.

AMC's now order more than 80% of all appraisals.[13] The indirect effect of this policy is that the AMC's typically take a percentage of the appraisal fee, as well as, the bank or other lender that owns the AMC, resulting in the individual appraiser being paid less. With little incentive to perform to the highest standards, the appraisers' quality of work has greatly diminished as they are now faced with covering larger market areas and completing more paperwork for less money. The tacit concern is how do the aforementioned affect the homebuyer or seller? With shoddy appraisal work, the mortgage lender is more frequently requesting "second appraisals;" this means that not only is the home buyer responsible for the cost of the initial appraisal (generally a few hundred dollars), they are then responsible for a second appraisal, which requires the appraiser to start from scratch.

NCRC is very concerned that many AMCs are gaming the original intent of the HVCC and now Dodd-Frank, to ensure an arms length transaction and that they are prioritizing low costs and speed over quality and competence even under the scrutiny of the GSE's and the FHA. While there are many responsible AMC's who celebrate compliance with FIRREA, USPAP, and the HVCC and Dodd-Frank, overall, the growing number of complaints from industry and not for profit providers alike indicate emerging compliance and safety and soundness issues that need to be addressed. It is NCRC's position that neither the ASC nor the prudential regulators are

[12] Ted C. Koshiol, "Should the HVCC Settlement Be Treated As An Agency Rulemaking?" April 2009. http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=ted_koshiol

[13] Kate Berry, "Fed's Appraisal-Fee Revamp Befuddles Mortgage Industry." April 23, 2012. www.activerain.com/blogsview/3177693/confusion-about-appraisal-fees-

adequately supervising the AMCs, the GSE's or the FHA. While NCRC notes that Title XI of the Act places the day-to-day supervision of AMCs with state appraiser licensing boards and requires the federal banking regulators, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection to establish minimum standards for states to apply in registering AMCs, the ASC can be much more effective in establishing national standards and holding the AMC's and the states to those standards. For example, NCRC has become aware that some appraisers who do business with AMC's are renting mailing addresses to fraudulently represent that they have an office and are doing business in areas that AMC's are seeking valuation, when in reality they have little or no actual knowledge of the community and its valuation nuances. Further, though they accept a lower fee for their services from the AMC, they also produce a defective product.

Five years ago professional appraisers would spend a full day or more researching and completing a valuation package on behalf of a lender. Today, many AMC's expect them to produce two or more reports in one day. Valuation professionals are fearful that AMC's and lenders will inappropriately report them to the CFPB or other regulators if they voice their concerns, or place them on "do not use" lists. It is critical that the ASC, the CFPB and the prudential regulators establish an even playing field with clear rules for every stakeholder in the mortgage transaction.

Notably, it was also never the HVCC's intent to create AMC's to be appraisal gatekeepers. The ASC should consider recognizing or certifying state or regional appraisal companies as local providers who can serve as AMC proxies in their communities with appropriate national and state rule substantial equivalence. While a number of states began regulating AMCs in 2009, the regulatory requirements vary. Setting minimum standards and a goal of national and state "substantial equivalence" that address key functions performed by AMCs would enhance oversight of appraisal services, provide greater assurance to lenders, the enterprises, and others of the credibility and quality of the appraisals provided by AMCs.

Specific areas of concern that have been brought to NCRC's attention regarding AMC's include 1) Inadequate ASC and prudential regulator AMC oversight; 2) AMC selection of appraisers for assignments who are not familiar with the communities where the property is located; 3) Limited or insufficient knowledge or sensitivity of Federal, State and Local fair housing laws; 4) Review and inappropriate rejection of completed appraisal reports; 5) Inappropriate placement of licensed professionals as a means of coercion on AMC "do not use" lists; 6) Establishing artificial qualifications for appraisal reviewers; 7), Reliance on inaccurate or illegal use of broker price opinions in short sales or other transactions and 8), Paying the appraisers who perform appraisals a fraction of what would fairly be considered a reasonable and customary fee in violation of Dodd Frank.

Further, many AMCs are directly or partially owned by mortgage wholesalers, large national banks, or title companies raising serious and ongoing conflict of interest questions. These originators cloak themselves behind the firewall of an independent AMC company, but if they own that company, either in whole or as a partial investor, undue influence can be exerted.

Many appraisal management companies are also deemphasizing the critical role and importance of the home valuation checks and balances while profiting from AMC appraisal fees or the up sale and marketing of related settlement products, such as title insurance, filing services, etc.

To quote one NCRC Center advisory board member, "imagine needing a medical doctor and having to go through an intermediary tasked with deciding which doctor you may visit, and that doctor is chosen primarily on his fee charged, not expertise."

In addition to the aforementioned concerns, it is imperative for Congress and prudential regulators to immediately investigate the emerging practice of mortgage originators assigning or requiring that Appraisal Management Companies and/or the appraisal professionals they do business with, assume the buy-back risk from the secondary market or insurer claims relating to loan origination.

The FDIC, as receiver for the failed lender Washington Mutual, sued appraisal management company, LSI Appraisal and its corporate parent Lender Processing Services, for breach of contract and gross negligence on May 9, 2011.[14] The lawsuit relates to hundreds of thousands of appraisals managed by LSI for WaMU between June 2006 and May 2008. The FDIC alleges that at least 220 of the reports it has analyzed were faulty and seeks more than $150 million in damages based only on those appraisals. As a result of this case, many lenders are requesting that AMC's assume all risk for the work of independent appraiser contracts, accepting the FDIC's proposition that these individuals are, in fact, "agents" of the AMC's when they do business.[15] The policy response from appraisers and AMCs is that they simply cannot afford to hold, pay for, or insure, originators claims or secondary market buy back provisions. Dodd-Frank does create a duty of care for appraisers and AMC's, but in the absence of fraud or negligence, NCRC's position is that in most cases it is inappropriate to transfer liability from an originator to a third party contractor, unless the AMC is a division or affiliate of the lender, or fraud, discrimination, negligence or related consumer protection issues are present.

Compensation for Appraisal Professionals:

The Dodd-Frank Act requires that Appraisal Management Companies (AMCs) pay "customary and reasonable fees" to their appraisers. Responding to evidence that appraisal management companies have been dominating the market and pressuring appraisers to accept assignments with unreasonable requirements and unreasonably low fees, the law specifically prohibits basing fees on the current practices of appraisal management companies.

[14] "The FDIC Suffers a Setback in Case Against Lender Processing Services and LSI Appraisal." Peter Christensen. November 3, 2011. http://www.appraiserlawblog.com/2011/11/fdic-suffers-setback-in-case-against.html

[15] Ibid.

Unfortunately, the Federal Reserve Board recently adopted a rule that will allow appraisal management companies that control up to 80 percent of residential appraisals to pay appraisers a fraction of what a customary and reasonable fee would be as defined in the law— sometimes as much as 50 percent or more below the prevailing rates.[16] As a result, industry experts report, the problems that Congress sought to address have been exacerbated and the reliability of residential real estate appraisals is once again subject to question. The American Guild of Appraisers has filed a petition with the Federal Reserve Board (Fed) and the CFPB, requesting that the Fed and CFPB take immediate action to prohibit AMC practices that under compensate appraisers in violation of Dodd Frank.

Appraisal professionals who support the work of the Center for Responsible Appraisal and Valuation have repeatedly informed NCRC that this structure has forced many experienced appraisers away from the trade and limited the ability of a new generation of talent to become licensed who are unwilling to do more work for much less money.

To quote the American Guild of Appraisers - "The profession is struggling to attract and maintain a vibrant base of qualified individuals because the fees are too low to support even a modest income and because of the unsustainable pressures under which appraisers are forced to work. The impact on the consumer can be dramatic in the form of lesser quality appraisal outcomes resulting in lost sales, lost financing opportunities and lost equity. The beachhead that professional appraisers have been able to secure over the years as an independent voice to protect the consumer is eroding dramatically as evidenced by the increasing number of seasoned appraisers leaving the work force and the diminishing number of new appraisers entering the field.[17]"

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[16] "American Guild of Appraisers Petitions Federal Reserve Board." February 28, 2012. http://www.opeiu.org/Home/tabid/37/ctl/ArticleView/mid/1886/articleld/300/American-Guild-of-Appraisers-Petitions-Federal-Reserve-Board.aspx

[17] The American Guild of Appraisers. "Consumer Protection Afforded by Professional Real Estate Appraisers." June 2012.

Certainly fees are a component of the issue but so is the fact that the mandated appraisal forms created by the GSEs and widely used have turned appraisers into merely form-fillers. And while the forms accommodate addendum commentary, the FHFA/GSE UAD does not digitize this portion of their appraisal report. Only the first 6 template pages are digitized in the UAD stream for analytics and review purposes.

While NCRC is sensitive to the fact that any new requirement to pay appraisers a customary and reasonable fee could increase consumer costs, we believe that such a result is far from inevitable. Since the appraiser who performs an appraisal is legally required to assume full responsibility for compliance with all appraisal standards under USPAP, the AMCs cannot be adding material value to the appraisal work product. If lenders value the administrative services that AMCs provide to lenders, they should decide how much value such services provide and pay for them accordingly. In most markets, when an appraisal is ordered through an AMC, the fees for the appraisal paid by lenders and ultimately passed on to the borrower, are generally the same as when the appraisal is ordered directly from an appraiser. If lenders value additional services provided by AMCs, they are free to contract for them but such fees should be separated from the appraisal fee and not be the responsibility of the borrower.

There are many in the industry that doubt that the AMCs are generally adding significant value. NCRC believes that the importance of arms length valuation in the absence of conflict of interest is critical, but that the current approach should be improved upon through new rulemaking.

Currently, AMC profits result from under compensating the appraisers who do the work. Further, it is our hope that with greater mortgage disclosure or new substantially equivalent rules for local appraisal companies, AMC's will be prompted to lower their fees in order to make their services more efficient and competitive while ensuring reasonable and customary fees are paid to the licensed appraiser in the community.

Fannie Mae & Freddie Mac Should Not Escape Appraisal Subcommittee Review and Enforcement:

In the January 2012 Appraisal Sub-Committee report, the GAO reported that Federal regulators and the enterprises represented that they hold lenders responsible for ensuring that AMCs' policies and practices meet their requirements for appraiser selection, appraisal review, and reviewer qualifications. While ambitious, the truth is that they generally do not directly examine the AMCs' operations. This presents a major safety and soundness risk to the market as a whole and does a disservice to licensed appraisers and the diverse communities & neighborhoods that they serve across the country.

Limited Use of AVM's:

The Automated Valuation Model or AVM technology emerged in the late 1990's and was used primarily by institutional investors to determine risk when purchasing collateralized mortgage loans. Given the wavering state of the housing market and economy alike, many mortgage companies, banks, lenders, etc., began looking for ways to cut costs and improve their operational efficiency, leading to the increased use of the AVM in the appraisal process.

An AVM is a residential valuation report that can be obtained in mere seconds. AVMs are statistically based computer programs that typically calculate the value of particular properties using a combination of hedonic regression and repeat sales index data. The results of this are weighted/ analyzed and then reported as a final estimate of value based on a request date. Due to the many limitations of AVMs, the Interagency Guidelines for Real Estate states: "An institution should establish standards and procedures for independent and ongoing monitoring and model validation, including the testing of multiple AVMs, to ensure that results are credible. An institution should be able to demonstrate that the depth and extent of its validation processes are consistent with the materiality of the risk and the complexity of the transaction. *An institution should not rely solely on validation representation provided by an AVM vendor.*[18] The guidelines illuminate and stress the importance of using AVMs as a supplement to a traditional walk-through appraisal conducted by an unbiased, competent individual appraiser.

NCRC's major concern with the use of an AVM is that the age of the data that undergoes the AVM analysis is not always clear. Many AVMs use transactional data that may lag anywhere from three to six months thus, automated valuation tools cannot clearly indicate the differences between the value of a home in 2005 versus its current value in 2012.[19] Furthermore, AVMs often provide inaccurate reports, as it is possible, in fact probable, for an AVM to come up with a value based on a previous foreclosure sale or short sale, or to produce a value based on a property that was sold to a family member at a price far below the market value-when, in fact, the true value of these homes may be thousands of dollars more.[20]

Though AVMs are increasingly being used by mortgage lenders to determine the value of a property in order for them to lend against the valuation, and they present helpful real estate sales data, fraud alerts, and compliance indicators, they will never replace a full walk through, but have the potential to complement a full walk through appraisal. Until "I Robot" becomes reality rather then fiction, 1) An AVM cannot determine whether or not a property actually exists; 2) An AVM does not include the condition of the property which is necessary information for an effective valuation; and 3) An AVM cannot tell a requester if a specific property is located in an area with a declining market or an area that is becoming increasingly more popular.

[18] Interagency Guidelines for Real Estate. Interagency Guidance, 75 Fed. Reg. at 77, 469.

[19] George Demopulos. "The Good, The Bad And The Fuzzy: Where AVMs Score And Miss." October 2010. www.sme-online.com

[20] Ibid.

A Need for More Effective Consumer Protection, Transparency & Education:

While the ASC is charged with developing a new complaint portal, it is targeted at industry stakeholders and whistle blowers. It is NCRC's position that a new and objective consumer complaint process should be developed by the Consumer Financial Protection Bureau in cooperation with a not-for-profit organization such as the Center for Responsible Appraisal & Valuation and/or the Appraisal Foundation. This concept was included in the recent GSE agreement but defunded when Fannie Mae and Freddie Mac entered receivership. Further, NCRC applauds the CFPB's efforts to develop simpler mortgage disclosure forms, and notes that the latest concept requires that appraisal AMC and Professional Fees be appropriately disclosed to consumers. Other recent policy changes aim to provide lenders with a greater incentive to estimate costs accurately and require lenders to provide consumers with a copy of the valuation report prior to closing. NCRC is also collaborating with the Appraisal Guild and the Appraisal Foundation to develop new educational tools for consumers and the trade alike. A well-informed consumer is one of the benefits of a transparent process in the appraisal process. The homeowner has the biggest stake in the process and they should have the ability to understand what they read in an appraisal report. Consumers need to have a greater understanding and appreciation for the role of the professional real estate appraiser as an independent voice in the valuation process that protects them from abuse from other interested parties. It is a benefit to consumers for the appraiser to discuss with the homeowner improvements, remodels, and even other sales in the area, e.g. the home across the street that sold for a significantly lesser price may have been due to a distressed relocation. Encouraging direct communication between the appraiser and the consumer alleviates the need to have a middleman tacking on higher costs to the consumer and ensures that the information that the consumer perceives to be material is communicated directly to the professional conducting the analysis.

Responsible Appraisal Practices Ensure and Expand Housing Opportunities in an Open Society:

The National Community Reinvestment Coalition celebrates the Appraisal Foundation's, the ASC and the prudential regulators commitment to fair lending and a market free of discrimination, but more work needs to be done with the private and public sector industry. Appraisals that use descriptive terms such as "low pride of ownership," "lack of marketability" or an assessment of the "desirability" of the neighborhood should be scrutinized for discrimination. Similarly, an imbalance of positive and negative comments on the area or a consideration of inappropriate factors for the type or property and price range of the housing may indicate discrimination on the part of the appraiser. The amenities considered and the way they are valued should be consistent with the neighborhood and its needs. In lower income neighborhoods, convenient access to commercial areas and public transportation is a strong positive - not a neutral or negative factor.

The age of homes, predominant value, and use of comparables should be considered very carefully under our nation's fair housing laws.

Age: The age of the housing stock can have a realistic relationship to value. However, it can also be used inappropriately to devalue property based on the residents of the neighborhood. This has been a factor in redlining cases filed against Homeowners Insurance providers. Because minority neighborhoods tend to be older housing stock, a negative treatment of older housing stock can have the effect of devaluing minority neighborhoods. How an appraiser treats improvements in an older neighborhood can indicate whether discriminatory perceptions were taken into account. Some appraisals allegedly devalue improvements based on the average value of the neighborhood in which they are located. By limiting the value of improvements because of their relative value to other housing in the neighborhood, the appraiser puts an artificial cap on values there.

Predominant value: Like many American markets, the housing market is measured against a norm. Appraisers, underwriters, and even the secondary market prefer that the property in question fit into a recognizable slot. This leads to what many find as a depressing sameness of products - and of neighborhoods. One aspect of valuation is to consider how the property relates to its setting - the neighborhood. To do this, the age, style, and value of the property are compared. When a newly improved property is compared to the rest of the neighborhood, the lower value of the neighborhood can put a ceiling on the value of the improved property, effectively discounting the value of the improvements. This practice can have a negative effect on neighborhood renewal and may also have an impact on a prohibited basis.

Comparables: The comparables should be taken as closely as possible from the same price range, age, and location as the property being appraised. Choice of comparables can have a significant effect on the valuation of the property. Fair housing advocacy groups have alleged that appraisers have chosen comparables to reflect a lower value for the property being appraised.

Inappropriate Appraisal Undervaluation Is Equally Damaging To Homeowners, Communities, the Tax Base, and Investors & Insurers:

The National Community Reinvestment Coalition has previously testified twice before the House Oversight and Government Reform in 2010 concerning the widespread use of broker price opinions and the growing trend of "flopping." Unfortunately, these issues persist in broker short sales and servicer real estate owned transactions post foreclosure. Owners of REOs are eager to dispose of REOs because they are costly to maintain and attract vandalism and crime. These REO owners have enlisted real estate brokers to issue BPOs for the value of these properties. The real estate brokers, acting as agents of the REO owners, develop hasty and inaccurate BPOs that underestimate the values of the REOs. Undervaluation is often destructive to local markets and depresses the value and equity of neighbors of REO properties.

Also, NCRC has documented numerous instances where real estate brokers have intentionally undervalued short sale or REO properties in order to facilitate a purchase by a colleague in the same office who later sells it for its true fair market value – aka flopping. NCRC has requested the prudential regulators to address this issue and called upon industry trade associations to police and educate their own members to prevent this troubling activity that inhibits the return of strong real estate markets.

Regarding mortgage servicing and REO, the Government Accountability Office in a report issued in November 2011 recommended that federal regulators require the mortgage servicers they oversee to obtain updated valuations before initiating foreclosures.[21] The report also pointed to the shortcomings of automated valuation models and broker price opinions. "Simply using a BPO or AVM without consideration of up-to-date property or neighborhood conditions may result in abandoned foreclosures because the actual resale value and accurate expected proceeds from foreclosure sale may not be reflected in the valuation," read the report.

The GAO's monthly report notably cites the need to prevent abandoned foreclosures from blighting neighborhoods. This finding has particular resonance in urban and suburban communities were foreclosure is prevalent, such as Metro Chicago, Baltimore, Cleveland, Detroit, Las Vegas, and several California metro areas. According to the report, servicers typically abandon a foreclosure when they determine that the cost to complete the foreclosure exceeds the anticipated proceeds from the property's sale – which is usually determined after a loan has been delinquent for 90 days.[22] The GAO however, found that most servicers interviewed were not always obtaining updated property valuations before initiating foreclosure. "Fewer abandoned foreclosures would likely occur if servicers were required to obtain updated valuations for lower-value properties or those in areas that were more likely to experience large declines in value," read the GAO report. Specifically, the GAO recommended that the Federal Reserve and the Office of the Comptroller of the Currency require servicers,

[21] The United States Government Accountability Office (GAO). November 2011.

[22] Ibid.

under their jurisdiction, to adopt new valuation requirements. The report noted that the Fed neither agreed nor disagreed with these recommendations while the OCC has yet to comment.

Last, the issue of AMC undervaluation and rejection of reasonable valuation reports is well known in the building, real estate and appraisal trades, and HUD Certified Housing Counselors are documenting the issue while working with consumers to facilitate short sales in lieu of foreclosure or who are attempting to refinance their existing mortgage. In one recent matter that NCRC documented, an African-American couple who resided in Prince George's County, Maryland, was approved for the refinance of their home and planned to use the loan proceeds to pay off the existing loan that was in foreclosure. The appraisal valued the property at $464,000. The borrowers had substantial equity in the property and although closing of the new loan had been scheduled, and the documents were signed by the borrowers in a timely manner to achieve disbursement prior to the foreclosure date, the servicer opted to move to foreclosure after receiving a lower and inaccurate broker price opinion (BPO). The bid price by the lender at foreclosure was $350,000. This resulted in the homeowners' suffering a loss of $114,000, or one could fairly say, the investor profited at the expense of the homeowner due to an inaccurate BPO. This case is now in litigation.

States Must Suspend Redirecting Funds Intended for Appraisal Compliance, Professional Development and Licensing to their General Funds:

The GAO reports that most state regulatory entities do not have sufficient funding, staff, or other resources to enforce the basic regulatory provisions of FIRREA. The problem is not a lack of money. The problem is that the states are siphoning off appraiser registration and regulatory funding fees. Appraiser regulatory fees are put into state general funds for other expenditures instead of the enforcement of the federal mandate to regulate real estate appraisers and appraisal activities. This practice must stop.

Conclusion

In conclusion, I reiterate that the time has come for members of Congress, the prudential regulators, the Appraisal Subcommittee and the Consumer Financial Protection Bureau to work collectively to ensure that consumers and all the industry stakeholders involved in the home buying and refinance process will benefit from a system of regulation that helps ensure the independence and integrity of the appraisal process while promoting equal access to responsible and sustainable credit and a robust mortgage marketplace that meets our nations immediate housing finance needs. To accomplish this end, it is crucial to consider the following recommendations:

1. *Review and define a more modern, robust appraisal reporting process and not accept the Uniform Residential Appraisal Report form by the GSEs but rather to call on the industry to define more robust and standardized reporting that can be tailored to the lending situation. The recent changes by FHFA regarding the Uniform Appraisal Dataset have only added further confusion to the already inadequate mandated appraisal form.*

2. *Require professional appraisals by licensed appraisal professionals for all residential mortgages above $50,000 regardless if they are originated or insured by the private sector or Fannie Mae, Freddie Mac, or Federal Housing Agency.*

3. *The role and impact of Appraisal Management Companies (AMC) must be critically reviewed by the ASC to ensure that they are not negatively affecting appraisal quality and further Congress should immediately investigate the emerging practice of mortgage originators assigning or requiring that Appraisal Management Companies and/or appraisal professionals they engage for business assume the buy-back risk from the secondary market or insurer claims relating to loan origination.*

4. *Appraisal professionals enhance safety and soundness and protect the interests of all the parties to a mortgage transaction—including consumers—and they must be appropriately compensated under any usual & customary fee standard that is developed*

5. *The banking regulators, Fannie Mae, Freddie Mac and the FHA should not escape Appraisal Subcommittee valuation safety and soundness review and enforcement.*

6. *While Automated Valuation Models (AVM's) serve as a useful and cost competitive compliance tool and an effective check against fraud, they should never replace the use of an appraisal by a licensed appraiser for all mortgages that exceed $50,000.*

7. *There is a need for more effective Consumer Protection, Transparency & Education.*

8. *Responsible Appraisal Practices Ensure and Expand Housing Opportunities in an Open Society.*

9. *Inappropriate appraisal undervaluation is equally damaging to homeowners, communities, the tax base, investors & insurers.*

10. *States must suspend redirecting funds intended for appraisal compliance, professional development and licensing, to their general funds.*

Testimony of
David S. Bunton, President
The Appraisal Foundation

Appraisal Oversight: The Regulatory Impact on Consumers and Businesses

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity

June 28, 2012

THE APPRAISAL FOUNDATION
Authorized by Congress as the Source of Appraisal Standards and Appraiser Qualifications

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INTRODUCTION

Madame Chair and members of the Subcommittee, The Appraisal Foundation greatly appreciates the opportunity to appear before you today to offer our perspective on the regulation of real estate appraisers.

There are many misconceptions about The Appraisal Foundation and let me begin by stating that the Foundation is not:

- a government agency or regulatory body;
- created by Congress;
- an appraisal trade association.

Rather, The Appraisal Foundation:

- is a non-profit 501 (c) 3 educational organization;
- was founded by eight national appraisal organizations 25 years ago;
- serves as an umbrella organization representing over 100 organizations and government agencies with an interest in valuation (see attached list);
- was created to foster professionalism in appraising.

We are the private sector expertise in the real property appraiser regulatory system. The Foundation was given specific authority by Congress in 1989 (Title XI of FIRREA) regarding the real property appraiser regulatory system. The Foundation does not have any regulatory authority, but it provides tools for the regulatory community. Specifically:

- individuals seeking to become a trainee appraiser, supervisory appraiser, state licensed appraiser or state certified appraiser must meet the minimum qualification requirements established by the Foundation's Appraiser Qualifications Board;

- all states and territories must use licensing and certification examinations either issued or endorsed by the Foundation's Appraiser Qualifications Board; and

- all state licensed and certified real estate appraisers must adhere to certain standards of conduct (the *Uniform Standards of Professional Appraisal Practice*) written by the Foundation's Appraisal Standards Board.

Before addressing the specific topics on which you are seeking our perspective, I would like to provide some additional background on the Foundation and its work to date.

FOUNDATION STRUCTURE

The Appraisal Foundation is governed by a 25 member Board of Trustees. The Board of Trustees appoints members to the Foundation's independent Boards, secures funding for Foundation operations and provides oversight of the Foundation's advisory councils and independent Boards. The three independent Boards are:

Appraiser Qualifications Board (AQB)

The AQB sets the minimum education, experience and examination requirements for trainees, state licensed appraisers, state certified residential appraisers and state certified general appraisers. These AQB established minimums are collectively known as the *Real Property Appraiser Qualification Criteria ("Qualification Criteria").* State regulatory agencies must meet the threshold set by the AQB and may exceed that level if they so choose.

First offered in 2008, the AQB National Uniform Licensing and Certification Examination is currently used by all 55 states and territories that license and certify appraisers. States and examination vendors may opt to develop their own examinations that must be approved by the AQB, but at the present time none have chosen to do so.

Approximately every five years the AQB reviews the *Qualification Criteria* to determine what, if any, revisions should be made. Their most recent revision will go into effect on January 1, 2015 and, for the first time a college degree will be required for the state certified classifications. Even with four significant *Qualification Criteria* revisions over the past twenty years, the U.S. still has the distinction of having one of the lowest sets of qualifications for appraisers in the industrialized world. For example, in Mexico an individual must first become an architect or engineer before they can subsequently become an appraiser (known as a "valuer" in most other countries).

Appraisal Standards Board (ASB)

The ASB sets forth the rules for developing an appraisal and reporting its results through the *Uniform Standards of Professional Appraisal Practice* (USPAP). USPAP contains the recognized standards of practice for real estate, mass appraisal, personal property and business appraisal and is considered one of the finest sets of domestic valuation standards in the world.

The authority of USPAP extends beyond FIRREA. Since 1992, the Office of Management and Budget (OMB) has required federal land acquisition and direct lending agencies to use appraisals in conformance with USPAP. In addition, many states require appraisals performed for any purpose to be USPAP-compliant and completed by state licensed or certified appraisers.

In addition to containing the Standards, USPAP also provides guidance in the form of Advisory Opinions and over 300 Frequently Asked Questions. Originally updated quarterly, USPAP is now published every two years. USPAP is a living document that reflects the ever-changing needs of the marketplace. For instance, the growing presence of Appraisal Management Companies (AMCs), alternative valuation products and the electronic transmission of appraisal reports in recent years has resulted in numerous inquiries to the ASB from appraisers, appraiser regulators and users of appraisal services.

Appraisal Practices Board (APB)

The APB was created by the Foundation in 2010. This board offers voluntary guidance to appraisers, regulators and users of appraisal services on recognized valuation methods and techniques for all valuation disciplines. For lack of a better term, it is our "how to" board.

The genesis of the APB was the collapse of the housing market in 2008. For many appraisers this was the first time that they were confronted with declining prices, short sales and foreclosures. Because a majority of appraisers do not belong to any professional appraisal organization, the question became *"Where do appraisers get guidance for their practice?"* The Foundation established the APB to fill an existing void.

The APB annually solicits stakeholders to identify topics where additional guidance appears to be needed. Teams of experts are then selected to work with the APB in developing the appropriate guidance. This guidance is known as a *Valuation Advisory* and may include more than one recognized method or technique that addresses the specific issue.

Valuation Advisories issued to date include:

- *The Identification of Contributory Assets and the Calculation of Economic Rents* (Business Valuation)
- *Adjusting Comparable Sales for Seller Concessions*
- *Residential Appraising in a Declining Market*

Valuation Advisories currently under development include:

- *Identifying Comparable Properties*

- *Appraising Green Buildings – Background Competence*
- *The Valuation of Customer-Related Assets* (Business Valuation)
- *Control Premiums for Financial Reporting* (Business Valuation)
- *Contingent Consideration* (Business Valuation)

It should also be noted that this guidance is available to appraisers, regulators and the general public at no charge and there is no requirement to use or adhere to the guidance.

PUBLIC TRUST AND TRANSPARENCY

A cornerstone of the work of the Foundation lies in building and maintaining public trust in the appraisal profession. In fact, the words "public trust" appear in our mission statement:

> *The Appraisal Foundation is dedicated to promoting professionalism and ensuring* ***public trust*** *in the valuation profession. This is accomplished through the promulgation of standards, appraiser qualifications, and guidance regarding valuation methods and techniques.*

One important way to build and maintain public trust is to promote transparency whenever and wherever possible. Our Boards conduct public meetings and adopt their work product in that setting. The Boards issue exposure drafts of pending work and post all public comments received on our website. We also conduct public interviews of candidates seeking to serve on our Boards.

In addition, as part of our commitment to promoting the public trust, we have worked with several U.S. government agencies, at their request, on developing specific recommendations to improve their internal appraisal operations, to assist in their investigative work relating to valuation or to assist in developing new policies and procedures. Over the past several years we have worked with the following government agencies:

- U.S. Department of Agriculture, Forest Service
- U.S. Department of Interior, Bureau of Land Management
- Office of Special Trustee for American Indians
- U.S. Department of the Interior, Minerals Management Service
- U.S. Department of Agriculture, Natural Resources Conservation Service
- U.S. Department of Energy

FOUNDATION PROJECTS TO IMPROVE THE REAL PROPERTY APPRAISER REGULATORY SYSTEM

In recent years we have had an excellent working relationship with the Association of Appraiser Regulatory Officials (AARO). The real property appraiser regulatory system is an unfunded federal mandate which has resulted in many states facing significant personnel and financial challenges. As a part of the appraiser regulatory system, the Foundation has made it a priority to assist state appraiser regulators whenever possible. The following are some examples of collaborative efforts benefitting state appraiser regulators.

State Investigator Training

State appraiser regulatory agencies investigate complaints using a variety of methods. Some states have full-time appraiser investigators, some share investigators with other professions and trades, some use state board members and others contract with appraisers.

To help promote consistency in investigations of appraisal complaints, AARO and the Foundation developed a 2 ½ day course focusing on USPAP, fundamental investigative and interviewing techniques and reporting the findings.

Since 2009 we have conducted ten State Investigator Training Course offerings attended by more than 360 state investigators. Nearly 240 investigators have taken the entry-level course and over 125 have gone on to take the 2 ½ day advanced course. This year, we are offering the entry-level course in June and the advanced course in August. The Foundation, with a grant from the Appraisal Subcommittee (ASC), covers all of the travel and lodging expenses for the attendees so that state budgetary restrictions do not limit participation.

In addition, in December 2011 we filmed a four-hour "investigator update" at the Mock Court Room of George Washington University Law School. This update is for those who have taken both the entry-level and advanced courses. It is our belief that this video will have a shelf life of at least five years and can be viewed from the investigators home or office.

This project is a great example of how the Foundation, AARO and the ASC can cooperatively produce a successful program that benefits the public in the form of a more efficient and consistent nationwide appraiser regulatory system.

Foundation eLibrary/Training Videos

The Appraisal Foundation has produced a series of video training sessions, some designed specifically for state appraiser regulators and others for all appraisers. These training videos are located in the eLibrary on the Foundation's web site.

Some of the videos currently included in the eLibrary are of specific interest to state appraiser regulators, including:

- *USPAP Summary of Actions for the 2012-13 Edition*
  A brief summary of the most recent changes to USPAP provided by the ASB Chair and Vice Chair.

- *2012-13 USPAP Update for State Regulators*
  A presentation by the ASB Vice Chair on the most recent changes to USPAP geared specifically for state regulators.

- *Mock Administrative Hearing*
  A four-hour Mock Administrative Hearing that includes a question and answer session with state regulators.

- *An Introduction to Green Buildings and their Valuation*
  A panel discussion including representatives from the White House, the U.S. Department of Energy, the U.S. Green Building Council and Cushman & Wakefield.

- *Appraisal Regulatory Investigator Update*
  An update for participants who have completed the entry level and advanced level of the State Investigator Training filmed at the George Washington University Law School.

This August we are filming the following videos that will be of interest to state appraiser regulators:

- Understanding the Real Property Appraiser Regulatory System
- The AQB *Real Property Appraiser Qualification Criteria* Changes Effective 2015
- The Role and Responsibilities of the Appraisal Practices Board

Consistent Enforcement

Many jurisdictions have differing enforcement philosophies, with some placing more emphasis on fines, education or probation. However, they are all enforcing the same document, USPAP, so there should be consistency in enforcement.

The Foundation appointed a task force composed of state and federal appraisal regulators to develop recommended voluntary disciplinary guidelines for the states. In August 2010 the Foundation issued a *Voluntary Disciplinary Action Matrix* for use by state appraiser regulatory agencies. The matrix cites specific violations of USPAP and recommended disciplinary action. The matrix also contains a list of aggravating and mitigating circumstances to consider. The matrix is updated with each edition of USPAP and is made available to all state regulators.

SPECIFIC COMMENTARY REQUESTED BY THE SUBCOMMITTEE

1) Please provide a summary of and the challenges of the new strategic plan of The Appraisal Foundation and a review of the evolution of the Appraisal Practices Board (APB).

The Proposed Strategic Plan of The Appraisal Foundation

The Strategic Plan Task Force was established in 2011 by the Chair of the Board of Trustees. With 2012 marking the 25th Anniversary of The Appraisal Foundation, the leadership of the Board of Trustees agreed that the time was right to take a close look at where The Appraisal Foundation is heading as it moves into its next 25 years. The Task Force, which is composed of appraisers, users of appraisal services and regulators, with representation from the many appraisal organizations and stakeholders, was charged with reviewing the history of The Appraisal Foundation (where it started, where it is now and where it will go in the future).

Since May of 2011, the Task Force met numerous times via conference call and held in person sessions in September 2011 and January 2012. The January meetings culminated in an initial briefing with the Executive Committee of the Board of Trustees. Since that meeting, the Task Force held several conference calls to refine its initial recommendations. These draft recommendations were presented to the Board of Trustees and the Sponsors of the Foundation on May 17 and May 18 in conjunction with the Spring Board of Trustees meeting.

It is anticipated that the proposed Strategic Plan of the Task Force will be submitted to the Board of Trustees next month. Assuming it is accepted by the Board of Trustees, *it will be publicly exposed to all stakeholders for ninety days.* This November the Board of Trustees will take into account public comments received and make a final determination on approving the Strategic Plan.

The main elements of the plan include:

1) Revised Foundation Vision and Mission Statements
2) Outreach and Communications
3) Interaction with State and Federal Regulators
4) Future Educational Role of The Appraisal Foundation
5) Potential Future Funding Sources
6) Future Role of Foundation Sponsors
7) Proposed Foundation Structure
8) Staying Abreast of Changing Valuation Products
9) Reaching out to Young and New Professionals
10) Future Foundation Relationship with Academia
11) Branding of The Appraisal Foundation

Following the briefing to the Trustees in May on the above items, the Board voted to revise the Vision and Mission Statements as suggested by the Task Force because they were viewed by the Trustees as being merely clarifying in nature. A National Education Partnership Task Force was also appointed to further define and look into the feasibility of draft recommendation #4, which included a joint effort to develop educational course materials with the Sponsors of the Foundation.

The Evolution of The Appraisal Practices Board

The genesis of the APB was the collapse of the housing market in 2008. For many appraisers this was the first time that they were confronted with declining prices, short sales and foreclosures. Because over two thirds of appraisers do not belong to a professional appraisal organization, the question became *"Where do appraisers get guidance for their practice?"* This was first brought to the attention of the Foundation at a meeting with the Appraisal Subcommittee in December 2008. At that meeting some members of the Appraisal Subcommittee expressed concern about the fact that the Foundation was not providing guidance to appraisers regarding valuation methods and techniques. They stated that, given our public charge, the Foundation has a responsibility to be of assistance.

This discussion was brought to the attention of the Executive Committee of the Foundation's Board of Trustees by Foundation staff the following month. It was the determination of the Trustees that a task force should be appointed to determine:

1) Does a void currently exist regarding the issuance of guidance on valuation methods and techniques?

2) If such a void exists, is the Foundation the appropriate organization to fill the void, or is there another vehicle (or entity)?

Following several months of deliberations, the Task Force on Recognized Valuation Methods and Techniques recommended that the Foundation Board of Trustees give consideration to creating a third independent Board charged with issuing recognized valuation methods and techniques.

In October 2009 the Board of Trustees approved the creation of the Appraisal Practices Board (APB). It was constituted on July 1, 2010.

The APB annually solicits stakeholders to identify topics where additional guidance appears to be needed. Teams of experts are then selected to work with the APB in developing the appropriate guidance. This guidance is known as a *Valuation Advisory* and may include more than one recognized method or technique that addresses the specific issue.

In summary, it is important to note the following about the APB:

(1) The APB <u>does not</u> have any Congressional authority and adherence to the guidance is *strictly voluntary;*

(2) The APB <u>does not</u> operate with any public/grant funds; and

(3) The Foundation <u>does not</u> charge for the Valuation Advisories issued by the APB.

<u>2) Please provide a summary of and the challenges to the Uniform Standards of Professional Appraisal Practice (USPAP).</u>

The *Uniform Standards of Professional Appraisal Practice* (USPAP) are promulgated by the Appraisal Standards Board of The Appraisal Foundation. They are the generally recognized set of valuation performance standards in the United States and are considered one of the best sets of domestic standards in the world. In addition to real estate, USPAP also covers, mass appraisal, personal property and business valuation.

Promulgating USPAP has several challenges. The first is that it must be flexible and broad enough to address the myriad of valuation problems confronting appraisers while at the same time being definitive enough to be an effective enforcement document for appraiser regulatory officials to use in their disciplinary proceedings. This is one of the primary reasons that the Foundation has established such a close and productive relationship with the Association of Appraiser Regulatory Officials (AARO) over the years. AARO shares concerns the regulators have about USPAP and we have the opportunity to share the rationale and intent of the Appraisal Standards Board in drafting the Standards.

The ever changing conditions of the marketplace present another challenge for the Appraisal Standards Board in promulgating USPAP. For instance, the growing presence of Appraisal Management Companies (AMCs), alternative valuation products and the electronic transmission of appraisal reports in recent years has resulted in numerous inquiries to the ASB from appraisers, appraiser regulators and users of appraisal services.

As far as the effectiveness of the Appraisal Standards Board in issuing standards, the Government Accountability Office (GAO) report issued in January of this year (Report 12-147) contained a survey of state appraiser regulatory agencies. One question asked about the effectiveness of the Appraisal Standards Board in setting standards for the way appraisals should be conducted. The results were as follows:

Very/Somewhat Effective: 74%
Somewhat/Very Ineffective: 6%
Neutral/Don't Know: 20%

3) Please provide an overview of the regulatory actions taken by The Appraisal Foundation and the Appraisal Subcommittee.

The Appraisal Foundation

As previously stated, the Foundation does not have any regulatory authority but does provide the tools for the appraiser regulatory community to perform its duties. The Dodd-Frank Financial Reform Act gave additional Congressional authority to the independent Boards of the Foundation.

States who have a state licensed residential appraiser classification must now meet the *AQB Real Property Appraiser Qualification Criteria* for that classification. In addition if a state has a trainee appraiser classification, it must meet the AQB *Qualification Criteria* for trainee appraiser as well as for supervisory appraisers. The AQB adopted revisions to the *Qualification Criteria* for these and other classifications in December 2011, with an effective date of January 1, 2015.

The Dodd-Frank Financial Reform Act also calls for the Federal financial regulatory agencies to consult with the Appraisal Standards Board regarding quality control standards for automated valuation models (AVMs). While we have not been contacted to date, we stand ready to assist.

The Appraisal Subcommittee

We believe that the increased regulatory authority granted to the Appraisal Subcommittee as a result of the enactment of the Dodd-Frank Financial Reform Act enhances and clarifies the role of the Appraisal Subcommittee. Grants to the states, the establishment of a national appraisal hot line, the ability to promulgate regulations and the future regulation of Appraisal Management Companies (AMCs) all are improvements to Title XI.

4) Please outline any other industry related Federal activities that are of importance to your organization.

We have two areas of industry related Federal activities that are of importance to the Foundation:

Recommendation Regarding Appraisal Subcommittee Grants to the States

The Dodd-Frank Financial Reform Act authorizes the Appraisal Subcommittee to:

> *"make grants to state appraiser certifying and licensing agencies in accordance with policies to be developed by the Appraisal Subcommittee, to support the efforts of such agencies to comply with this title, including the complaint process, complaint investigations and appraiser enforcement activities of such agencies."*

Providing grants to individual jurisdictions may prove to be problematic due to issues relating to defining specific needs, tracking funds and grant administration. We recommend that consideration be given to using the funds to train numerous states concurrently. This could be done through the classroom format used for state investigator training or through videos and/or webcasts. While we may never achieve *uniformity* in all 55 states and territories regulating appraisers, this would go a long way to help promote *consistency* among the states. Topics for such training could include:

1. Legal Staff Training
2. Board Member Training
3. Administrative Staff Training
4. Understanding the Complaint Process
5. Promoting Consistent Enforcement

The Appraisal Foundation stands ready to assist in administering these training sessions, as it has with the state investigator training sessions.

Recommendation Regarding The Feasibility of Establishing a Self-Regulatory Organization System for Appraisers in the U.S.

It has been brought to our attention that there may be a proposal offered at the hearing to replace the current appraiser regulatory system as mandated by Title XI of FIRREA with a Self-Regulatory Organization (SRO) system, operated by a trade association.

For the past two decades the Foundation has been working with non-profit organizations and governments around the world regarding appraiser regulatory systems. In countries where there is one principal appraisal trade organization, such as in Great Britain and Australia, the system can work quite well. It can also work well in countries or regions where the valuation profession is just developing. We assisted groups in Russia and the League of Arab States in the Middle East in this regard.

However, in many countries it can be problematic and the U.S. is one of those countries. The Appraisal Institute is the largest trade association in the U.S., yet over two–thirds of state licensed and certified appraisers are not members. In addition, there are over fifteen national and regional appraiser organizations. Due to this fragmentation, an SRO doesn't appear to be feasible.

In addition, there is the question of effective enforcement. According to the Government Accountability Office (GAO) report issued in January of this year (Report 12-147), state appraiser regulatory agencies, often with limited resources, have been very active over the past ten years. They have issued almost 16,000 disciplinary actions, including almost 2,300 revocations and voluntary surrenders and over 1,800 suspensions.

We don't believe an SRO system would produce anywhere near the diligence and enforcement record that has occurred in the 55 jurisdictions currently regulating appraisers. In addition, it is important to note that Title XI was in large part enacted because the trade associations did not adequately police their own members.

CONCLUSION

The Title XI real property appraiser regulatory system, while certainly unique and not without its flaws, has made a very real difference. It is the glue that holds the 55 jurisdictions together and every effort should be made to further refine and improve a system that has demonstrated effectiveness *without the use of appropriated funds.* The

Appraisal Foundation stands ready to assist with this effort in any manner you believe is appropriate.

Again, The Appraisal Foundation appreciates the opportunity to share its perspective with you today and we urge this Subcommittee and all members of Congress to continue to use the Foundation as a fair, impartial and objective resource on valuation-related issues.

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UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

HEARING REGARDING

APPRAISAL OVERSIGHT: THE REGULATORY IMPACT ON CONSUMERS AND BUSINESSES

JUNE 28, 2012

INTRODUCTION

Madam Chair, Ranking Member Gutierrez, and members of the Subcommittee, I am Francois (Frank) K. Gregoire, President of Gregoire & Gregoire, Inc., based in St. Petersburg, Florida. I thank you for the opportunity to participate in this hearing on behalf of the one million members of the National Association of REALTORS® (NAR). NAR is America's largest trade association, including its eight affiliated Institutes, Societies and Councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,400 local associations or boards, and 54 state and territory associations of REALTORS®. NAR represents a wide variety of housing industry professionals, including approximately 30,000 licensed and certified appraisers, committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers.

I have been involved in appraising real property since 1977. I am a state-certified residential appraiser in Florida and have been awarded the Residential Accredited Appraiser (RAA) Designation by NAR and the Independent Fee Appraiser (IFA) Designation by the National Association of Independent Fee Appraisers. As a member of the Board of Directors of the Florida REALTORS® and NAR, I have been involved in their public policy committees since 1992. While serving on the Florida Real Estate Appraiser Board, I represented Florida on the Appraisal Foundation State Regulator Advisory Group and as a member of the Association of Appraiser Regulatory Officials Board of Directors. Specializing in one-four unit family residential properties, Gregoire & Gregoire offers a variety of services from appraisals for mortgage loans to providing expert testimony in administrative and judicial courts for disciplinary proceedings and litigation.

NAR believes a strong and independent appraisal industry is vital to restoring faith in the mortgage origination process. In my testimony today I would like to address a number of issues impacting the credible valuation of real property, which is one of the most critical and overlooked aspects of the recovery of our industry. The challenges faced in the appraisal industry can be broken into three areas: 1) challenges facing the appraiser; 2) challenges in the appraisal process; and 3) concerns in regulatory oversight. There are a myriad of issues hindering the appraisal process and, while we will offer some solutions, it is important to note that there is no "silver bullet" remedy. As we see markets stabilizing and improving across the country it is also paramount that we discuss the future of valuing real property.

We thank the House Financial Services Committee for holding this hearing on an issue that is paramount to restoring confidence in the U.S. housing market.

APPRAISAL ISSUES AND CHALLENGES

There are a myriad of circumstances and issues working to hinder the recovery of the nation's housing market. Among them, and often overlooked, are those related to the credible valuation of real property. A credible valuation provided by a licensed or certified professional 1) ensures the real property value is sufficient to collateralize the mortgage, 2) protects the mortgagor, 3) allows secondary markets to have confidence in the mortgage products and mortgage backed securities, and 4) builds public trust in the real estate profession. However, in today's world there are many road blocks in the way of valuing property and, as a result, allowing for a healthy recovery of the broader real estate industry. Because there are many roadblocks there is no one, "silver bullet" solution.

Appraiser Competency. An important component of the Uniform Standards of Professional Appraisal Practice (USPAP) is the Competency Rule. The rule requires the appraiser to be competent, acquire competency, or decline the appraisal assignment. Competency requires the appraiser to have the ability to identify the valuation problem to be solved, the knowledge and experience to complete the assignment competently, and to have a recognition of and compliance with, laws and regulations that apply to the appraiser and the assignment. Absent the competency required, the appraiser must disclose their lack of knowledge or expertise to the client before accepting the assignment, take all necessary or appropriate steps to complete the assignment properly, and make necessary disclosures in the appraisal report. The term "Competency" refers to a number of factors. Among them are familiarity with a specific property type, a specific market, a geographic area, specific laws and regulations, an intended use, and analytical methods.

Legislation and regulation in the 1980's forced changes to the real estate appraisal profession; many of them positive. Litigation, legislation, and regulations in the 2000's also have forced changes to the real estate appraisal business. Despite the good intent, the changes have diminished the importance of appraiser competency as a requirement for appraisal assignments to the detriment of the enterprises, lenders, mortgage insurers, and consumers. The insertion of middlemen or brokers of appraisal services between loan originators and appraisers resulted in a focus on fee and turn-around time rather than the appraiser's competency, knowledge, professional designations, and experience. Clearly, this was not the intent but it appears to be an unintended consequence.

Knowledge of the local market, more commonly referred to as geographic competency, is the most common concern cited by our members. USPAP requires appraisers to spend sufficient time in a local market to understand the nuances of a particular location. It is important to note that USPAP does NOT limit the distance an appraiser may travel to an assignment. While a distance traveled limit sounds like a simple solution it is far from effective. This is because markets vary widely – an appropriate distance limit in an urban market may not be appropriate in a nearby rural area. What is important is that clients retain services from appraisers with a level of geographic competence sufficient to complete the assignment with credibility

NAR offers some recommendations to address concerns with competency. The most effective solution to appraiser competency may be improved communication between the appraiser and others involved with the appraisal report. Communication between appraisers and real estate agents and their clients is not prohibited and should, in fact, be encouraged. Appraisers should feel compelled to offer their competency to stakeholders. Real estate agents and their clients should ask questions to get a better understanding of the appraiser's qualifications, education, experience, and professional designations. While communication should be encouraged; coercion and other attempts to influence value are, and should continue to be, prohibited. Another solution is enhanced education requirements for appraisers. NAR has long supported this as the key to ensure appraisers maintain the necessary skills to provide their critical services.

Appraisal Management Companies. According to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law No. 111-203), an appraisal management company (AMC) is a third party that oversees a network or panel of more than 15 appraisers within a state or 25 or more appraisers nationally in a given year and has been authorized by lenders to recruit, select, and retain appraisers; contracts with appraisers to perform appraisal assignments; manages the process of having an appraisal performed; or review and verify the work of appraisers.[1] Services provided by AMCs may include identifying appraisers, reviewing appraisal reports as part of quality control, and managing the appraisal process.

Many AMCs provide legitimate services for legitimate fees, but a large number of AMCs are contributing to problems in the appraisal business, the appraisal profession, and the housing market. Although many loan originators have contracted with these third party brokers of valuation services in an attempt to comply with their Dodd-Frank related regulatory obligations to avoid conflicts of interest and ensure appraiser independence, there is evidence that appraiser independence is often being compromised by the AMC itself.

Some of our appraiser members have reported that working with a quality AMC, even for a slightly reduced fee, may be worthwhile because they offer a steady stream of work, offer competitive fees, promote and respect appraiser independence, and treat appraisers appropriately. However, these AMCs are not the problem. More often than not our appraiser members report that AMCs, particularly those owned by, or affiliated with lending institutions, are insisting appraisers provide appraisal reports with an unacceptable turnaround time, a burdensome scope of work, and for a significantly reduced fee. Less experienced appraisers are accepting these assignments and are often willing to skirt competency requirements in the process; experienced appraisers will not accept these assignments. The end result is a stain on the profession and home values that are not credible. Lenders and consumers are being underserved.

Prior to the fixation on perceived conflicts of interest related to appraiser selection and retention initiated by the Home Valuation Code of Conduct (HVCC), most licensed and certified appraisers typically maintained a wide and often diverse client base. As a service business, appraisers and firms competed on the basis of knowledge, skill, competency, reputation, price and service. Although market driven ebbs and flows affected the firm's client base, the principals cultivated their clients and business relationships. Contrary to the belief of many, most of these relationships were not sinister and based solely on an appraiser's willingness to compromise their ethics and professional responsibility by producing appraisal reports to "hit the number". Most appraisers value their license, are serious about their profession, their duty to the public, and would strive to produce well

[1] Dodd-Frank Act § 1473(f)(4) (codified at 12 U.S.C. § 3550(11)).

documented, credible appraisal reports. A large, diverse client base allowed the appraiser to be independent and to concentrate on professionalism.

The appraiser–client business relationships built on the foundation of knowledge and trust have been shattered over the past few years. According to a recent GAO study, the market share of AMC appraisal business has increased from 15 percent to 60 – 80 percent[1]. An appraiser's disagreement that might have resulted in the loss of one client prior to HVCC or Dodd-Frank might now represent the loss of 20 – 60 percent or more of the appraiser's business. In the place of well-cultivated business relationships are panels of appraisers maintained by a relatively few AMCs, the largest of which are owned by the nations' biggest lenders. For the most part, the AMC is interested in a vendor rather than a professional. Their vendor is offered appraisal assignments often based on their willingness to accept a lower fee than a competing vendor, or their promise to deliver the completed appraisal report faster. For the more unscrupulous AMCs, their vendor must only meet the minimum standards of 1) having a license or certification as an appraiser, and 2) showing proof of errors and omissions insurance. Instead of selecting the best appraiser to complete the appraisal assignment on the basis of experience, knowledge and competency, the assignment is often awarded to the vendor responding first to an email blast sent to dozens or hundreds of appraisers that happen to be on the AMC panel in that state. Is it any wonder appraiser competency and appraisal quality is questioned when such tactics are employed?

In a stable market, with an abundance of arm's length transactions, it might be possible to quickly fill in the blanks on a form, decide on an opinion of value, and be reasonably accurate. Unfortunately, today's housing market is anything but stable and is replete with transfers of property tainted by circumstances that may have an effect on the eventual sales price; such as bank-owned properties, short sales, and tax sales. The development of a credible opinion of value requires research, verification, knowledge, analysis, skill and time. It is much more than merely filling blanks on a form. Often, the pressure on the appraiser to meet deadlines makes the research and analysis necessary for credible results impossible. At times, comparable sales tainted by distress are included in the appraisal report and fail to provide a reliable indication of the value of the property appraised.

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[1] *Residential Appraisals: Opportunities to Enhance Oversight of an Evolving Industry.* US Government Accountability Office. July 2011.

In short, unreasonably short time of completion requirements imposed by some AMCs contributes to unacceptable appraisal quality.

The independent judgment of the appraiser is compromised when AMC "reviewers" unreasonably question the use, or failure to use, specific transactions as comparable sales in an appraisal report, question individual adjustments made to the Comparable Sales, or suggest what would be considered "acceptable" adjustments. AMC personnel, who are often non-appraisers with only a cursory knowledge of valuation, and working from a checklist or printout from an automated valuation model (AVM), interfere with appraiser independence by asking or insisting that specific observations about the property, comparable sales, or market be excluded from the appraisal report. In one recent instance, an AMC reviewer's reaction to an appraiser's positive adjustment to comparable sales for an appreciating market was "you'd better retbink those date of sale/time adjustments". Other examples abound, but the day-to-day experience of appraisers in the field makes it clear the claim that AMCs ensure appraiser independence is a myth.

The altered business relationships between appraiser's and their clients, unreasonable completion time requirements, diminished appraisal fees, and interference in the appraiser's independence all contribute to the most recent issue identified as an obstacle to housing market recovery – the failure to recognize positive movement in prices and values in many market areas. Accurately estimating market value in a dynamic market has always been challenging, but not impossible. Unfortunately, the events of the past few years and the current regulatory environment tend to encourage lenders, underwriters, mortgage loan insurers, and AMCs to question an appraiser if the opinion of value is higher than that of a similar property six months earlier. Too many involved in the lending decision have forgotten that prices and values do actually rise. This is particularly true when inventories are low, demand is steady or high, and financing at reasonable rates is available. Competent appraisers are capable of extracting proof of an improving market, applying that proof by making adjustments to recently closed sales, and developing an estimate of value consistent with an improved market. This universe of competent appraisers is diminished when their independence is compromised, or when they choose to leave the business or abandon mortgage lending appraising because of unreasonable fees, unreasonable completion requirements, unacceptable assignment conditions, or scope creep.

NAR generally supported the appraisal provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act. NAR did not support the language that effectively regulates AMCs on two different tracks. The two-track approach has exacerbated many of the problems. AMCs not owned by a lender are required to register with the state appraisal regulatory body. However, Dodd-Frank exempts AMCs from the registration requirement if the AMC is a subsidiary owned and controlled by a financial institution that is regulated by a federal financial institution regulatory agency. Though it would require a legislative change, NAR continues to believe that all AMCs should be required to register with state appraisal regulatory bodies where they are providing appraisal management services. Further, NAR believes that lenders should be prohibited from retaining the services of an AMC where the lender maintains any level of ownership.

Credible Valuations in Recovering Markets. Perhaps the single biggest valuation issue that will hinder or help the recovery of real estate and the nation's economy is valuing real property in markets that are no longer declining. As mentioned earlier, it has always been a challenge for appraisers to identify value and support their opinions of market trends where neighborhood prices are in a state of transition. Identification of the transition and trend is possible if the appraiser is competent, and is afforded the opportunity to conduct the appropriate research, complete the necessary market data verification, and conduct the proper analysis. Roadblocks to housing recovery are erected when lenders, underwriters, mortgage loan insurers, and AMCs interfere with the appraiser's independence, and neglect to recognize their market derived opinions and conclusions.

Scope of Work is Critical. Scope of Work refers to the type and extent of research and analysis conducted by an appraiser to complete an appraisal assignment. At a minimum, the Scope of Work must include the research and analysis necessary to develop a credible opinion of value, and meet or exceed 1) the expectations of parties who are regularly intended users for such appraisal assignments, and 2) what the appraiser's peers would do when completing a similar appraisal assignment. Although the expectations and requirements of the client and regular intended users are considered by appraisers in deciding on the appropriate Scope of Work, interference in appraiser independence is possible when client-imposed conditions either define or limit the scope of work to a degree that assignment results (opinion of value) are not credible. The Appraisal Standards Board of the Appraisal Foundation advises appraisers that "while it is common and reasonable for the client to provide input to the appraiser regarding a desired scope of work, the responsibility for determining the appropriate scope of work resides with the appraiser."[2]

Some appraisers are leaving the industry because of unwarranted scrutiny and scope of work creep. This is a symptom of a larger buyback issue facing lenders. Lenders report that mortgages that are backed by the federal government are often required to go through additional review because the currently regulatory environment indicates that lenders will be required to re-purchase or buyback any loans with underwriting errors of any kind. Lenders have said that in the past it was accepted practice that loans that defaulted after three years generally did not default because of poor underwriting.

Lenders, underwriters, mortgage loan insurers, and the government sponsored enterprises generally are the parties who are regularly intended users of appraisals completed for mortgage loans. These parties expect sales used as comparables to be recent and to reflect current market conditions. Appraisal guidelines published by the enterprises specify broad selection criteria and specifically allow use of comparable sales that have been settled or closed up to 12 months prior to the effective date of the appraisal. The same published guidelines specifically state that "Time adjustments must reflect the difference in market conditions between the contract date of the comparable and the effective date of appraisal for the subject property. The adjustment may be either positive or negative."[3]

The unfortunate reality is that some lenders and AMCs impose assignment conditions that may prevent the appraiser from producing an independently developed, credible opinion of value. Clients can stipulate conditions in the appraisal development which can influence the appraisal conclusion. This means lenders may instruct an appraiser to include or exclude certain data such as short sales or other distressed sales as comparables. It is not uncommon for lenders and AMCs to improperly instruct an appraiser to include or exclude certain data such as short sales or other distressed sales as comparables. Appraiser members tell us that the scope of work requires upwards of 6 comparable sales located within a couple of blocks of the property and must be less than 90 days old. After receiving the report, lenders and AMCs are asking for additional comparables and analysis.

[2] *Uniform Standards of Professional Appraisal Practice*. 2012. Advisory Opinion 28 – Scope of Work Decision, Performance, and Disclosure

[3] *Fannie Mae Selling Guide* – 5/15/2012, Date of Sale and Time Adjustments, Page 581

Eventually, an appraiser has no choice but to include the distressed property regardless of whether it is appropriate for the subject property. The Appraisal Foundation warns that when a "client stipulates the inclusion or not of a particular type of comparable, the appraiser may have to revisit, with the client, the type of value developed"[2]. This will help ensure that a misleading analysis or assignment result is not reported. In other words, the opinion of value developed under such conditions may not be Market Value. Lenders, underwriters, and the enterprises, however, expect a Market Value opinion when evaluating the collateral for a mortgage loan.

AMCs often require appraisers to accept any and all liability if a loan defaults if there is any claim related to the value of the property. Appraisers should bear the responsibility for producing credible appraisal reports based on reliable data and strong analysis. Insisting the appraiser accepts all liability for a process that is otherwise out of their control negatively impacts the appraiser's ability to complete a credible report. This also adds unnecessary risk to the mortgage transaction and to the broader real estate market's still fragile recovery.

NAR supports the independence of the appraisal process and believes this independence should be strengthened to ensure that appraisals are based on sound and fair appraisal principles. Federal rules and regulations from Truth in Lending (TILA) to guidelines published by the government sponsored enterprises (GSE)[4] to Interagency Guidelines work to ensure independence in the valuation process. In practice, there is little independence in valuation of real property. Appraisers are beholden to their clients, fear being black listed, and are often improperly blamed for loan defaults and other losses.

Appraisal pressure undermines the integrity of the mortgage lending process if the result is a mortgage loan made based on inaccurate property valuation. Such interference with appraiser independence must cease.

Establishing a Trend - Statistical Tools for Analysis. Identifying and proving a trend has always been a challenge for appraisers because most of the data is retroactive. Housing price indexes published by government agencies, trade groups, and data aggregators are helpful, but have significant lag times,

[2] *APB Valuation Advisory #3: Residential Appraising in a Declining Market.* The Appraisal Foundation. May 7, 2012.
[4] Government sponsored enterprises (GSE) refers to Fannie Mae and Freddie Mac.

and rarely have the specificity to identify trends in incredibly local, granular housing markets. It takes time to develop a trend – spotting a trend and proving it are very different things.

Identifying trends can be assisted with technology. Recent publications have noted that appraisers increasingly have access to automated valuation models (AVM) or Computer Assisted Mass-Appraisal (CAMA) models. This technology can allow appraisers to access and develop their own statistical tools to support opinions about market trends. NAR offers REALTORS® Property Resource (RPR) as a member benefit, which includes tools specific to appraisers. Advanced reporting features offered by RPR allow the REALTOR® to create custom reports to provide to clients and customers. These reports, sourced from a rich database of public and private multiple listing service information, will be available to all NAR members, regardless of their professional specialty. We expect our appraiser members will use these reports to provide more credible, and well supported, appraisal reports and valuation products.

Limitations of Forms and Appraisal Report Delivery. In a dynamic market the intended users of the appraisal are looking to the information and conclusions stated in the Market Conditions (MC) Addendum form to support the appraiser's opinions about demand, supply, inventory mix, and price trends. Unfortunately, because the Market Conditions Addendum form was developed and implemented to identify declining markets, it appears there is reluctance to accept the form might reveal the opposite. NAR's Valuation Committee anticipated this problem, and has been working with RPR to develop a means to auto-populate the Market Conditions Addendum form. The initial approach was to do it "by the book" and stick to populating the fields that are provided in the form. According to Committee members, the overall implementation RPR was proposing - the possibility of extracting different types of analytics from the RPR site to create graphs and charts to clearly illustrate and "make the case" to lenders, underwriters and AMCs would make the appraisal report much more useful to lenders, underwriters, AMCs, and consumers. This discussion clearly illustrated the limitations of the current reporting format.

Our efforts to enable our appraiser members to provide more information and make graphical content more useful and meaningful to clients and consumers may not have the intended effect. Appraisers routinely supplement the standard appraisal form and Market Conditions Addendum with narrative comments, explaining the characteristics and conditions of the market in detail. Some are already supplementing their narrative with spreadsheets and graphs to further illustrate not only the trend, but the data and analysis considered in developing the appraiser's conclusion. It is unfortunate that this additional information is often never delivered to the AMC, lender, or underwriter due to the limitations imposed by some of the appraisal report delivery portals. In other words, in many cases, it is not uncommon for the intended user to receive an appraisal report containing less information and supporting documentation than the appraiser produced. This shortcoming must be corrected.

Definitions May Impact Value. The scope of work for most mortgage loan valuations requires the appraiser to indicate if the market is declining, stable, or increasing. The appraiser's opinions and conclusions are often measured or tested by lenders, mortgage insurers and AMCs by comparison to a published national or proprietary index of complied data. These often lag actual market trends and are not specific to the market or neighborhood identified by the appraiser in the report. Pressure on the appraiser to make their report conform to old data and published conclusions is inappropriate, interferes with appraiser independence, and will produce misleading results.

There are often discrepancies between areas identified as "markets" by publishers of information and appraisers. It's not uncommon for published sources to identify broad areas such as MSAs, regions, counties, zip codes and census tracts. Appraisers may define the market by neighborhood, school district, geographic boundaries, or property type. With varying definitions of "markets" it's easy to understand how an appraiser's observations, opinions and conclusions are sometimes at odds with what some lenders, underwriters, mortgage loan insurers, and AMCs believe. The actual market may be improving, despite a published index stating a different trend.

Funding State Regulators. One of the most significant challenges to the regulation of appraisers is the current funding structure of appraisal programs at the state level. In most states and jurisdictions, licensing and certification fees paid by the appraisers to the state are to be used for funding state appraisal boards. However, in many cases these fees are directed to a state's general fund, causing the state appraisal board to compete with other state discretionary programs for funding. Inadequate funding of state appraisal boards means that recommendations offered by ASC through site visits and Compliance Reviews are difficult, if not impossible, to implement. States are struggling financially but reducing funds for appraisal regulatory agencies results in insufficient protection for the public.

The regulatory burden imposed on state appraiser regulatory agencies is also affected by regular and constant changes to appraisal standards. The Uniform Standards of Professional Appraisal Practice has been amended and new versions published nineteen times since 1990. To maintain compliance with the Financial Institutions Reform, Recovery, and Enforcement Action of 1989 (FIRREA) and avoid sanctions by the Appraisal Subcommittee some state regulatory agencies must seek regular legislative action to incorporate the modifications. Resources devoted to legislative activity reduce those dedicated to their mission of appraiser regulation and consumer protection. Banks, lenders, underwriters, the public and appraisers might be better served if the standards were standard.

Human Capital Turnover. The number of appraisers in the industry is in decline. According to the Appraisal Subcommittee[5], the number of credentialed appraisers is down more than 5,000 since the peak in 2006. The Subcommittee notes that it is not uncommon for appraisers to hold multiple state credentials, and the number of individuals is likely down even more. NAR appraiser members report that their colleagues are leaving the industry for many reasons. Perhaps the most cited reason is that experienced appraisers refuse to work under the current AMC imposed climate.

The level of scrutiny and blame being placed on appraisers is unprecedented. The scope of work continues to expand while fees and turnaround times are diminishing. After a report is submitted it is often compared against an automated valuation model (AVM) or a broker price opinion (BPO). If the report is not within the threshold determined to be acceptable by the client it is the appraiser and their report facing the scrutiny, regardless of whether the report is or is not credible. The appraiser is the party expected to justify their work with additional sales, additional listings, explanations, and data. Experienced appraisers are choosing retirement or new fields of work.

At the same time, it is more difficult than ever to become an appraiser. Individuals interested in becoming appraisers must meet education requirements, experience requirements, and pass state-administered national examinations. To become a state-certified appraiser individuals are required to take 200 hours of education coursework and complete 2,500 hours of experience within a 24 month

[5] Appraisal Subcommittee Annual Report 2011. Appendix D. National Appraiser Credential Statistics.

period. These are minimum standards as established by the Appraisal Foundation's Appraisal Qualifications Board. States may require additional training. The experience requirement, which is effectively an apprentice program, is extremely difficult to meet. Simply stated, the apprentice system is in need of reform. Experienced appraisers are often unwilling to train young appraisers because the trainer assumes all liability for work completed by the trainee.

While NAR does not have an official position on appraiser turnover, it may be time for the industry to explore alternatives. The Appraisal Foundation continues to discuss a four year college degree as an alternative to some or all of the education requirements. In fact, some college education enhancements have already been incorporated by the Foundation. Perhaps similar alternatives can be created that would offer greater opportunity for trainees to meet the experience requirements. Any alternatives to the experience requirement must continue to meet the current standards required by the Appraisal Foundation.

NAR ROLE IN VALUING REAL PROPERTY

While some organizations focus on appraisals only, the National Association of REALTORS® is the only real estate trade association that can speak with authority on appraisals and alternative valuation products. Some of our members provide broker price opinions (BPO) and comparative market analyses (CMA). Some of our members are appraisers and provide the full range of appraisal services. NAR's subsidiary, REALTORS® Property Resource (RPR), offers an AVM. NAR is positioned, along with its RPR subsidiary, to provide one of the most comprehensive sets of data and tools for determining home values.

NAR has long been proactive in seeking to ensure credible valuation of real property for our industry. In 2007, we adopted the Responsible Lending Policy that included policy positions on appraisals. The policy recommendations include the following measures to strengthen the appraisal process:

- Require lenders to inform each borrower of the method used to value the property in connection with the mortgage application, and give the borrower the right to receive a copy of each appraisal.
- Enhanced penalties against those who improperly influence the appraisal process. Those with an interest in the outcome of an appraisal should only request the appraiser to consider additional information about the property, provide further detail, substantiation, or explanation for the appraisal; and correct errors.
- Federal assistance to states to strengthen regulatory enforcement activities related to appraisals.
- Support for enhanced education requirements for appraisers.

Beginning in 2010, NAR embraced an all-encompassing approach to real property valuation. NAR Leadership recognized the shifting landscape within the industry and the demand for alternative valuation products and services. Today, NAR believes there are a variety of valuation products, each with a critical role to play in the future of homeownership. Appraisals are the "gold standard" for mortgage origination but there is an important role for BPOs, CMAs, and AVMs as well.

In February 2012, NAR adopted the Responsible Valuation Policy, which serves as our statement of federal policy on valuing real property. It serves as a guide for members and staff in advocacy efforts for federal legislation and regulatory policy. As a reminder to all members who provide these services, the policy document contains Standards 11-1 and 11-2 of the 2012 National Association of REALTORS® Code of Ethics. These standards ensure that services "REALTORS® provide to their clients and customers shall conform to the standards of practice and competence which are reasonably expected in the specific real estate disciplines in which they engage."

According to industry estimates, more than 10 million BPOs are performed annually. BPOs provide critical information for decisions, and have been widely adopted as a valuation tool in the mortgage industry and – increasingly – for government programs intended to aid the economy and help homeowners avoid foreclosure. Among other uses, these non-appraisal services can help determine listing prices and are used to estimate potential selling prices of a property. Evaluating properties depends more than ever on professional expertise and competence, the best use of technology, and a commitment to approach the valuation assignment from all pertinent perspectives. NAR now offers the Broker Price Opinion Resource (BPOR) Certification for members providing this valuable service. "BPOs: The Agent's Role in the Valuation Process" is a course specifically designed to help residential real estate agents and brokers enhance their skills in creating BPOs, reducing risk, and applying alternative valuation techniques.

BPOs and comparative market analyses (CMA) performed by REALTORS® contain, at a minimum, the information specified in Standard of Practice 11-1 of our Code of Ethics except where the party requesting the opinion requests a specific type of report or different data set, or where the opinion is developed in pursuit of a listing or to assist a potential purchaser in formulating a purchase offer.

Except where exempted or prohibited by our Code of Ethics, state, local or federal law, a BPO should include the disclosure of a review of the subject property, subject neighborhood review and analysis, local and regional market information and trends, and a description of comparable properties tbat are similar to the subject property. NAR policy states that any BPO or CMA that does not provide the aforementioned components shall be disclosed by the provider of the service. Non-appraisal opinions must make it clear to the intended user that it is not an appraisal. Per our Responsible Valuation Policy:

- Non-appraisal opinions, such as BPOs, shall be prepared by a real estate licensee or registered, licensed or certified appraiser. A licensee completing these services for a client is not necessarily assured of receiving the listing of the property.
- Generally, in conjunction with the purchase of a consumer's principal dwelling, BPOs may not be used as the primary basis to determine the value of real property for the purpose of a loan origination of a residential mortgage loan secured by such property.
- When not restricted by law, non-appraisal opinions may be appropriate for many real estate transactions, such as short sales, foreclosures, and loan modifications.
- In adhering to Article 11 of the REALTORS® Code of Ethics, consideration must be given to the intended use and intended user when developing any valuation.
- A CMA is generally used to provide information to sellers or buyers in determining listing price or offering price.

NAR's policy with respect to AVMs applies to individuals, organizations, or corporations that develop AVM software and related algorithms. The end user, whether a consumer or REALTOR®, should not be held liable for the product or results provided by any AVM owned or developed by a third party. Individuals or companies that create AVMs should ensure that AVMs: 1) protect against the manipulation of data, including disassembly and redistribution without explicit authorization; 2) employ appropriate quality control measures, including disclosure of a confidence score calculated using a statistical methodology, such as forecast standard deviation; 3) utilize only data which has been explicitly licensed and authorized; 4) avoid conflicts of interest; 5) require random sample testing and reviews; and 6) not be used as the principle method of valuation in mortgage origination.

The unique value of RPR's AVM is that it incorporates real-time market information from more than 400 Multiple Listing Services (MLS) nationwide, comprising approximately two-thirds of NAR's membership. Much of this MLS data contains more than 10 years history on most properties. RPR's AVM, known as the REALTORS® Valuation Model (RVM), is more accurate than most other AVMs when tested on both the national and local levels. Incorporation of MLS data combined with accuracy allows the RVM to offer the strongest value proposition in today's market. Here are some highlights of its value:

- Captures loan performance data including delinquencies, short-sale status and REO (transparency for the REALTOR® and consumer).
- Provides extensive reporting capabilities and comparable analysis.
- Provides recent trend data on home prices in both macro and micro markets.
- Uses properties sold not currently listed for sale.
- Data is refreshed frequently to keep pace with changing markets.

Through RPR, REALTORS® have access to comprehensive tools to improve comparable property selection to determine the tradeoff between days on market and price. This also allows for improved disposition of distressed properties based on local trends and connections to REALTORS® equipped to sell these unique properties. RPR is an investment in capabilities that ensure a

REALTORS® expertise in local markets remains a critical component in improving and enabling a viable housing finance system from the point-of-sale to the mortgage investor.

As a demonstration of their commitment to appraiser members, valuation, and the importance of competency, since 1993 NAR has encouraged their appraiser members to demonstrate their professional competence by earning one or both of their appraisal designations. The Residential Accredited Appraiser (RAA) and General Accredited Appraiser (GAA) designations are awarded to certified appraisers with education and experience in excess of the minimum qualifications specified by the Appraiser Qualifications Board of the Appraisal Foundation for state-certification.

RAA and GAA designated appraisers are kept up to date on valuation policy and regulation with regular correspondence developed by NAR and provided opportunities to participate in exclusive NAR provided education and seminars.

CONCLUSION

Developing and reporting property values more accurately is critical to market performance, reducing risk, and strengthening the housing finance system. There are no easy, "silver bullet" fixes to the problems facing credible valuation of real property. The issues mentioned in this testimony are further complicated by a market that nationally appears to be slowly recovering but with many local markets less healthy than others.

The National Association of REALTORS® believes that homeownership matters. We see a bright future for the housing market and the overall economy. However, our members are well aware that the future we see rests on the industry's and the economy's ability to successfully navigate some continuing and persistent obstacles. Congress and the housing industry must maintain a positive, aggressive, forward looking partnership if we are to ensure that housing and national economic recoveries are sustained. NAR stands ready to work with you on this most important issue.

Joint Testimony of the Real Estate Valuation Advocacy Association (REVAA) and Coalition to Facilitate Appraisal Integrity Reform (FAIR)

BY

DON KELLY, EXECUTIVE DIRECTOR, REVAA

FOR THE HEARING ON
"APPRAISAL OVERSIGHT: THE REGULATORY IMPACT ON CONSUMERS AND BUSINESSES"

BEFORE THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON INSURANCE, HOUSING, AND COMMUNITY OPPORTUNITY

JUNE 28, 2012

STATEMENT OF DON KELLY BEFORE THE SUBCOMMITTEE ON INSURANCE, HOUSING, AND COMMUNITY OPPORTUNITY OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES

Introduction and Summary

I am Donald E. Kelly, Executive Director of the Real Estate Valuation Advocacy Association ("REVAA"). I appreciate the opportunity to provide testimony on behalf of REVAA and the Coalition to Facilitate Appraisal Integrity Reform ("FAIR") for the Insurance, Housing, and Community Opportunity Subcommittee's hearing on Appraisal Oversight: The Regulatory Impact on Consumers and Businesses.

With this testimony, I hope to:

- describe the important role that REVAA and FAIR members play in the valuation industry;
- explain why the appraisal management company ("AMCs") industry exists and how the services provided by AMCs benefit appraisers, lenders, investors, and most importantly, homeowners.
- describe the existing federal and state regulatory structure governing AMCs, as well as our industry's proactive efforts to work collaboratively with the relevant federal agencies as they develop rules establishing minimum standards for AMCs, and the states as they implement registration and regulatory requirements for AMCs; and
- provide insight from our industry regarding the regulatory implementation of the "customary and reasonable" compensation requirement contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

Background on REVAA and FAIR

REVAA is a real estate valuation industry trade association that promotes education, high ethical standards, political awareness, and the professional development of the real estate valuation industry.

REVAA believes that homeowners, the mortgage lending industry, and the economy as a whole are best served by a diversified array of real estate valuation products. With growing complexity regarding real estate valuation in today's challenging market, it is vital that end-users have the ability to select the most appropriate valuation service to meet their specific needs.

REVAA members have committed to being proactive in efforts to promote and expand the industry. Our members produce and deliver real estate valuation products including Appraisals, Broker Price Opinions (BPOs), Automated Valuation Models (AVMs), and other innovative valuation methods that benefit mortgage investors, servicers, originators, and borrowers.

FAIR is a coalition of five of the nation's largest AMCs,[1] which operate networks of individual appraisers and appraisal firms for the completion of appraisal reports. FAIR members have become leaders in the industry by adopting responsible polices and procedures to protect appraiser independence, promote quality appraisals, and serve lender-client needs in a timely manner for the ultimate benefit of homeowners.

AMC's Role in the Industry and Overview of their Functions

AMCs operate regional and national networks of employee appraisers, independent contractor appraisers, and appraisal companies/firms for the completion of appraisal reports. In addition to pre-qualifying these appraisers and receiving appraisal orders from lenders and other clients, AMCs facilitate and manage the entire appraisal delivery process, including tracking the progress of the order, managing all communication between the lender and the appraiser, reviewing specific elements of appraisal reports for quality and compliance with applicable laws, ensuring prompt delivery of completed appraisals, and collecting and paying the appraisers' fees for their services. Today, there are approximately 315 AMCs operating in the United States.

AMCs act as a centralized appraisal source for mortgage lenders that operate on a wide geographic basis. Rather than contacting hundreds of individual appraisers in each state or jurisdiction, most lenders obtain appraisals through a centralized AMC model. AMCs recruit and qualify vendors for their networks, by verifying appraisal licensure and/or certification, checking references, performing background checks, performing examinations, and auditing work samples. AMCs also negotiate service level expectations and maintain service level agreements with individual vendors.

Once contacted by a lender for an assignment, the AMC then works to match the assignment with a qualified, geographically competent appraiser. This selection is based on a number of factors, including the appraiser's geographic proximity to the subject property, and performance metrics such as the quality of an appraiser's work. The selected appraiser then performs the physical inspection of the property and issues an appraisal report containing the appraiser's opinion of property value. During this process, the AMC performs extensive quality control functions on behalf of both the appraiser and the lender to ensure a high quality appraisal report is delivered to the client.

In addition to managing networks of independent, third-party service providers, AMCs also manage all of the ordering, tracking, quality control and delivery tasks associated with the appraisal process. Below are some of the specific functions that an AMC provides:

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[1] The five AMCs are: (1) LSI, a division of Lender Processing Services, Inc.; (2) ServiceLink Valuation Solutions, LLC, a Fidelity National Financial, Inc. company; (3) Valuation Information Technology, LLC d/b/a Rels Valuation, an affiliate of CoreLogic, Inc. and Wells Fargo Bank; (4) CoreLogic Valuation Services; and (5) PCV/Murcor.

- Assume loan-level administrative duties for the large numbers of transactions in their pipelines, including (i) performing order entry and assignment, (ii) tracking order status, (iii) updating clients on progress or delays, (iv) performing both pre- and post-delivery quality control, (v) transmitting preliminary and final hard copies of appraisal reports to clients, (vi) handling accounts payable and receivable, (vii) engaging in dispute resolution between lenders and appraisers, (viii) providing and administering warranties and errors and omissions insurance, and (ix) ensuring proper record retention;

- Offer advanced technology interfacing specializing in the assignment, tracking, and reviewing of appraisal reports and the electronic delivery of reports consistent with the needs of the lender and/or investor;

- Warrant the quality of the final appraisal product to supplement the errors and omissions insurance carried by appraisers;

- Maintain a platform for the administration of appraisals uniformly across jurisdictions; and

- Provide a single point of contact for lenders.

Importantly, by acting as the sole point of contact between the lender and appraiser, AMCs insulate the individual appraiser from any influence or coercion by the lender. This singular issue has been the primary goal of most recent appraisal-related regulation and a key reason for the growth of the AMC model. Imprudent mortgage underwriting practices, including the quality and credibility of some valuations, led to the recent housing collapse. Overzealous mortgage brokers and lenders were partly to blame for overvalued properties and inflated appraisals values, as they used the promise of future business in a booming market and higher appraisal prices to influence the ultimate valuation conclusions made by licensed and certified appraisers. Unfortunately, too many appraisers chose to follow the temptation of additional work and preferences in exchange for suspect and faulty valuations. This undue pressure and coercion led to a series of regulatory reforms specifically targeting the appraisal practices of mortgage lenders and brokers designed to insulate individual appraisers and their valuation conclusions from improper influence.

Most notable is the Home Valuation Code of Conduct ("HVCC"), which resulted from a March 2008 settlement between the Federal Housing Finance Administration, the New York Attorney General, and Fannie Mae and Freddie Mac. The HVCC, which took effect May 1, 2009, applied to all conventional mortgage loans sold to Fannie Mae and Freddie Mac and prohibited mortgage lenders and their agents from influencing the independent judgment of appraisers through collusion, coercion, and bribery.[2] It, therefore, was no surprise that the Dodd-Frank Act sought to make appraisal independence standards permanent by amending the Truth in Lending Act ("TILA") statutes.

[2] *See e.g.,* Freddie Mac, Home Valuation Code of Conduct, http://www.freddiemac.com/singlefamily/pdf/hvcc_746.pdf

The HVCC also first introduced prohibitions on a lender's reliance on appraisers selected, retained, or compensated by mortgage brokers, real estate agents, or other third parties.[3] In response to these requirements, lenders sought to order appraisals through intermediaries to ensure a layer of insulation between those responsible for loan production and independent appraisers. Although AMCs existed long before the HVCC, they became the preferred intermediary for mortgage lenders to distance themselves from individual appraisers and to ensure compliance with new appraisal independence standards.

In addition to providing appraisal services, many AMCs also provide alternative valuation products such as Automated Valuation Models (AVMs) and Broker Price Opinions (BPOs). While appraisals remain the primary method for assessing a property's value in connection with a loan origination, alternative valuation products have a proven track record of accuracy and efficiency and are commonly used in the mortgage lending industry to assess and validate appraisals, to conduct due diligence reviews of loan portfolios, to assess loss mitigation strategies for distressed loans, and to establish eligibility for government-sponsored foreclosure alternative programs. In particular (i) banks use BPOs and AVMs to determine the sales price of real estate owned (REO) properties, to approve proposed short sale transactions, and to modify distressed loans and avoid foreclosure; (ii) investors use BPOs and AVMs to conduct due diligence on loans that they are buying or selling; and (iii) government-sponsored enterprises (GSEs) utilize BPOs and AVMs to establish the eligibility of distressed loans for the Home Affordable Modification Program (HAMP) and the Home Affordable Foreclosure Alternatives Program (HAFA).

Most states recognize the use of BPOs and AVMs for these purposes, and many states have updated their statutes in recent years to specifically permit the use of BPOs in the mortgage lending industry. The Dodd-Frank Act likewise permits the use of BPOs in all contexts other than as the primary basis for a mortgage origination decision in connection with the purchase of a consumer's primary dwelling. The Interagency Appraisal and Evaluation Guidelines specify a wide range of transactions that do not require a traditional appraisal, and provide standards for the alternative use of non-appraisal evaluation products. Finally, BPO Standards and Guidelines (BPOSG) have been widely adopted in the valuation industry to provide a comprehensive framework for the preparation of BPOs on a national level. In each case, there is recognition of the essential role that alternative valuation products play in today's mortgage lending industry, and AMCs have been instrumental in the development and distribution of these products.

The Benefits of Working With an AMC

There are significant benefits for appraisers, lenders, and homeowners when appraisals are ordered and delivered by an AMC.

AMCs Benefit Lenders

AMCs benefit lenders by: maintaining an appraiser panel of competent, licensed and/or certified appraisers; engaging a real estate appraiser; performing the administrative functions

[3] *See* III.A. of the HVCC, available at: https://www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/appcode/pdf/hvcc.pdf

involved in the appraisal ordering, tracking, and delivery process; performing quality control functions; and handling the invoicing and payment of the appraiser.

AMCs' promote high quality appraisals. Lenders have no incentive to hire an AMC that fails to provide high quality appraisals. In an era where appraisals are the foundation for many repurchase demands from secondary market participants, a lender must place additional emphasis on the quality of its underwriting and its valuations. Since preventing potential repurchase demands is of vital importance to an AMC's client, those AMCs that fail to prioritize the quality of their appraisals are weeded out of the market. AMCs implement strong internal controls around recruiting, order placement, tracking, and delivery to provide greater assurance to lenders of the credibility of the appraisals they provide.

Notably, AMCs play a crucial role in ensuring the selection of experienced and qualified appraisers. They ensure that only licensed, insured, experienced and qualified appraisers perform appraisals. This is particularly important because it is extremely difficult to distinguish a "bad" appraisal from a "good" appraisal at a transaction level. Even with all of the technology tools available today, it is still possible to have a "bad" appraisal that passes all inspections and quality control checks in the process. This is why lenders bave turned to AMCs, which focus on apprais*er* management and not just apprais*al* management. The AMC model recognizes that the only way to ensure good quality appraisals is to carefully manage the panel of appraisers completing them.

When selecting appraisers for a specific assignment, many AMCs use an automated system that identifies the most qualified appraiser based on criteria such as the requirements for the assignment, the appraiser's geographic proximity to the subject property, and performance metrics, such as the quality of an appraiser's work. Many AMCs will only compare fees when two appraisers are equally qualified for an assignment.

Although some have alleged that AMCs routinely select appraisers without regard to familiarity with the relevant neighborhood, AMCs note that real estate appraisers have a professional duty under Uniform Standards of Professional Appraisal Practice ("USPAP") to accept only assignments they have the knowledge and experience to complete competently, to disclose any lack of competency to clients, and to take all necessary steps to achieve such competency prior to completing the assignment. AMCs encourage appraisers to comply with USPAP and do not stand in the way of their professional duty.

AMCs also require appraisers to satisfy rigorous qualification criteria, including submitting a sampling of their work for review and submitting reference and background checks before admitting them to the networks. AMCs also often offer ongoing continuing education courses that keep appraisers informed of changes in the market and current federal, state, and lender guidelines. If appraisers fail to continuously meet these qualifications or are deemed to produce substandard appraisals, AMCs will remove these appraisers from the networks.

AMCs Benefit Appraisers

An appraiser benefits from working with an AMC by having a firewall and an advocate to ensure that no inappropriate or improper attempt is made to influence the appraiser process.

Appraisers also rely on AMCs to market the appraisers' services, generate work, manage client relations, collect fees from lenders, and offer continuing education. Prior to the proliferation of AMCs, appraisers spent a large portion of their time marketing and soliciting business or working for an appraisal firm. Because AMCs provide these functions, appraisers have the opportunity to spend more time actually appraising as opposed to performing the back-office work that is associated with the appraisal profession. Not unlike the traditional model for appraisal firms, where the firm splits the fee with the appraiser in exchange for continued work and marketing, AMCs provide similar stability for qualified appraisers.

In addition to these services, AMCs also have created and/or provided technological innovations in the appraisal industry, including the development of electronic appraisal delivery and the development of supplemental addendums and products to complement the current standardized appraisal forms. AMCs have also provided expertise in the development of the MISMO XML standards and other "landmark" technological developments in the appraisal industry over the past 15 years. These technological advances reduce the time that appraisers spend fixing errors and resolving underwriting suspensions and help to limit appraisers' buyback exposure.

The majority of appraisers are individual proprietors who have no realistic ability – other than through AMCs – to benefit from having third-party quality control processes performed on their appraisal reports.

AMCs Benefit Homeowners

In addition to the benefits provided by AMCs to appraisers and lenders, it is important to also note the benefits enjoyed by homeowners when an appraisal is procured by a lender through an AMC. AMCs eliminate conflicts of interest by standing between the lender and the appraiser. Additionally, the AMC model, which has been utilized by many large lenders for over twenty years, promotes high quality appraisals and provides efficiencies to the appraisal process that allow mortgage transactions to close in less time and help ensure that services are performed at competitive, market-based prices.

The success of the AMC business model has been seen throughout the industry with the result being that nearly 70% of all residential appraisals ordered and produced nationwide are provided through an AMC. Government entities (*e.g.*, the Federal Housing Administration or "FHA") have also recognized the presence and importance of AMCs in the appraisal industry and have provided specific guidance to lenders that utilize AMCs (*e.g.*, Mortgagee Letter 2009-28).[4]

The Regulatory Structure Applicable to AMCs

AMCs are subject to multiple regulatory requirements – at both the federal and state level. First, AMCs are the subject of new federal regulatory requirements, including new minimum standards and a national registry applicable to AMCs under the Dodd-Frank Act.

[4] *See* Mortgagee Letter 2009-28, available at: http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-28ml.pdf

Second, existing banking regulatory standards are imposed on AMCs as the agents of federally regulated banks and lenders. Third, AMCs are subject to registration requirements and operational standards under state laws. Finally, because mortgage lenders are the AMCs' clients, any appraisal reforms targeted at lenders also have a direct effect on the operations of an AMC.

Regulatory Requirements Prior to the Dodd-Frank Act

Twenty-one years ago, Congress enacted Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") in response to the Savings and Loan Crisis. FIRREA instituted appraisal reforms designed to enhance the quality of appraisals but did not cover AMCs. Prior to the Dodd-Frank Act, Title XI of FIRREA's purpose was to "provide that Federal financial and public policy interests in real estate transactions will be protected by requiring that real estate appraisals utilized in connection with federally related transactions are performed in writing, in accordance with uniform standards, by individuals whose competency has been demonstrated and whose professional conduct will be subject to effective supervision."[5] Before the enactment of Title XI, there were no universally accepted appraisal content standards, no system of licensing appraisers, no appraiser education and experience qualification standards, and no laws requiring the use of appraisals. Title XI created a regulatory framework that includes federal bank regulatory agencies, a federal agency with authority to monitor state activities (the Appraisal Subcommittee of the Federal Financial Institutions Examination Council), a nonprofit appraisal organization (Appraisal Foundation), and state agencies that license and certify appraisers (state appraisal boards).

New Regulatory Requirements Under the Dodd-Frank Act

The Dodd-Frank Act amends and expands Title XI of FIRREA to establish a real estate appraiser regulatory system involving an interrelationship among the federal government, the states, and the Appraisal Subcommittee. As well, the Dodd-Frank Act gives the Appraisal Subcommittee broad new powers and responsibilities to implement a regulatory framework to supervise the appraisal industry, including AMCs. The Appraisal Subcommittee is now authorized to:

- <u>Monitor State Appraisal Boards</u>. (1) Monitor the states' registration and supervision of the operations of AMCs; (2) Determine whether the state completes investigations, appropriately disciplines sanctioned appraisers and AMCs, and reports complaints to the national registries on a timely basis; and (3) Determine whether the state has adopted effective laws aimed at maintaining appraiser independence.[6]

- <u>Maintain National Registry for AMCs</u>. Impose an annual registry fee for AMCs, and grants the Appraisal Subcommittee the authority to impose a minimum registry fee to protect against AMC underreporting.

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[5] 12 U.S.C. 3331.

[6] *See* the Dodd-Frank Act, Pub. L. No. 111-203, § 1473(f)(1) (2010).

- Take Disciplinary Action. (1) Remove an appraiser or a registered AMC from a national registry on an interim basis pending state action; and (2) Impose sanctions against state appraisal boards that fail to have "effective appraiser regulatory programs."[i]

- Issue Regulations. Prescribe regulations on topics such as temporary practice, national registry, information sharing, and enforcement.

- Establish Complaint Hotline and Encourage Appraiser Education. (1) Encourage states to accept pre-approved courses; (2) Establish an appraisal complaint hotline if it determines within 6 months that no national hotline exists; and (3) Follow up complaint referrals to state appraisal boards and federal regulators.

Additionally, under the new regulatory framework for AMCs, the federal agencies[7] must jointly by rule establish minimum requirements to be applied by a state in its AMC registration. At a minimum, they must require that the AMC:

- register with and be subject to supervision by a state appraisal board in each state where the company operates (except a subsidiary which is owned and controlled by a federal financial institution);

- verify that only licensed or certified appraisers are used for federally related transactions;

- require that appraisals coordinated by the AMC comply with the USPAP; and

- require that appraisals are conducted independently and free from inappropriate influence any coercion pursuant to the appraisal independence standards under Section 129E of TILA.[8]

In addition to the minimum requirements noted above, the Dodd-Frank Act also imposes a restriction that an AMC cannot be registered by a state or included on the national registry if the company, in whole or in part, directly or indirectly is owned by any person who has had an appraisal license or certificate refused, denied, cancelled, surrendered in lieu of revocation, or revoked in any state. Owners of more than 10 percent of the company are subject to background investigations and must be of good moral character, as determined by the state appraisal board, although it is unclear if this restriction applies to owners of AMCs that are not subject to state registration. Overall, the Dodd-Frank Act attempts to ensure that those who commit appraisal fraud or those who lose their licenses or certificates cannot establish AMCs.

Existing Banking Regulatory Standards

[7] The Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, and National Credit Union Administration, Federal Housing Finance Administration and the Bureau of Consumer Financial Protection.

[8] *See id.* § 1473(f)(2).

Although the federal agencies do not directly examine AMC operations, regulatory standards are imposed on AMCs as the agents of federally regulated banks and lenders. For example, the latest Interagency Appraisal and Evaluation Guidelines devotes a section to the due diligence procedures for selecting a third party for valuation functions (such as an AMC) including an effective risk management system and internal controls. The federal banking agencies review a lender's policies and controls for overseeing AMCs, including the performance expectations outlined in contracts, and processes for assessing appraisal quality. Ultimately, the AMC must act in conformity with the applicable regulatory standards to maintain their business relationships with their federally-regulated lender clients. Further, as potential service providers to banks and non-banks supervised by the Consumer Financial Protection Bureau ("CFPB"), AMCs will be required to comply with all applicable federal consumer financial laws.[9]

Registration Requirements and Other Comprehensive Standards of Conduct under State Laws

Although the Dodd-Frank Act requires a state to implement a regulatory scheme for AMCs within three years of the federal agencies finalizing their rules establishing minimum requirements (subject to an extension by the Appraisal Subcommittee), the majority of states have elected to act sooner. Even prior to the passage of the Dodd-Frank Act, several states had begun the process of enacting AMC laws to require the registration of AMCs and regulate the activities of AMCs. By our count, 33 states have enacted AMC registration laws, and an additional eight states have such laws pending. Many of these laws either already encompass the minimum standards that are in the Dodd-Frank Act or are now in the process of amending their laws to ensure they reflect the minimum standards enumerated in the Dodd-Frank Act.

Many of the state laws contain common elements, including requiring AMCs to have processes in place for adding appraisers to their panels, reviewing appraiser's work, keeping records of appraisal orders and activities, and complying with appraisal independence standards. For example, many state provisions specify the following to fully regulate the activities of AMCs, to:

- Require an AMC operating in that state to register with the state appraisal board, post security bonds, pay a registration fee, and submit to background checks before issuing an license;
- Designate a "controlling person" as a main point of contact;
- Set minimum education and licensing requirements for certain employees of an AMC;
- Prohibit a person who has had an appraiser license or certificate refused, denied, canceled or revoked from performing certain activities;

[9] Consumer Financial Protection Bureau, Service Providers, CFPB Bulletin 2012-03, (Apr. 13, 2012), available at: http://files.consumerfinance.gov/f/201204_cfpb_bulletin_service-providers.pdf

- Require an AMC's oversight of the appraisers it engages to conduct appraisal services, including:
    - Requiring that appraisers confirm in writing that the appraiser is competent and licensed and/or certified in the jurisdiction of the property.
    - Prohibiting an AMC from removing an appraiser from its appraisal panel or otherwise refusing to assign requests for appraisal services to an appraiser without providing writing notice (identifying the alleged violation) and an opportunity to respond;
- Regulate fees by prohibiting an AMC from knowingly;
    - failing to separate and disclose any fees that it charges a client for the completion of an appraisal from the fees its charges a lender, client, or other party providing appraisal management services;
    - prohibiting an appraiser from recording the fee its was paid by the AMC within the appraisal report;
- Regulate AMCs conduct by imposing restrictions, such as:
    - Require an AMC to ensure that all appraisals are provided independently and free from inappropriate influence and coercion, as required by the appraisal independence standards of Section 129E of TILA;
    - Require AMCs to pay appraisers reasonable and customary fee, consistent with the presumptions of compliance defined under federal law; and
    - Prohibit: (a) requiring an appraiser to prepare an appraisal report if the appraiser, in his or her own professional judgment, believes he or she lacks the necessary expertise for the specific geographic area; (b) requiring an appraiser to prepare an appraisal report under a time frame that the appraiser, in his or her own professional judgment, believes does not afford the appraiser the ability to meet all relevant legal and professional obligations; or (c) prohibiting or inhibiting communication between an appraiser and a lender, real estate licensee, or any other person from whom the appraiser in his or her own professional judgment, believes information would be relevant.
- Provide authority to promulgate regulations and authorize state appraisal boards or other state agencies to enforce the state AMC laws.

AMCs have been actively involved with the states from the inception of these registration laws and have long supported transparency and independence in the appraisal process and the registration of bona fide AMCs. AMCs also are working proactively and collaboratively with state regulatory agencies to craft regulations to implement these laws and ensure that the most effective processes are in place to achieve the goals of the registration laws. These laws are designed to protect the credibility of AMCs and the reliability of the appraisal process.

AMCs provide valuable services in the course of a real estate appraisal, and it is important to us that appraisals are ordered from reputable and sound AMCs that are committed to transparency in the process, full compliance with all registration laws, and delivering the highest-quality appraisal products. REVAA and FAIR support reasonable requirements that balance consumer protection with responsible appraisal management services.

We also believe it is important to work towards consistency and uniformity in state AMC laws and regulations to ensure that AMCs can effectively implement the necessary compliance procedures to operate on a national basis. The degree of variation between existing state laws creates considerable challenges for AMCs trying to develop a reliable compliance program without materially increasing costs to consumers. We will continue to support the states' efforts to implement reasonable and appropriate laws and standards to improve the appraisal industry. We will also continue to support the federal banking agencies by providing clarifying information about the industry for their use in promulgating minimum and uniform standards for AMCs.

The Dodd-Frank Act "Customary and Reasonable" Appraiser Compensation Requirements

As noted above, AMCs provide valuable services to various parties in the appraisal process. AMCs have contractual agreements with lenders and are compensated by the lender for the appraisal and the services provided in the process of facilitating the completed appraisal report. The fees are combined on the HUD-1 appraisal statement as dictated by the Real Estate Settlement Procedures Act, which permits the appraisal fee to include both the appraiser's and the AMC's services.[10]

The Dodd-Frank Act amended TILA by adding Section 129E to require adherence to appraisal independence standards and also to require that lenders and their agents (including AMCs) compensate appraisers at a "customary and reasonable" rate for appraisal services in the market area of the property being appraised. The Dodd-Frank Act also provided that "evidence for such fees *may* be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys." (Emphasis added.) Fee studies, however, are required to "exclude assignments ordered by known appraisal management companies."[11]

The Federal Reserve Board ("Board") was charged with promulgating interim final regulations to implement Section 129E. These interim final regulations became effective April 1, 2011. The Board established two alternative presumptions of compliance for lenders and their agents to satisfy the "customary and reasonable" rate requirement.

REVAA and FAIR believe that the appraiser compensation standards promulgated by the Board are in compliance with the Dodd-Frank Act, and they reflect the variations in actual

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[10] *See* 12 USC § 2603.

[11] *See* Section 129E(i)(1) of TILA.

services and other factors that exist in the marketplace. Appraisal services are not one-size-fits-all, and we believe the Board has created a compliance structure for the payment of "customary and reasonable" appraisal fees that reflects market realities and ensures that prices paid by consumers will remain competitive.

The first presumption permits lenders and their agents to rely upon recent rates actually paid for appraisal services (including rates paid by AMCs) in the relevant geographic market, adjusted as necessary to account for six other factors, such as type of property or scope of work. Although the term "customary and reasonable" was undefined in the Dodd-Frank Act, the Board recognized that the Dodd-Frank Act language is identical to the Department of Housing and Urban Development's requirement obligating FHA lenders to ensure that appraisers are paid "at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised." Consistent with HUD's approach within Mortgagee Letter 2009-28, the Board concluded that the marketplace should be "the primary determiner of the value of appraisal services, and hence the customary and reasonable rate of compensation for fee appraisers."

The second presumption permits reliance on objective third-party information, including fee schedules, studies and surveys prepared by independent third parties such as government agencies, and academic institutions and private research firms, provided they are based on recent rates paid to a representative sample of appraisers in the geographic market of the property being appraised (but excluding compensation paid to appraisers for assignments ordered by an AMC).

REVAA and FAIR believe that the Board correctly implemented Congress' plain language and intent by establishing two presumptions – one that relies on the recent rates actually paid in the marketplace and one that relies on objective third-party fee surveys that exclude fees charged by AMCs. There are currently very few third-party fee surveys in the marketplace, none are comprehensive enough to include all of the differences in geographic areas/markets, and they do not fully encompass all of the appraisal products offered by AMCs.

The Board did not issue a "final" rule before its rulemaking authority was transferred to the CFPB. While the interim final rule remains effective without such "finalization," AMCs are concerned that some appraisers may seek reconsideration by the CFPB with the intention to mandate a higher level of compensation for appraisers than is supported by current market rates. Under this scenario, consumers would be subjected to higher appraisal fees that would often exceed the market rate; however, consumers would not be gaining additional services in return for these higher fees. Instead, they would be paying higher costs for the same services, and it is most certainly the case that these higher costs will ultimately be passed along to homeowners.

Furthermore, guaranteeing a higher fee for appraisers would not ensure better performance, as decades of experience has shown that higher appraisal fees do not necessarily correspond to higher quality appraisals. Appraisers are required by USPAP to ensure that appraisals meet minimum requirements regardless of the fee or the nature of the assignment. Prior to recent regulatory reforms, higher appraisal fees were the custom for many appraisers who, in partnership with overzealous mortgage brokers and lenders, produced appraisal reports that were impacted by inappropriate influence and coercion. The resulting appraisals often reflected inflated values and certainly did not constitute "high quality" appraisals. The members of REVAA and FAIR respectfully suggest that Congress and the CFPB should resist calls from those appraisers to mandate increased rates for appraisals as opposed to allowing the marketplace to dictate appraisal rates.

Certain industry groups allege that higher fees would benefit the appraisal industry by attracting better qualified appraisers to the profession. These groups suggest that quality and price are somehow linked. There is no empirical evidence to suggest a correlation between quality and price. That is, it is not necessarily the case that an appraiser who asks for the highest compensation will deliver a better quality appraisal than an appraiser who asks for less compensation.

The conclusion that paying higher fees to appraisers would generate an influx of new appraisers to the industry is misplaced. Rather, one of the main reasons that the industry has difficulty attracting new appraisers is not a function of compensation, but of the state appraisal laws that impose a particularly steep barrier to entry.[12] Most states require applicants for licensure or certification to submit an experience log that lists, with some specificity, each of the appraisals claimed for experience credit. In some instances, states may require a person to complete 3,000 work hours.[13] Before then, they are just "trainees." Fannie Mae and Freddie Mac, however, which make up a majority of the market, prohibit hiring a trainee on a loan they purchase. Arduous qualification criteria for licensed appraisers is the real impediment to the industry's growth and attraction of new appraisers to the profession.

In addition to the items discussed previously regarding the potential negative impacts on consumers by mandating a higher level of compensation, it is also important to note that there is no single standard or uniform price for appraisals throughout the country. Instead, appraisal fees are set by the competitive marketplace and reflect variations in the scope of work performed by appraisers; the nuances of individual transactions, such as the type and location of the property; the costs associated with producing appraisals in different markets; how quickly the lender has required the report; and the appraiser's level of efficiency in performing an assignment.

Indeed, while Section 129E(i) of TILA provides that lenders and their agents may generally rely on fee studies created by objective third parties to form the basis for "customary and reasonable rates," no reliable and objective fee studies exist across the appraisal spectrum. In fact, two studies that are referenced most actively in the appraisal community to support uniform higher fees demonstrate significant difference between fees within those two surveys for the same areas, do not represent the appraisal industry as a whole, and do not account for the fact that appraisals have multiple uses and multiple markets. Further, we are concerned that undue reliance on fee studies may result in increased collusion among some appraisers to set their fees

[12] *See* Justin T. Hilley, Licensed Appraisers in Mass. Shrink 39% Since 2007, Housing Wire (Jun. 8, 2012) available at: http://www.housingwire.com/news/massachusetts-appraisers-shrinks-nearly-40-2007

[13] For example, to become a Certified General Appraiser, the Appraisal Qualifications Board's *Real Property Appraiser Qualification Criteria* requires 3,000 hours of experience accumulated during no fewer than 30 months, of which 1,500 hours must be non-residential. Many states have adopted this critera. See http://www.dpor.virginia.gov/dporweb/AQB_Real_Property_Appraiser_Qualification_Criteria.pdf

at artificially high rates, thus influencing fee studies in their area and ensuring that inflated appraisal prices are paid for years to come.

We are also concerned that states may promulgate appraiser compensation requirements that are inconsistent with federal appraisal law. For example, Kentucky previously introduced a proposed rule regulating AMCs that would require an AMC to compensate Kentucky appraisers at a fee mutually agreed upon, provided the fee is at least equal to the amount set in the VA fee schedule for comparable properties in the same geographic areas. Kentucky's one-size-fits-all approach not only was contrary to the Board's conclusion that a single standard price for appraisers cannot exist, but also had the effect of circumventing the federal scheme. While this proposed rule was not ultimately adopted, we are concerned that it may exemplify a trend of overreaching by state appraisal boards.

Because of the services and many efficiencies provided by AMCs on behalf of individual appraisers, appraisers are willing to set their appraisal prices at a lower rate for orders accepted from AMCs due to the benefits an appraiser received by working with an AMC. The efficiencies and technological advances that AMCs have introduced into the appraisal report process reduce costs. Additionally, AMCs go to great lengths to ensure that only the most qualified and experienced appraisers belong to their networks, with many relationships existing over a 10-15 year period or longer. Appraisers recognize and utilize the extensive quality control processes provided by AMCs to increase the quality of appraisal reports that they produce. Accordingly, while appraisers may set their prices lower when utilizing AMCs, AMCs produce high quality appraisals by ensuring that inappropriate influence does not occur during the appraisal process and by having multiple layers of quality control.

We hope that the CFPB, in issuing final regulations to implement the appraiser compensation standards required by the Dodd-Frank Act, will maintain the compliance structure for the payment of "customary and reasonable" appraisal rates that the Board established.

Conclusion

In sum, REVAA and FAIR members play an important role in the housing market and provide significant benefits to lenders, appraisers, and homeowners. As well, AMCs are subject to multiple federal and state regulatory requirements, and AMCs are working collaboratively with the relevant federal and state regulators to establish minimum standards and to develop and implement registration and regulatory requirements. Finally, we believe that the FRB correctly implemented Congress' plain language and intent in creating a compliance structure for the payment of "customary and reasonable" appraisal fees that reflects market realities and ensures that prices.

Thank you for the opportunity to provide testimony and insight in support of the important work of Congress. We hope that the Subcommittee will continue to look to us as a resource as you continue your efforts to reform the mortgage origination process.

TESTIMONY OF KAREN MANN

On Behalf Of

THE AMERICAN SOCIETY OF APPRAISERS
and the
NATIONAL ASSOCIATION OF INDEPENDENT FEE APPRAISERS

Before The

Subcommittee On Insurance, Housing And Community Opportunity, Committee On Financial Services, U.S. House of Representatives

June 28, 2012 Hearing On

"Appraisal Oversight: The Regulatory Impact on Consumers and Businesses"

I. Introduction

Chairwoman Biggert, Ranking Member Gutierrez and members of the Subcommittee, my name is Karen Mann and I am the president of Mann & Associates, a residential and commercial real estate appraisal firm, established in 1983, with offices in the San Francisco Bay Area and the California Central Valley. I hold a California Certified General Appraiser credential, a Nevada real estate appraiser license and have earned a Real Property professional appraiser designation from the American Society of Appraisers, on whose behalf I am testifying today. In addition, I am also testifying on behalf of the National Association of Independent Fee Appraisers.[1] I am also a member of two other professional appraisal organizations.

I want to thank the Subcommittee and particularly Congressman Gutierrez, for providing the American Society of Appraisers and the National Association of Independent Fee Appraisers an opportunity to testify at today's important appraisal oversight hearing.

II. Executive Summary Of Testimony

- The current appraisal regulatory structure, tiered across federal and state governments and the private sector, is a dramatic improvement over the "Wild West" environment in which appraisers operated prior to the Savings and Loan Crisis of the 1980's and the enactment of Title XI of FIRREA. Pre-Title XI, appraisers operated without minimum appraiser qualifications, minimum appraisal standards, and patchwork oversight. The regime instituted by Title XI of FIRREA continues to be an effective structure that mirrors similar regulatory approaches which apply to other professions whose members are involved in federal matters, like accountancy; and has been mirrored in legislation designed to regulate mortgage loan originators through the SAFE Act. The appraisal regulatory system we now have provides consumers, government agencies and mortgage market participants with confidence that real estate appraisers meet minimum educational and experience requirements, that appraisals are subject to a set of generally-accepted uniform standards, and that appraisers who fail to meet these requirements will be held accountable by their state appraisal board, as well as by any professional organization which has accredited them.

- We believe the Appraisal Foundation has been and continues to be an indispensable factor in the growth of the appraisal profession in our country. We reject the view that the Foundation has engaged in "mission creep" or in any other inappropriate activity. We believe that the creation of the Appraisal Practices Board is a natural and necessary adjunct to helping professional appraisers understand and apply the appraisal standards promulgated by the Foundation's Standards Board. It is also important to understand that Foundation decisions involving standards, qualifications and best practices are made in a completely transparent manner with an opportunity provided to all appraisers to comment

[1] ASA and NAIFA each teach, test and credential their members for professional appraisal practice and appraisal review in residential and commercial real property valuation. Additionally, ASA is a multi-disciplinary appraisal organization that teaches, tests and credentials its members for professional appraisal practice and appraisal review in business valuation and in personal property valuation (including machinery and equipment, fine art, antiques, gems and jewelry and the contents of homes and offices).

on proposed actions. Such transparency and the opportunity for all stakeholders to be heard often stands in contrast to the way other organizations make decisions.

- While we believe there is no need for an alternative approach to the current appraisal regulatory regime, we do believe that some improvements could be implemented to bolster the existing regulatory structure's effectiveness. We concur with the findings of the General Accountability Office's January 2012 study regarding the activities and operations of the Appraisal Subcommittee, but we also acknowledge that the Subcommittee has made steady improvements over the last year or two.

- There are several concerns facing professional appraiser which, if left unaddressed, stand to undermine not just the appraisal profession, but the safety and soundness of the residential mortgage lending market and the rights of consumers. These concerns include:
  - The need for the Consumer Financial Protection Bureau, when it issues final appraiser independence regulations, to undo the stunning and completely inappropriate loophole left in the Federal Reserve Board's original Interim Final Rule. That rule allows appraisal management companies to consider the fees they pay appraisers to justify their compliance with Dodd-Frank Act's "customary and reasonable fee" provisions. The Board's Interim Final Rule amounted to a unilateral repeal of the clear language and intent of the Act by regulatory fiat. If the loophole remains in the final rule, the cramdown in appraiser fees it permits will continue to cause the most experienced professional appraisers to leave the residential appraisal market, denying consumers and lenders access to their expertise while forestalling trainee appraisers from obtaining the required apprenticeship hours – likely leading to a severe shortage of available appraisers.

  - Rules to implement many of Dodd-Frank's appraisal provisions have yet to be proposed. While we recognize that the statutory deadlines imposed on some provisions of the Act take precedence, we urge the responsible federal agencies to propose implementing rules as early as possible so appraisers, users of their services and consumers all understand the "rules of the road."

  - In connection with the Consumer Financial Protection Bureau's "Know Before You Owe" mortgage form disclosure initiative, our organizations have urged the Bureau to approve a Good Faith Estimate form and a Settlement form which separate the fee paid to the appraiser from the fee collected by an Appraisal Management Company when the appraisal is ordered through an AMC. Not only would the separate disclosure comport with the Bureau's own efforts to "protect and empower" consumers, but it affords consumers with critical information as to the true cost of appraisals, as well as the available universe of options for hiring an appraiser both in terms of cost and qualifications. In many cases, failure to separately disclose appraisal fees and AMC fees leads consumers to default into using an AMC, which often leads to higher consumer costs while obtaining an appraisal from a less experienced, less geographically competent appraiser – essentially, paying more while receiving less.

- The ever-increasing threshold *de minimus* levels established by the federal banking agencies deny consumers and market participants the significant safety and soundness and consumer protections provided by an appraisal, as opposed to a less expensive but inherently unreliable and far less informative valuation product, like an automated valuation model. We strongly believe that the current threshold levels ($250,000 for a residential loan, $1 million for a commercial loan) should be eliminated or substantially reduced. GAO estimates that 70% of residential mortgages made from 2006 – 2009 were below the threshold. But, in many neighborhoods across the country in today's economy, the $250,000 threshold would exclude virtually 100% of financed residential properties.

III. Relevant Background

In connection with the specific subject matter of today's hearing, I think it is useful to revisit for a brief moment the state of our residential mortgage and mortgage lending markets in the mid-1980s which caused Congress to enact the real estate appraiser licensing provisions of Title XI of the Financial Institutions Reform Recovery and Enforcement Act of 1989 (FIRREA). As we all know, FIRREA was Congress's principal response to the S&L crisis of the 1980s, a crisis whose total cost to resolve was $153 billion – the vast majority of which was borne by U.S. taxpayers.[2] According to Congressional studies and virtually all analyses, the banking problems of that period "came primarily from unsound real estate lending." An FDIC analysis concluded that in many cases, prudent underwriting standards were not observed and necessary documents and controls were not put in place. It went on to say that real estate lending "was appraisal driven and was often based on the overly optimistic assumption that property values would continue to rise."

To the extent that faulty and fraudulent appraisals contributed to the losses of the S&L debacle – and they did – the principal cause was the "Wild West" environment in which appraisers operated in that era.[3] While many appraisers were thoughtful, conscientious and did good work, many did not and there is little mystery as to why:

First, there were no generally-recognized appraiser qualifications that providers of appraisal services had to meet. A relatively small number of residential appraisers held legitimate credentials from a few professional appraisal organizations; some earned illegitimate credentials from diploma mills; and others had no meaningful valuation credentials at all;

Second, there were no generally-accepted, uniform appraisal standards that all practitioners were required to observe. Some appraisers operating in that era adopted whatever valuation approaches and methodologies suited the valuation conclusions needed to create the illusion that a real estate loan was adequately collateralized;

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[2] The thrift cleanup was Congress's response to what many have characterized (at least until the subprime and related financial meltdown of the past few years) as the greatest collapse of U.S. financial institutions since the 1930s. The FSLIC and the Resolution Trust Corporation closed 1,043 institutions holding $519 billion in assets and resulted in a massive restructuring of the number of firms in the industry. From January 1, 1986, through year-end 1995, the number of federally insured thrift institutions in the United States declined 50 percent from 3,234 to 1,645.

[3] See, for example, House Committee on Government Operations, *Impact of Appraisal Problems on Real Estate Lending, Mortgage Insurance, and Investment in the Secondary Market*, 99th Cong., 2nd Sess., 1986, H.Rep. 99-981.

Third, there was no effective system of appraiser accountability. At the time Title XI was enacted into law, most states had little or no authority to oversee or sanction appraisers operating in their states; and, with very few exceptions, federal agencies with an interest in reliable valuations had requirements that were ineffectual or ignored; and,

Fourth, there were no effective laws in place either at the state or federal levels that protected appraisers from the enormous pressures on them at that time, to reach a pre-determined fair market value.

The enactment of Title XI and the regulatory framework it established for federally-related transactions changed all that; and, together with the important appraisal reform provisions of the Dodd-Frank Act, changed things in a way that ensures the competence and independence of appraisers; effectively safeguards taxpayer interests; and provides consumers with critical and independent information on the fair market value of property collateralizing the most important financial transaction they will ever enter into – their mortgage loans.

Notwithstanding the giant leap forward which Title XI represents, it is not the position of the American Society of Appraisers and the National Association of Independent Fee Appraisers that every real estate appraisal performed today is flawless or that the current appraisal regulatory system – including its several component parts – is perfect and cannot be improved. It can be improved and should be. However, it is our unequivocal view that the overall competence and independence of our nation's 100,000 plus real estate appraisers are dramatically better than before Title XI's enactment; and, that the current regulatory framework – which is financed by the appraisal profession – is fundamentally sound and very much a success story that benefits taxpayers and consumers.

IV. Responses To The Issues Raised In The Subcommittee's June 22nd Letter Of Invitation

We believe that the issues raised in the first two bullet points of the Subcommittee's letter of invitation are interrelated. Accordingly, our response treats them together:

- **"Views regarding the federal role in appraisal regulation" and "Options for improving the appraisal regulatory structure, including alternative systems of oversight that would improve efficiency and reduce duplicative regulations in the real estate appraisal industry" –**

  We believe that the federal role in appraisal regulation is indispensible since the mortgage markets are national in scope and since it is federally-related transactions and federal taxpayer dollars which the appraisal regulatory system is designed to protect. While we agree that some components of the tripartite appraisal regulatory structure can and should be improved, we regard the overall framework as fundamentally sound.

  While some have described the appraisal regulatory framework as byzantine or convoluted, we strongly disagree and think it is long past time to address this misconception. The division of responsibility involving the federal government, state governments and the private sector is straightforward, sensible and, in fact, similar to regulatory arrangements involving other professionals, such as accountants, who often play important roles in federally-related transactions. Under the Title XI structure:

The 50 states and territories have exclusive responsibility for licensing real estate appraisers and for disciplining them if their performance is unprofessional or unethical, including the loss or suspension of their license to practice;

The federal government, principally through the Appraisal Subcommittee (ASC), is responsible for overseeing state appraiser licensing systems to ensure that they meet minimum "safety and soundness" and effectiveness standards and that the appraisers they license are competent and independent when their appraisals involve federal financial interests. Federally agencies, whose regulatory or administrative responsibilities include oversight of collateral valuations (such as the banking agencies; HUD; IRS in relation to tax-related valuations; and the SEC in connection with mortgage-backed securities), sometimes and appropriately establish additional valuation requirements they believe are necessary to carry out their missions. But even agencies which add appraisal requirements still rely on Title XI to ensure real estate appraiser competence and independence;

The private sector, principally The Appraisal Foundation (TAF), promulgates generally-accepted appraisal standards (i.e., the Uniform Standards of Professional Appraisal Practice or USPAP) and minimum education, experience and testing qualification requirements for appraisers whose valuations involve federally-related transactions. States are able to establish requirements which exceed those of TAF. Additionally, private professional appraisal organizations, such as ASA and NAIFA, are able to establish educational, testing and experience requirements which exceed those of TAF or state licensing entities for individuals who wish to earn a professional appraiser designation from them.

The structure described above for appraisers is not dissimilar to the regulatory structures of other professions that interact with government, such as accountancy. Accountants are licensed and/or certified by state boards of accountancy and are subject to discipline by them (similar to the role of state appraiser boards). The Financial Accounting Standards Board (FASB) is the designated private sector organization for establishing standards of financial accounting that govern the preparation of financial reports and its standards are officially recognized by the SEC and other federal agencies (similar to the role of the Appraisal Foundation's boards whose work is recognized by federal agencies). While the federal government does not maintain a body to oversee the activities of the state accountancy boards (in the same way the Appraisal Subcommittee oversees state appraiser licensing agencies), the Securities and Exchange Commission and the Public Company Accounting Oversight Board exercise a form of indirect authority over the state boards of accountancy. It is also worth noting that the SAFE Mortgage Licensing Act of 2008 (which licenses and registers individuals who engage in the business of residential mortgage loan originations for federally-regulated financial institutions) established an organizational structure that is roughly comparable to the Title XI system for appraisers.

In short, the overall regulatory structure which exists for the appraisers (i.e., state licensure; federal oversight; and, reliance on an independent, non-profit private sector entity to establish professional standards and qualifications) is neither novel nor even unusual. We are convinced that it is a tried and true structure that works well.

Accordingly (and in direct response to the Subcommittee's question), the American Society of Appraisers and the National Association of Independent Fee Appraisers do not believe there are any realistic "options for improving the overall appraisal regulatory structure, including alternative systems of oversight that would improve efficiency and reduce duplicative regulations in the real estate appraisal industry." More importantly, we do not believe any alternative structures are necessary or desirable.

Nevertheless, we believe that individual components of the current system should be strengthened so that they operate more effectively. Specifically, we concur with the findings and recommendations of the General Accountability Office (GAO) in its January 2012 report regarding the need for additional resources and greater efficiency relative to the operations and activities of the Appraisal Subcommittee.[4] While the Subcommittee faces significant future challenges in connection with its additional Dodd-Frank responsibilities, we want to acknowledge our belief that it has substantially improved its effectiveness over the past two years.

- **"Concerns facing real estate appraisers" –**

  There are several major areas of concern facing the real estate appraiser profession. They range from very important to critical, as follows:

(1) **CUSTOMARY AND REASONABLE FEES – The Federal Reserve Board's Interim Final Rule on Dodd-Frank's "Customary and Reasonable" Appraiser Fee Provision Violates Congressional Intent and the Clear Language of the Statute:** While our organizations found many of the Federal Reserve Board's proposed regulations implementing the appraiser independence provisions of Dodd-Frank to be faithful to the letter and intent of the statute – particularly those that prohibit pressure on appraisers – we were stunned by the manner in which the Board proposed to implement the law's "customary and reasonable" appraiser fee provisions. By permitting Appraisal Management Companies to factor the compensation they pay appraisers into the calculation of what constitutes "customary and reasonable" fees under Dodd-Frank (which the Fed's Interim Rule commentary says they can do), the Board turned Congressional intent on its head. If the Consumer Financial Protection Bureau (CFPB), which now has jurisdiction over the Interim Rule, allows it to become final with the Fed loophole intact, the agencies will have effectively repealed the law by unilateral, regulatory fiat.

[4] *Real Estate Appraisals: Appraisal Subcommittee Needs to Improve Monitoring Procedures*, GAO-12-147, January 2012.

The "customary and reasonable" fee provision was included in Dodd-Frank in recognition of, and in response to, the practice of many of the largest AMCs to cramdown fees that had been customarily paid directly to appraisers by mortgage lenders and other users of their services. The vast majority of appraisal assignments are now ordered by mortgage lenders through AMCs (the estimates range from 60 – 80 percent). The experience of our residential members in the marketplace indicates that AMCs typically take for themselves about 30 - 35 percent of the appraisal fee consumers pay. This means that for a typical residential appraisal assignment for which the appraiser is paid $450.00,[5] the AMC would take between $ 135.00 and $158.00 leaving the appraiser with a fee of between $292.00 and $315.00 – an amount far below what is financially necessary for appraisers with established practices and significant experience to make a living from that book of business.

Given the huge book of business controlled by AMCs, the fee-splitting arrangement between appraisers and AMCs is driving many of the nation's most experienced and competent real estate appraisers out of the market entirely. It is not an exaggeration to say that if the Fed-created loophole is not closed by the CFPB when it issues the final appraiser independence rule, the pool of experienced professional appraisers available to perform residential valuations will shrink to unacceptable levels. If that is allowed to happen, the professional appraisal community will suffer and confidence in our mortgage markets by consumers and secondary market investors will be seriously undermined.

While we acknowledge that AMCs can sometimes make it easier for national and regional mortgage lenders to order and process large numbers of appraisals, our experience is that AMCs do not add meaningful safety and soundness value to appraisals; and, they do not reduce the cost of an appraisal. Indeed, there is evidence that an increasing number of appraisals ordered through AMCs are more costly than those ordered by lenders directly from appraisers or appraisal firms. In today's computer and information technology age, even large lenders can readily meet their appraisal requirements by ordering directly from appraisers in the relevant housing markets.

The cramdown of appraisal fees to well below customary market levels by many AMCs has been disruptive of and deeply troubling to the community of professional residential appraisers. But, it should be equally troubling to consumers because the cram down has caused many of the nation's most experienced and qualified appraisers to refuse AMC assignments. As a result, many of the appraisers willing to accept AMC assignments have less experience, less knowledge of the collateral property's market area and have fewer overall professional credentials than their counterparts who are retained directly by lenders. In short, AMC-ordered appraisals do not save any money for consumers and may in fact cost them more, but in both cases consumers are likely to get the appraisal from the least experienced appraisers in their communities.

(2)<u>IMPLEMENTATION OF REMAINING APPRAISAL REFORM PROVISIONS OF DODD-FRANK</u>: With the important exception of Dodd-Frank's appraiser independence provisions, most of the law's appraisal reform provisions have yet to be proposed, let alone

[5] The Department of Veteran Affairs' appraiser fee schedules demonstrate that a $450 fee for a non-complex single-family appraisal is typical in most areas of the country.

implemented, through rulemaking. These provisions involve enormously important issues including, for example, Property appraisal requirements in connection with extensions of credit; Supervision and registration of Appraisal Management Companies by states and the federal government; Development of quality control standards for Automated Valuation Models (AVMs); Establishment of an appraisal complaint hotline; Establishment of qualification requirement for appraiser trainees; Requiring CFPB concurrence that the banking agencies' existing dollar thresholds for residential and commercial property below which an appraisal is not required ,"provide reasonable protection for consumers who purchase 1-4 unit single-family residences" ; and, the establishment of limits on the permissible use of broker price opinions to value collateral property.

Our organizations recognize that Dodd-Frank imposes significant and far-reaching rulemaking responsibilities on a relatively small number of Executive Branch and regulatory agencies, some of which include statutory deadlines which must take precedence over those which do not. We also appreciate the fact that the agencies are working on drafts of some of these potential rules. Nevertheless, the Act's appraisal provisions are of enormous consequence not only to our members and the entire community of professional appraisers, but also to consumers and, we believe, to the efficient and fair functioning of the nation's collateralized credit markets. Accordingly, we respectfully urge the banking agencies, the Appraisal Subcommittee and the state licensing agencies to propose implementing rules at the earliest possible opportunity for all of Dodd-Frank's appraisal reforms that fall within their areas of responsibility.

(3)SEPARATING THE APPRAISER FEE FROM THE AMC FEE IN MORTGAGE SETTLEMENT DISCLOSURE DOCUMENTS: Given the dominance of AMCs in the appraisal ordering process, we believe consumers are entitled to know who receives the money they pay during the mortgage loan application and underwriting process for an appraisal of the value of the property they are purchasing. Beginning late last year, the Bureau requested comment on its "Know Before You Owe" mortgage disclosure forms initiative. The Bureau requested comment on the success of its efforts to design a new Good Faith Estimate (GFE) form and a mortgage disclosure Settlement form that consolidates, in one place, information about the costs, terms and conditions of a mortgage loan; and, does so in a way that is readily understandable by consumers and the mortgage industry. The CFPB asked whether the different iterations of the forms it was testing in several mortgage markets would provide borrowers with a clear understanding of the final costs, terms and conditions of a mortgage loan; and, allow them to compare these costs, terms and conditions with the information in the Good Faith Estimate provided to them during the loan application and loan settlement process.

Our comments urged the agency to adopt GFE and Settlement forms that disclose to mortgage applicants that when the appraisal of the collateral property is ordered through an AMC, a substantial portion of the appraisal fee shown on both forms does not go to the person who actually performs the appraisal but instead pays for the backroom administrative services of the AMC – a company that is sometimes an affiliate of the mortgage lender making the loan. We pointed out that while there is nothing improper about an appraisal being ordered through an affiliate of the borrower's mortgage lender, this arrangement does represent an undisclosed, even a hidden, consumer payment to that lender. When an AMC is utilized to order the appraisal, we believe that the absence of information on the GFE and settlement forms disclosing this fee splitting arrangement is harmful to consumer interests for two integral reasons:

First, it violates the basic premise of the Bureau's "Know Before You Owe" policy to "protect and empower" consumers in what the CFPB correctly characterizes as "one of the biggest financial decisions a consumer can make"; and, it undermines the agency's objective of making mortgage-related costs "clear at all stages of the mortgage process."

Second, it deprives consumers of important information that would allow them to make informed decisions about the valuation component of the mortgage lending process. Our organizations are concerned that with the rapid increase of lender reliance on AMCs, there has been an accompanying decrease in consumer understanding of the appraisal function, including who is actually performing the appraisal and what it actually costs. When the GFE or settlement forms conflate the appraiser's fee with the AMC's fee, consumer choice relative to the appraisal has been effectively denied – that is, borrowers are deprived of crucial information that would open up options available to them if they understood the possible differences in the range of costs of a professional appraisal as well as the range of qualifications and depth of experience of those likely to be performing them, depending on whether the appraisal is or is not ordered through an AMC.

While the cost of an appraisal ordered through an AMC can be comparable to one ordered by a lender directly from an independent appraiser or appraisal firm, the AMC ordered appraisal can also be more expensive. When lenders contract directly with an independent appraisers or appraisal firm to value collateral property, the backroom administrative costs that are added on by an AMC are avoided and the overall cost to consumers is sometimes reduced. However, if the Good Faith Estimate fails to disclose that the appraisal will be ordered through an AMC and fails to separately identify the portion of the consumer's payment that goes to the AMC, the borrower will have been deprived of essential information bearing on the likely qualification level of the appraiser performing it and, quite possibly, on the cost of the appraisal.

Without a breakout of the appraisal fee from the administrative fee on the disclosure forms, a borrower will have no reason to ask the lender to consider ordering the appraisal directly from an appraiser practicing where the collateral property is located rather than from an AMC – a process that was commonplace prior to the explosive growth of AMCs and the one most likely to produce an appraisal by a highly experienced and skilled appraiser. Without this breakout, borrowers are unknowingly locked into what can be a more costly appraisal process that is overly dependent on less experienced appraisers who are willing to work for fees substantially below what is customarily and reasonably paid to appraisers who are independent of AMCs.

The CFPB is testing various iterations of GFE and Settlement forms in several mortgage markets. Some of those iterations do, in fact, separate the appraiser fee from the AMC fee when the appraisal has been ordered through an AMC; other iterations do not. Our organizations are urging the Bureau to adopt the forms which separate the fees because we strongly believe they benefit consumers and their right to know how their dollars are being spent.

(4) ELIMINATION OF OR SUBSTANTIAL REDUCTION IN THE BANKING AGENCIES THRESHOLDS FOR LOANS ON COLLATERALIZED RESIDENTIAL AND COMMERCIAL PROPERTIES: Section 1473 of Dodd-Frank requires the CFPB to consider whether the banking agencies' existing dollar thresholds for residential property ($250,000) and commercial property ($1 million) "provides reasonable protection for consumers who purchase 1-4 unit single-family residences". Collateralized loans below the thresholds are exempted from the agencies' appraisal requirements. If the Bureau concludes that either or both thresholds do not reasonably protect consumers, then the banking agencies would be required to eliminate or reduce their thresholds, thereby empowering consumers to have appraisals of the fair market value of their purchases.

Our organizations believe that professional appraisers serve critical safety and soundness and consumer protection purposes. We concur with the view expressed by the GAO in its July 2011 "Residential Appraisals" report to the House Financial Services Committee and the Senate Banking Committee that appraisals play "a critical role in mortgage underwriting by providing evidence that the market value of a property is sufficient to help mitigate losses if the borrower is unable to repay the loan." We believe that competent and independent real estate appraisals are as important to the safety and soundness of a collateralized mortgage loan as the creditworthiness of borrowers. We recognize of course that the fair market value of property collateralizing a mortgage loan can move up or down, sometimes at a rapid pace. We also recognize that borrowers – even those with sterling credit scores – can lose their jobs and, with that loss, their creditworthiness. As a consequence, collateral valuations and creditworthiness are both important to the safety and soundness of a mortgage loan. We do not believe that one measure is inherently more or less important than the other. Instead, they complement each other.

Moreover, because professional appraisers are independent of all parties to a real estate transaction (i.e., sellers and lenders) appraisals provide a significant consumer protection function by giving buyers objective information about the fair market value of property they may be purchasing and financing, in relation to comparable properties in the neighborhood.

But, the safety and soundness and consumer protection attributes of appraisals are rendered moot by the ever-increasing threshold levels established by the banking agencies since Title XI's enactment in 1989. Even before the collapse of the residential real estate markets in most parts of the country over the last several years, the residential threshold level of $250,000 established by the banking agencies frequently results in a denial of the protections afforded by appraisals to millions of home buyers. Today, tens of millions of homebuyers are adversely affected by the threshold level, which GAO estimates as covering 70% of all residential mortgage financings between 2006 and 2009. That percentage is likely to be considerably higher in today's depressed mortgage markets; and, in many neighborhoods across the country, it is likely that 100% of residential properties would be covered by the threshold exemption.

Given the substantial safety and soundness and consumer protection benefits which appraisals provide, we strongly believe that the $250,000 threshold levels for collateralized residential loans and the $1 million dollar threshold for commercial loans collateralized by real estate, should be eliminated or, at a minimum, substantially reduced to properly reflect not only current real estate markets but the heightened sense which now exists of the need for much greater consumer protections in mortgage transactions.

V. Issues Relating To The Appraisal Foundation And The Appraisal Subcommittee

Our Organizations Strongly Support the Indispensible Roles Played By the Appraisal Foundation (TAF) and the Federal Appraisal Subcommittee (ASC) In The Continuing Growth Of Appraiser Professionalism and To The Growing Acceptance – By Federal and State Agencies, By the Private Sector and By The Courts - of the Uniform Standards of Professional Appraisal Practice (USPAP) As The Generally-Recognized Standards of the Appraisal Profession: We believe that the appraisal standards and appraiser qualifications promulgated by Boards of The Appraisal Foundation are critical to professional appraisal practice in America. We reject the view expressed by some that TAF has engaged in inappropriate "mission creep" by establishing the Appraisal Practices Board (APB) and that the establishment of the APB infringes on the prerogatives of the professional appraisal organizations. The establishment of the APB for the purpose of drilling down on the meaning of certain USPAP provisions and addressing complex appraisal issues in the marketplace was widely requested; and, we believe serves important functions.

While ASA and NAIFA have active educational programs which teach USPAP and Best Practices to our members, we believe that the APB's best practices guidance is a logical and necessary adjunct to understanding how practitioners should implement USPAP's provisions (which are sometimes general in nature and require more detailed explication of the relevant valuation methods and techniques that should be applied). We also recognize that while the professional appraisal organizations have a vital role to play in contributing to the development of best practices, we are able to accomplish that role both through the voluntary service of our members on the APB and by providing the Board with our comments when it publicly exposes its proposed best practices guidance for stakeholder comment. We also recognize the need for uniformity in best practices so that the nation's real estate appraisers – most of whom do not belong to any professional appraisal organization – will apply the methods and techniques necessary to adhere to the provisions of USPAP, in a uniform and coherent way.

With respect to the Appraisal Subcommittee (ASC), we concur in the findings of GAO relative to the challenges facing the Subcommittee, most of which derive from the important additional responsibilities imposed on the agency by Dodd-Frank. We do believe that the ASC has become a more effective and responsive operation over the past year or two.

The American Society of Appraisers and the National Association of Independent Fee Appraisers greatly appreciate the Subcommittee's investment of time and effort to ensure that Title XI's real estate appraiser licensing system is working effectively on behalf of America's taxpayers and consumers. Thank you again for the opportunity to testify.

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STATEMENT OF

EXECUTIVE DIRECTOR JAMES R. PARK
APPRAISAL SUBCOMMITTEE
OF THE
FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

BEFORE THE

HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

HEARING ON

APPRAISAL OVERSIGHT: THE REGULATORY IMPACT ON CONSUMERS AND BUSINESSES

JUNE 28, 2012

I. Introduction

The Appraisal Subcommittee (ASC) appreciates the opportunity to provide an update on the ASC's current activities and future priorities. This statement will first provide general background and history of the ASC, including its creation in response to the savings-and-loan crisis of the 1980s, up to and including the ASC's expanded mission and authority pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Next, the statement will discuss ongoing responsibilities of the ASC pursuant to Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, as amended (Title XI), including its monitoring of the Appraisal Foundation. The Dodd-Frank Act amendments to Title XI, authored by Chairman Biggert and former Congressman Kanjorski, changed numerous provisions related to the ASC's operations, role, and responsibilities. This statement will also address the ASC's Compliance Review process for evaluating State[1] appraiser regulatory programs' compliance with Title XI, as well as other ongoing responsibilities. Finally, the statement will address actions taken by the ASC to fulfill Dodd-Frank Act amendments to Title XI.

II. History of the ASC

Title XI created the ASC as an entity within the Federal Financial Institutions Examination Council (FFIEC). In general, the ASC operates independently of the FFIEC. Historically, the primary role of the ASC, pursuant to Title XI, has been to monitor the requirements by States and the Federal financial institutions regulatory agencies[2] regarding minimum appraiser qualifications and appraisal standards in connection with federally related transactions. The

[1] "State" refers to the 50 States, the District of Columbia, and four territories (Commonwealth of Puerto Rico, Commonwealth of the Northern Mariana Islands, Guam, and United States Virgin Islands).

[2] The Federal financial institutions regulatory agencies consist of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency.

Federal and State appraisal regulatory framework governing federally related transactions includes any real estate-related financial transaction that a Federal financial institution's regulatory agency engages in, contracts for, or regulates, and that requires the services of an appraiser.[3]

Following the savings-and-loan crisis of the 1980s, Congress passed Title XI to address identified weaknesses in the appraisal profession and the quality of real property appraisals supporting the lending activity of federally regulated institutions. Title XI recognized the need for uniform appraisal standards and minimum qualification criteria for appraisers. Prior to Title XI, appraisers were, for the most part, unregulated at either the Federal or State level and there was no uniform set of appraisal standards. The federal financial institutions regulatory agencies had broad safety and soundness guidelines requiring regulated financial institutions to consider the nature and value of a loan's collateral value. Therefore, Title XI sought to address this situation with an emphasis on the importance of appraisals to support safe and sound real estate lending activity of federally regulated institutions and to protect Federal financial and public policy interests in real estate transactions.

Title XI created a unique regulatory framework for real estate appraisals and appraisers that involves Federal, State and private entities:

- At the Federal level, the ASC provides Federal monitoring, support and oversight to both the private and State entities; while the Federal financial institutions regulatory agencies are responsible for prescribing appropriate standards for the performance of real estate appraisals in connection with federally related transactions under their jurisdiction.
- At the State level, State regulatory agencies are responsible for the certification, licensing and supervision of appraisers.

[3] Title XI § 1121 (4), 12 U.S.C. 3350, as amended.

- On the private side, the Appraisal Foundation (Foundation), a private non-profit corporation, is responsible for promulgating uniform appraisal standards and minimum real property appraiser qualification criteria. The Foundation serves as the parent organization for two boards established to accomplish this mission: the Appraisal Standards Board (ASB) and the Appraiser Qualifications Board (AQB). These boards respectively promulgate and maintain the Uniform Standards of Professional Appraisal Practice (USPAP) and the Real Property Appraiser Qualification Criteria (AQB Criteria).[4]

The ASC is made up of seven members as designated by the heads of the Federal financial institutions regulatory agencies, the Department of Housing and Urban Development, and, pursuant to the Dodd-Frank Act, the Federal Housing Finance Agency and the Consumer Financial Protection Bureau. The ASC currently has a staff of ten. The ASC is hiring three additional staff to support the added responsibility given to the ASC by the Dodd-Frank Act.

III. Responsibilities of the ASC Pursuant to Title XI

The Dodd-Frank Act included an emphasis on consumer and residential mortgage lending, recognizing that appraisals provide important information on a property, including its market value, that assists consumers in making informed borrowing decisions, as well as providing important information for the lender to understand the risk in a real estate loan. With the enactment of the Dodd-Frank Act, the amendments to Title XI expanded the ASC's mission and authority and provided additional tools for the ASC in carrying out its responsibilities.[5]

Pursuant to Title XI as amended, the ASC monitors the requirements established by States for the certification and licensing of appraisers qualified to perform appraisals in connection with

[4] The AQB Criteria establish the minimum requirements for credentialing of appraisers qualified to perform appraisals for federally related transactions, including education (for initial qualification and continuing), experience and examination.
[5] Title XI § 1103.

federally related transactions (including a code of professional responsibility). Specifically, States must adopt and/or implement all relevant AQB Criteria for the certification and licensing of appraisers.

Title XI requires the ASC to monitor both the requirements established by the Federal financial institutions regulatory agencies with respect to appraisal standards for federally related transactions under their jurisdiction and the agencies' determinations as to which federally related transactions under their jurisdiction require the services of a State certified or licensed appraiser.

The ASC is required to maintain a National Registry (Registry) of State certified and licensed appraisers who are eligible to perform appraisals for federally related transactions. Through the Registry, State and Federal regulators, lenders, and consumers can determine whether an appraiser holds an active credential in good standing with the State, the type of credential and the State disciplinary history for that appraiser.[6] The Registry became operational in 1992 and is available on the ASC website (www.asc.gov). Over the years, system enhancements have been made to the Registry to improve public access. In March 2010, an updated Registry system and ASC website were implemented. The updated Registry allows authorized and properly trained personnel from each State to update in real time a State's Registry submission and disciplinary actions taken against its licensed or certified appraisers. The Registry contains fewer than 105,000 appraiser credentials[7], down almost 14 percent from the peak in 2007. With the Registry fee being the ASC's sole source of revenue, the reduction in the number of credentials

[6] The National Registry includes the following disciplinary action history for each credential: suspensions, revocations and surrendered in lieu of the aforementioned actions. See Appendix A – *Appraiser Disciplinary Actions Reported by States* for a list of State disciplinary actions since 1992.
[7] Some appraisers are licensed or certified in more than one State. Therefore the number of credentials is higher than the actual number of licensed and certified appraisers. There are approximately 88,000 distinct appraisers on the Registry.

on the Registry places additional challenges on the ASC to budget and plan for additional responsibilities arising from the Dodd-Frank Act mandates.

The ASC is required to transmit an annual report to Congress not later than June 15 of each year that describes its activities during the preceding year. The 2011 Annual Report has been submitted to Congress and is available on the ASC website (www.asc.gov).

The ASC is further required to monitor and review the practices, procedures, activities and organizational structure of the Foundation. In monitoring the Foundation, ASC staff attends all public and private meetings of the Foundation boards, including their Board of Trustees. ASC staff also reviews and, at times, comments on proposed and final published documents regarding the AQB Criteria and USPAP. ASC staff also attends meetings of the Appraisal Practices Board (APB) as part of the responsibility to monitor activities of the Foundation. No grant funds are awarded to the APB as Title XI only authorizes grants to the Foundation for the work of the ASB and AQB.

In 2011 the Foundation appointed a Strategic Plan Task Force to review and update its Strategic Plan. The Task Force held briefings for the Appraisal Foundation Board of Trustees and sponsoring organizations which were attended by ASC staff. Foundation staff indicated that the proposed Strategic Plan will be published this summer for a 90-day public comment period. Once the proposed Strategic Plan is published, the ASC will review it and provide comments. The ASC anticipates submitting comments to the extent that it affects the Title XI related work of the Foundation.

Pursuant to Title XI, amounts appropriated for or collected by the ASC shall be used, among other things, "to make grants in such amounts as it deems appropriate to the Foundation, to help defray those costs of the Foundation relating to the activities of the Appraisal Standards and

Appraiser Qualifications Boards."[8] Since making its first grant in 1992, the ASC has provided over $16 million in grant funds to the Foundation. The Foundation submits an annual grant request to the ASC for grant-related activities of the ASB and AQB. To receive reimbursement for those activities, the Foundation presents monthly reimbursement requests specifying the grant-related activities undertaken in a given month. ASC staff reviews the grant reimbursement requests and makes recommendations to the ASC as to whether the requests should be approved in total, in part, or denied. The ASC reviews the requests along with staff recommendations and approves or denies, in total or in part, the requests during the monthly public meetings. Further, the ASC engages an independent public accounting firm to review the Foundation's grant-related activities and the monthly reimbursement requests. For fiscal year (FY) 2012, the ASC approved an annual grant of approximately $900,000 to the Foundation and its boards, which includes funds for the State Investigator Training Program. The grant also defrays the expenses of grant eligible activities of the ASB and AQB such as the development and maintenance of USPAP and the AQB Criteria, and maintenance of the Uniform State Appraiser Examinations. The ASC provides the Foundation grant funds for the development, presentation, and hosting of State Investigator Training Courses. The program provides training to assist States in investigating complaints against appraisers. The courses, developed jointly by the Foundation, the States, and the ASC staff, fill a void for States that would not otherwise have access to these professional development opportunities, particularly at a time when many States have limited financial resources. In total, 63 State employees attended the training in 2011, bringing the total number of State employees to 330 that have attended the courses over the past three years. The training promotes more effective complaint investigation and resolution by State appraiser regulatory programs. The training covers topics such as USPAP and proper investigative techniques, and

[8] Title XI § 1109 (b) (4), 12 U.S.C. 3338, as amended.

provides resources to aid the States in their processing of complaints against appraisers. In response to the positive feedback from participating States, the ASC approved funding for additional investigator courses for 2012.

A key part of the ASC's role is to monitor and assess State appraiser regulatory programs relative to Title XI. State appraiser regulatory programs are reviewed every two years, at a minimum, through an on-site Compliance Review process. Compliance Reviews are scheduled to coincide with a meeting of a State appraiser regulatory program's decision-making body whenever possible, and are conducted over a two- to four-day period. ASC staff assesses the State appraiser regulatory programs for compliance with Title XI, ASC Policy Statements[9] and AQB Criteria. The ASC's Compliance Review of the State appraiser regulatory programs focuses on three key components of Title XI: (1) implementation and enforcement of USPAP and the AQB Criteria; (2) adequacy of the State's statutory or regulatory authority, funding and staffing to successfully carry out Title XI-related functions; and (3) consistency with Title XI in the decisions of the State appraiser regulatory programs.

The ASC issues a final Compliance Review Report and letter to the State with a determination regarding the State's compliance with Title XI. State appraiser regulatory programs are found to be either: (1) in substantial compliance; (2) not in substantial compliance; or (3) not in compliance[10].

The general areas of non-compliance with Title XI and the number of States experiencing those problems are presented in the 2011 Annual Report available on the ASC website (www.asc.gov). A summary of those findings over the past three years is also included in

[9] The ASC periodically issues Policy Statements to assist the States in understanding the ASC's expectations for State appraiser regulatory programs. The Policy Statements reflect the general framework that the ASC uses in the Compliance Review process.
[10] In Substantial Compliance – Applies when no issues of non-compliance or violations of Title XI, ASC Policy Statements or AQB Criteria are identified. Not in Substantial Compliance – Applies when there are one or more issues of non-compliance or violations of Title XI, ASC Policy Statements and/or AQB Criteria but the concerns do not rise to the level of "not in compliance." Not in Compliance – Applies when the number, seriousness or repetitivness of the Title XI, ASC Policy Statements and/or AQB Criteria violation warrant this finding.

Appendix B of this statement. Timeliness of the investigation and resolution of complaints against appraisers continues to be the most common area of non-compliance for the States.

In 2011, ASC staff conducted 33 on-site visits: 27 of those were full Compliance Reviews; 3 were Follow-up Reviews; 3 were on-site Priority Contact visits. These Priority Contacts provide ASC staff the opportunity to meet with a State that may pose a relatively high risk to the appraisal regulatory system, such as a State with a large population of appraisers, a State with major changes to the State appraiser regulatory program leadership, or a State with past compliance concerns.

As reported in the 2011 ASC Annual Report, the following 12 States collectively represented over 50 percent of the appraiser credentials on the National Registry: California, Florida, Georgia, Illinois, Michigan, New York, North Carolina, Ohio, Pennsylvania, Texas, Virginia, and Washington (listed alphabetically).

Title XI authorizes the ASC to take action against a State in the case of non-compliance, with an order of non-recognition. Such an order would effectively mean that federally regulated financial institutions would be unable to conduct real estate lending in a non-compliant State as institutions would be unable to employ the State's appraisers for appraisals in federally related transactions. The Dodd-Frank Act gave the ASC the authority to take interim action against a State in the case of non-compliance with Title XI (as an alternative to, or in advance of non-recognition). With regard to any future ASC rulemaking, the Dodd-Frank Act directs the ASC to establish an advisory committee of industry participants, including appraisers, lenders, consumer advocates, real estate agents, and government agencies, and hold meetings as necessary to support the development of such regulations.

IV. Current Activities and Future Priorities

Since the passage of the Dodd-Frank Act in 2010, the ASC completed numerous tasks associated with the amendments to Title XI including:

- Holding ASC meetings in open session after notice in the Federal Register
- Issuing Bulletins to State appraiser regulatory agencies noticing them on:
    - Increased National Registry fees from $25 to $40 (the fee of $25 was established in 1992 and had not changed since.)
    - Implementation of the new AQB minimum qualification requirements for State licensed appraisers, trainees, and supervisors
    - New State reciprocity requirements
    - Requirement to maintain adequate funding and staffing
- Providing Annual Reports to Congress by June 15.

In January, the ASC underwent significant change with the OCC, FRB and FDIC appointing new representatives. In addition, the CFPB member who had been acting in an advisory capacity became a voting member, and effective April 1st, the FFIEC appointed the HUD representative to a two-year term as the new ASC Chairman. The first meeting with the new members was held in February. Since then, the ASC has held five monthly public Meetings and ten Briefings. Substantial progress is being made in a number of areas, as discussed below.

Last fall the ASC voted to deploy the Appraisal Complaint National Hotline. Since that time, a website has been developed, a call center has been designed, and an overall process for handling complaints has been drafted. ASC member agencies are currently working to finalize the details for how they will handle the referral of a complaint from the Hotline. This effort involves interagency coordination and information sharing. Launch of the Hotline is anticipated before the end of 2012.

The ASC approved revised Policy Statements for publication in the Federal Register for public comment. This is the first complete rewrite of the Policy Statements since 1992, and incorporates changes to Title XI brought about by the Dodd-Frank Act. The ASC anticipates reviewing and considering the public comments and publishing adopted Policy Statements before the end of 2012.

Other ASC priorities include fulfilling the authority and responsibilities conferred by the Dodd-Frank Act in such areas as State grants and rulemaking. Many State appraiser regulatory programs do not control their funding, and, as referenced in the GAO study (discussed more fully below), can have their appraisal program funds swept[11] into the general fund. To provide broad support of all States the ASC currently funds the State Investigator Training Program, which pays travel and education related expenses for at least three individuals from each State to attend educational offerings on effective complaint investigation and prosecution techniques. While the ASC has not yet formally addressed rulemaking, the proposed Policy Statements would implement the interim sanctioning authority given to the ASC by the Dodd-Frank Act to remove appraisers from the National Registry for up to 90 days.[12] Use of any additional interim sanctioning authority would require rulemaking. If the ASC determines that there is a need for rulemaking the ASC will establish an advisory committee as required in the Dodd-Frank Act.

The Dodd-Frank Act also required the GAO to conduct a study of the ASC. The GAO conducted its study throughout 2011 and issued its report last January. The GAO made three

[11] Many State legislatures and or governors offices have the authority to "sweep" funds from State agencies. Sweeping the funds refers to taking the funds for use in other areas of the State government or borrowing the funds. In some cases borrowed funds are never returned.

[12] The Dodd-Frank Act also gave the ASC similar interim sanctioning authority for appraisal management companies. At such time that the ASC establishes the Appraisal Management Company National Registry, it will be necessary to revise the Policy Statements to implement the interim sanctioning authority for appraisal management companies.

recommendations, which the ASC is currently working to address. Following are the GAO recommendations and ASC progress in responding to them:

1. Clarify the definitions used to categorize States' overall compliance with Title XI and include them in ASC's compliance review and policy and procedures manuals, compliance review reports to States, and annual reports to Congress.
    - Added current compliance review findings definitions to the Policy and Procedures Manual, State Compliance Review reports, and are included in the 2011 Annual Report to Congress.
    - Drafted revised Policy Statements to include redefined Compliance Review findings and definitions that more specifically define States' level of compliance with Title XI, ASC Policy Statements and AQB Criteria.
2. Develop specific policies and procedures for monitoring the appraisal requirements of the federal financial institutions regulators and include them in the ASC's Policy and Procedures manual.
    - The ASC staff is drafting a policy to address this recommendation and will submit the draft policy to the ASC for approval. Additionally, ASC staff met with the interagency group working on appraisal-related regulations required by the Dodd-Frank Act, as well as the interagency group addressing the complaint hotline processes.
3. Develop specific criteria for assessing whether the grant activities of the Foundation are Title XI-related and include these criteria in ASC's Policy and Procedures manual.

- The ASC staff is drafting a policy to ensure that both the type and level of approved grant funding are appropriate and will submit the draft policy to the ASC for approval.

An overview of the ASC's completed, current and 2013 priorities is included in Appendix C of this statement.

V. Conclusion

In conclusion, the Dodd-Frank Act made significant amendments to Title XI that will take several years to fully implement. Given the significant additional responsibility and authority provided to the ASC, staffing and other resources are being carefully analyzed and monitored to ensure the ASC has the proper resources to fulfill its Title XI requirements. The ASC is dedicated to carrying out its new and existing Title XI mandates transparently and efficiently.

Appendix A – *Appraiser Disciplinary Actions Reported by States**

January 1, 1991 through December 31, 2011

STATE OR US TERRITORY	Revocation	Suspension	Voluntary Surrender	Downgrade	Probation	Fine	Additional Education	Official Reprimand	Warnings, Corrective Actions	Other	Total
ALASKA	1	1	4		6	7	4		3		**26**
ALABAMA	9	44	17	4	6	15	6	12		16	**129**
ARKANSAS	9	22	8	2	153	7	26		8	74	**309**
ARIZONA	40	27	43	1	74		1	2		361	**549**
CALIFORNIA	133	62	110	1	54	503	92		140	43	**1,138**
COLORADO	37	56	92	3	42	200	179	1	2	11	**623**
CONNECTICUT	6	6	7			145	36	1		6	**207**
DISTRICT OF COLUMBIA	2	5			9	19	2	2			**39**
DELAWARE	1	13			7	4	14	13			**52**
FLORIDA	272	185	27	1	607	570	125	6	4		**1,797**
GEORGIA	283	135	31							353	**802**
HAWAII	1					13	5		1		**20**
IOWA	17	8	33		54	47	138	19	4	6	**326**
IDAHO	5	18	9		70	163	117	4	4	36	**426**
ILLINOIS	138	108	8	1	21	94	13	11	660	3	**1,057**
INDIANA	88	100	10		154	24	15	55	7	73	**526**
KANSAS	32	16	16	1	104	80	165		18		**432**
KENTUCKY	3	43	19		2	153	85		5	4	**314**
LOUISIANA	2	13				23			24		**62**
MASSACHUSETTS	23	18	53		76	120	4	200	6		**500**
MARYLAND	12	40	3			79	39	13	1	2	**189**
MAINE	21	18	8		15	104	61	58	15	6	**306**
MICHIGAN	89	29	4		35	373	129				**659**
MINNESOTA	66	66			1	331	36	28	21	18	**567**
MISSOURI	99	130	17		259			2	2	52	**561**
MISSISSIPPI	10	18	5		26		39	2	1	278	**379**
MONTANA	9	8	3		25	38	35	6		2	**126**
NORTH CAROLINA	17	175	51	1		3	203	79	6	1	**536**
NORTH DAKOTA	2	5	5	2	11		16	1		1	**43**
NEBRASKA	1	6	21	3	9	2	66		3	34	**145**
NEW HAMPSHIRE	3	11	1			53	36				**104**
NEW JERSEY	17	71	12	2	37	176	44	74	5		**438**
NEW MEXICO	13	7	2		3	28	60	11	14		**138**
NEVADA	36	26	36	13	10	107	151		3	4	**386**
NEW YORK	139	85	1			137	26	1	49	5	**443**
OHIO	30	158	20			164	262	6	75		**715**
OKLAHOMA	376	171	18	3	15	138	39	3	2	13	**778**
OREGON	16	40	27			335	22	27	4	24	**495**
PENNSYLVANIA	8	49	22		35	243	184	14			**555**
PUERTO RICO		2				8	2			8	**20**
RHODE ISLAND	8	6	2			16	11			2	**45**
SOUTH CAROLINA	16	18	14	7	73	134	51	77	3		**393**
SOUTH DAKOTA	6	16	3			50	45	44	3	4	**171**
TENNESSEE	12	30	12	5	24	148	141	8	75	44	**499**
TEXAS	83	51	42		82	199	335	13	6	10	**821**
UTAH	17	5	32	7	13	155	69			22	**320**
VIRGINIA	32	82	5		2	8	4		117	1	**251**
VERMONT	2	6	2		2	4	8		23	7	**54**
WASHINGTON	58	45	5		82	65	16	2	34	1	**308**
WISCONSIN	16	61	46		8	127	220	103	12	10	**603**
WEST VIRGINIA	3	29			25	37	36	11	6	3	**150**
WYOMING	1	1	5		6	6	5			3	**27**
Total	**2,320**	**2,345**	**911**	**57**	**2,237**	**5,455**	**3,418**	**909**	**1,366**	**1,541**	**20,559**

*Public disciplinary actions on the National Registry are those State actions currently in effect that affect an appraiser's ability to appraise: revocations, suspensions or voluntary surrenders in lieu of discipline. No disciplinary actions have been reported by Guam, Mariana Islands or Virgin Islands.

Appendix B - ***2011 Compliance Review Findings***

2009 – 2011 Compliance Review Findings

Areas of Non-Compliance			
Requirement/Guidance Areas	2011 27 States Reviewed	2010 26 States Reviewed	2009 32 States Reviewed
Statutes, Regulations, Policies and Procedures:	4	2	7
Temporary Practice:	0	0	0
National Registry:	0	0	1
Application Process:	2	4	17
Reciprocity:	0	0	0
Education:	0	2	7
Enforcement:	18	19	16
State Compliance Status			
	2011 27 States Reviewed	2010 26 States Reviewed	2009 32 States Reviewed
In Substantial Compliance	15	9	14
Not in Substantial Compliance	11	17	18
Not in Compliance	1	0	0

The table above documents the 2009, 2010, and 2011 Compliance Review findings by requirement and areas of guidance.

State Compliance Status 2007 - 2011

State Compliance Status Showing Improvement					
	2011 27 States Reviewed	2010 26 States Reviewed	2009 32 States Reviewed	2008 26 States Reviewed	2007 30 States Reviewed
In Substantial Compliance	15	9	14	5	4
Not in Substantial Compliance	11	17	18	20	26
Not in Compliance	1	0	0	1	0
% In Substantial Compliance	56%	35%	44%	19%	13%

Appendix C – ***Dodd-Frank Act: ASC Project Log***

DODD-FRANK ACT: ASC PROJECT LOG		
	Completed Tasks	
Title XI as Amended	**Summary of Task(s)**	**Current Status**
§ 1104 (b) Open Meetings	• ASC to hold meetings in public. • Notice of meetings to be published in the Federal Register. • Amend ASC Rules of Operation and Policies & Procedures.	• Completed. • Open Meetings began July 2010. • ASC Rules of Operation/Policies & Procedures amended December 2010.
§ 1109 (a) Registry Fees Modified	• Issue ASC Bulletin to States to implement. • Amend Rules of Operation.	• Completed. ASC Bulletin issued October 14, 2010. • AMC Registry fees will follow timeline of AMC registration with States.
§ 1011 Amendments to Appraisal Subcommittee	• CFPB and the FHFA added as ASC member agencies. • Requires one ASC member be a licensed or certified appraiser or hold a professional designation.	• Completed. • FHFA designated member representative in November 2010. • CFPB designated member representative in November 2011.
§ §1116 (c) Criteria	• Issue ASC Bulletin to States to implement. • AQB Criteria mandatory for State Licensed Appraisers, and Trainee and Supervisory Appraisers.	• Completed. • ASC Bulletin issued March 18, 2011. • Ongoing ASC monitoring of State Programs.
§ 1118 Monitoring of State Appraiser Certifying and Licensing Agencies	• Issue ASC Bulletin to States to implement requirement for State Programs to maintain adequate funding and staffing to carry out Title XI-related duties.	• Completed. • ASC Bulletin issued March 18, 2011. • Ongoing ASC monitoring of State Programs.
§ 1122 (b) Reciprocity	• Issue ASC Bulletin to States to implement new reciprocity requirements.	• Completed. • ASC Bulletin issued March 18, 2011. • Ongoing ASC monitoring of State Programs.
§ 1122 (h) Appraiser Education	• Encourage States to accept courses approved by the AQB Course Approval Program. • Issue Bulletin to States.	• Completed. • ASC Bulletin issued March 18, 2011. • Ongoing as part of Compliance Review.

Immediate Priorities FY 2012		
Title XI as Amended	**Summary of Task(s)**	**Current Status**
§ 1103 (a) Annual Report	• Transmit Annual Report to Congress June 15.	• 2011 Report submitted timely. • 2010 Report submitted timely.
§ 1122(i) Appraisal Complaint Hotline	• ASC to determine whether hotline exists that satisfies provisions of Dodd-Frank Act. • If ASC determines no such hotline exists, ASC to establish and maintain appraisal complaint national hotline.	• January 12, 2011, ASC determined no hotline exists to satisfy provisions of Dodd-Frank Act. • Hotline deployment plan approved November 2011. • Website and call center in final stages of development. • Interagency working group finalizing agency processing of complaints and information sharing. • Phase One launch anticipated prior to end of 2012. Launch date dependent on agencies' readiness.
(Not Title XI) Dodd-Frank Act § 1476 GAO Study	• GAO study required.	• Study completed. • ASC addressing 3 GAO recommendations. • Recommendations to be addressed prior to end of 2012.
§ 1118 Monitoring of State Appraiser Certifying and Licensing Agencies	• Interim sanction authority to remove appraisers from the National Registry for up to 90 days; due process considerations addressed in revised Policy Statements.	• Draft revised Policy Statements in process. • Publish Policy Statements for comment in Federal Register w/in 30 days.
§ 1109 (b) Grants and Reports	• Make grants to State agencies in accordance with policies to be developed by the ASC to support State Program compliance with Title XI.	• Currently providing funding for State Investigator Training through the Appraisal Foundation grant process. • Draft policies for additional grant activities in progress. • Hiring of grant specialist in progress • Ongoing development of State grant policies anticipated.

Priorities for FY 2013		
Title XI as Amended	**Summary of Task(s)**	**Current Status**
§ 1122 (g) Appraiser Independence Monitoring	• Issue ASC Bulletin to States to implement. • Monitor State Programs to determine if policies, practices and procedures are consistent with maintaining appraiser independence, and whether State has adopted and maintains laws, regulations and policies aimed at maintaining appraiser independence.	• Currently, ASC staff gathers information from State Programs regarding laws, regulations and policies in place governing appraiser independence during the Compliance Review. • ASC Bulletin to be issued during FY2013 to formalize ASC monitoring function.
§ 1106 Regulations	• Regulatory authority granted in the following areas: (1) temporary practice; (2) National Registry; (3) information sharing; and (4) enforcement. ASC shall establish an advisory committee to support development of regulations.	• Initial research on rulemaking (APA) and advisory committee (FACA) completed. • Preliminary fiscal analysis on advisory committee completed. • ASC will form advisory committee once the need for specific rulemaking is identified.

To Be Completed		
Title XI as Amended	**Summary of Task(s)**	**Current Status**
§ 1124 Appraisal Management Companies (AMCs)	• Issue ASC Bulletin to States implement. • Monitor States' adoption and implementation of minimum requirements established by DFA Interagency Group for registration of AMCs.	• DFA Interagency Group to prescribe regulations by January 21, 2013. Once regulations are in final form and implemented by States, ASC will begin monitoring function.
§ 1109 (a) State Agency Reporting	• Issue ASC Bulletin to States to implement. • New reporting requirements for AMCs.	• DFA Interagency Group to prescribe regulations by January 21, 2013. Once regulations are in final form and implemented by States, ASC will begin monitoring function.

Statement of

Donald T. Rodgers, President
Association of Appraiser Regulatory Officials (AARO)

Before the
Subcommittee on Insurance, Housing and Community Opportunity
U.S. House of Representatives

June 28, 2012

Introduction

Chairwoman Biggert, Ranking Member Gutierrez, and Members of the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity, I thank you for the opportunity to testify today on Appraisal Oversight and Regulation.

My name is Donald T. Rodgers, and I am the Executive Director of the North Carolina Appraisal Board. I am currently the President of the Association of Appraiser Regulatory Officials (AARO). AARO is an organization which represents the real estate appraiser licensing and certification agencies of U.S. States and Territories.

The mission of the Association of Appraiser Regulatory Officials is to improve the administration and enforcement of real estate appraisal laws in member jurisdictions. AARO does this in four ways:

Facilitating communication and cooperation between and among appraiser regulatory officials and others concerned with appraiser and appraisal issues.

Conducting research and obtaining information relative to appraisal matters.

Participating in educational programs on appraisals and assisting with instructions, administration, and regulation of appraisal education for regulatory officials and others. In addition, AARO continually strives toward raising the level of competence and professionalism of all appraiser regulatory officials.

Developing and encouraging cooperation with all other organizations whose objective is similar in nature to its objectives and purposes.

My testimony today will focus on issues that are particularly relevant to state regulatory officials.

Challenges Facing State Appraisal Boards

Enforcement

States established appraiser licensing and certification programs as a result of the Financial Institution Reform, Recovery and Enforcement Act (FIRREA) of 1989. These agencies issue appraiser licenses and certifications to those individuals who possess the education and experience requirements promulgated by the Appraiser Qualifications Board of The Appraisal Foundation. The agencies also oversee compliance by appraisers with the Uniform Standards of Professional Appraisal Practice (USPAP), state law and agency rules. These programs have been set up in a variety of ways; however, most fall into one of the following categories. Some states have an umbrella licensing agency that handles all occupational licenses for the state. Others have a stand-alone agency that handles real estate broker and/or appraiser licensing. Finally, there are states, such as North Carolina, that have an autonomous board set up by statute.

Appraisal boards are funded in different ways. In an umbrella agency, licensing fees are sent to the state, and the state manages its personnel and funds its operation. In a stand-alone agency, fees are collected by the state and the agency then receives an appropriation to meet its budgetary needs. Most autonomous boards keep the fees they receive, and do not receive any state funding. Since there are territories and small states that have a few hundred or fewer appraisers, while one state has over ten thousand, the large disparity in the numbers of appraisers makes it difficult to establish one method to operate state appraisal programs.

There are also different approaches with regard to staffing. Most programs have an administrator or executive director that manages day-to-day operations; however, based on the number of appraises licensed by the board, it may be necessary for the administrative staff to manage multiple licensing programs to maximize economies of scale. States also use different approaches for investigations. Some have a pool of investigators available to all licensing boards. Others contract with appraisers on a per-case basis to assist staff. Some appraisal boards have staff investigators who in some cases are former law enforcement officers, while other states use appraisers who have been trained in investigations. State programs generally have legal representation provided by their state attorney general's office. Some of these attorneys are assigned on a per-case basis, while others provide a part time or full time attorney that deals solely with appraisal board cases. Attorneys who are not assigned solely to the appraisal board may have a case load involving cosmetologists, funeral homes and plumbers in addition to appraisers. Boards who have administrators, investigators and attorneys who are not trained in real estate appraisal are dealing with specific standards of practice and appraisal methodology. Even though they may obtain training in appraisal standards and methodology, it is difficult to sustain a level of competence when not dealing with these types of cases on a full-time basis.

State legislatures do not understand that appraisal boards have requirements that other occupational licensing boards do not have. For example, the Appraisal Subcommittee (ASC) issues Policy Statements that reflect the general framework they use when they review a state for compliance with Title XI. Policy Statement 10 states that "State agencies need to process complaints of appraiser misconduct or wrongdoing on a timely basis. Absent special documented circumstances, final State agency administrative decisions regarding complaints should occur within one year of the complaint filing date." States where the appraiser program is housed within an umbrella agency may not be able to comply as they are not provided with sufficient resources to resolve cases. Often state officials do not understand why this one licensing agency must be given priority when the state's backlog for other occupations is just as great. Although the ASC often points out that it is a state issue and not just an agency issue, when states are facing the significant funding problems that they have today, appraiser programs may face a reduction in funds and may be subject to having their funds swept into the state treasury for other uses.

Difficulty Detecting Fraud

Like most regulatory agencies, appraisal boards respond to complaints; they don't generally initiate investigations. An appraisal is an opinion of value, and it is difficult to dispute someone's opinion. Appraisal fraud involves the intent to deceive someone in the making of an appraisal, or at least some evidence of conspiracy. It is nearly impossible to prove an appraiser's intent to defraud by looking at an appraisal report. For that reason, law enforcement officials have often shied away from involving appraisers in a civil or criminal fraud case. In addition, to get them to pursue such a case, a fairly high financial threshold of harm must be present. They are more likely to pursue other players in a fraud scheme, such as mortgage brokers, developers and attorneys.

Several states have created or participate in task forces to deal with mortgage fraud. These task forces have banking, appraisal and real estate regulators, as well as state and federal law enforcement. This helps the members identify common participants in different fraud schemes, and to offer support to each other in prosecution of these individuals. State and federal law enforcement agencies, however, often are not able to share information with state appraisal boards and other regulators due to confidentiality laws and the concern that their investigation could be compromised. As a result, the task force is more beneficial to law enforcement in obtaining information than it is to regulators in the investigation of their own cases.

A big obstacle for appraisal boards is that often problems with loans and appraisals do not emerge until several years after a loan was made, when properties go into foreclosure or homeowner attempts to sell or refinance. It becomes more difficult to investigate an appraisal when a significant amount of time has passed, as an appraisal is an opinion of value as of a specific date in time. There may be changes in the property's condition and in market forces; also, data available to the appraiser at the time of the appraisal may no longer be available, and the appraiser may have destroyed his records (USPAP only requires that an appraiser keep his records for five years). Complaints were often not originated at the time the appraisal was performed, as many of the participants who are now complaining about low appraised values did not see a problem when values were meeting or exceeding sales prices.

Appraisers found to be involved in mortgage fraud schemes often didn't realize what they had gotten into. They may have drawn into schemes orchestrated by other unscrupulous players who withheld information from them or deliberately gave them erroneous information. Often they did not receive any additional fee or payment for participating in a fraud scheme; they were brought into it with the promise of a number of future assignments. In one instance in North Carolina, the investigator discovered that the appraiser had received a large payment that was noted on the HUD-1 settlement statement. This helped the appraisal board revoke the appraiser's license, and they were successfully prosecuted in federal court; however, it is seldom that this type of "smoking gun" is present. Although there is always a potential for mortgage fraud, the significant increase in scrutiny in underwriting of appraisals makes it difficult to perpetrate many of these schemes; however, it has also resulted in tightened guidelines for appraisers and loan requirements for borrowers.

Appraisal Management Companies

Appraisal management companies (AMCs) have existed for many years. In March 2008, Fannie Mae entered into an agreement with the New York Attorney General's office to adopt certain policies relating to appraisals for loans delivered to them. This agreement established the Home Valuation Code of Conduct (HVCC). As part of the HVCC, loan originators on commission were forbidden from selecting an appraiser for a particular appraisal assignment or from having any substantive communications with an appraiser relating to valuation, including ordering or managing an appraisal assignment. As a result of the HVCC, many more AMCs were established, and appraisers performing appraisals for residential loans were, for the most part, required to sign up with AMCs in order to obtain assignments. It is our understanding that in some cases, the AMCs were established or operated by former mortgage brokers or appraisers who had been sanctioned or lost their license to practice. There were no laws or regulations in place that prohibited these individuals or those with criminal backgrounds from setting up and managing these companies, even as they became such an integral part of the mortgage process.

As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act, all states will now have to register and supervise AMCs. A majority of states already have implemented a registration program, and issues have begun to surface. One is how to determine whether a company actually is an AMC. There are several electronic or portal companies that recruit, manage, send assignments, review appraisals, send appraisals back to the appraiser for changes, and transmit payment to the appraiser. Many traditional appraisal firms use subcontractors to perform assignments rather than have appraisers employed by the company. This has raised the issue as to whether these appraisal firms are acting as an AMC and must be registered as one. Various state legislatures have taken a strict view and required appraisal companies to register, while others have tried to limit registration to those who perform the full spectrum of appraisal management functions. In discussion with the staff of the Consumer Financial Protection Bureau (CFPB), it was obvious that it is very difficult to define an AMC for purposes of legislation and rulemaking.

Although AMCs do largely create the firewall envisioned by the HVCC, it has created the situation where it is hard for consumers, real estate brokers, builders and other users of appraisal services to provide necessary information to the appraiser and to express concerns with the appraisal itself. As AMCs have become more an integral part of the appraisal process, many consumers do not understand or are not aware of their role. Consumers may pay the AMCs invoice, which they consider to be substantial for an appraisal, but they do not understand that the appraiser receives only a part of that payment. It is not uncommon for AMCs to prohibit appraisers from speaking with any parties to the process, such as brokers, builders or borrowers. After the inspection is performed and the appraisal is transmitted to the AMC, the AMC may send the appraiser several requests for information, which can delay the transmission of the final appraisal to the lender. These situations increase consumer frustration, and this hostility is directed towards the appraiser. As a result of this misunderstanding, a consumer may file a complaint with the appraisal board.

Appraisers have their own concerns in dealing with AMCs. One AMC has numerous pages of instructions to the appraiser as to how to perform the appraisal. Another AMC tells appraisers what to wear when inspecting properties. Some appraisers are receiving assignments to appraise properties that are out of their market area. Even though they are required by USPAP to be or to become geographically competent to perform an appraisal, they feel pressured to accept these assignments in order to continue to receive work from the AMC, as well as the financial pressure of needing the income from these assignments. Some AMCs are slow to pay appraisers, even when faced with state laws giving them time limits for payment. There are instances where an AMC will automatically remove an appraiser from their panel if the appraiser has any form of disciplinary action, including a reprimand or the requirement of additional education which is based on a technical violation of a state's rules. Appraisers who do not comply with the AMC's requirements or who complain against an AMC fear removal from the AMC panel, which could, in turn, limit their ability to receive work from other AMCs and result in a large loss of income.

State appraiser boards have their own issues with oversight of AMCs. An overlying problem for boards is that they must license two entities, appraisers and AMCs, whose interests are often at odds. Each group may attempt to get legislators and state boards to adopt laws and enact rules that impact the other's ability to function. Most state legislation to date focuses on registration of AMCs, not regulation. Boards have limited ability to oversee the functions of an AMC unless there is evidence of a violation of appraiser independence. When complaints are received, it will likely be difficult for agencies with limited funds and personnel to investigate corporations that usually are not domiciled within their state. For example, in North Carolina, there are 144 AMCs registered, but only 6 are headquartered in the state.

Hopefully, once rules are adopted by the CFPB and minimum requirements for states are defined by the Appraisal Subcommittee, many of these issues with regard to AMCs will become clearer.

Oversight of Alternative Valuation Services

Automated Valuation Models (AVMs), Broker Price Opinions (BPOs) and other evaluation products are generally not regulated by appraiser licensing boards, unless they are performed by an appraiser in violation of state licensing laws. In many instances consumers do not realize tbe difference between these products and may think they are receiving an appraisal, when an appraiser is not actually involved in the process. The North Carolina Appraisal Board received a complaint from a consumer earlier this year regarding what she thought was an appraisal. The letter valuing property gave her an estimate of what the property was worth, and she was charged $450 for the valuation. It turned out that this was not an appraisal, but was a statement of worth from a real estate broker. Although the Appraisal Board referred this matter to the North Carolina Real Estate Commission, there are currently no standards of practice for BPOs and there is limited authority to discipline brokers for errors in the development of a value.

Some states have no restrictions on the preparation or use of BPOs, while others have laws that severely limit the use of BPOs to traditional brokerage services such as listing or selling properties. If a BPO is not done by an appraiser, state appraisal boards don't regulate this product and there is no requirement that the person performing the BPO conform to the Uniform Standards of Professional Appraisal Practice (USPAP). Many states that allow BPOs have no minimum education or experience requirements to perform this service, and have not adopted guidelines or standards for brokers to follow in the preparation of this product. BPOs and other alternative valuation products, therefore, are not sufficiently regulated.

Potential Improvement to the Appraisal Regulatory System

What Works Well

In order to look at where the system can be improved, it is helpful to look at what elements are working well. There have been several joint efforts of the three components of the regulatory structure (state appraisal boards, the Appraisal Subcommittee and The Appraisal Foundation). Some of these are:

- An investigator training program was presented to state regulators at no cost to their agencies. This program was developed by AARO members, administered by The Appraisal Foundation and funded by the ASC.
- A task force of these three groups explored issues surrounding the supervision of trainees. Since that time the Appraiser Qualifications Board (AQB) of The Appraisal Foundation has developed criteria that will be mandatory for states in licensing and overseeing trainees and their supervisors as of January 2015.
- Another task force of the three groups developed a Voluntary Consistent Enforcement Matrix to provide guidance to states as to how various types of USPAP violations could be sanctioned.
- The groups developed, filmed and have made available to states a Mock Administrative Hearing as an education tool for appraisal board members and staff. This hearing was done at an AARO conference with many state regulators in attendance.
- The ASC and The Appraisal Foundation have made themselves freely available to AARO conferences and meetings.
- The Appraisal Foundation has scheduled meetings of its boards (the Appraisal Standards Board and the Appraiser Qualifications Board) in conjunction with AARO meetings in order to allow state regulators to attend the meeting and encourage participation in AARO.
- The Appraisal Foundation also put together a State Regulators Advisory Group (SRAG) in order to provide direct input to the Foundation. The SRAG meeting is another opportunity for the three groups to work together as the ASC participates in that meeting as well. These meetings are also held in conjunction with AARO conferences.
- The Appraisal Foundation issues exposure drafts and requests comments when there are proposed changes to USPAP or the appraiser qualification criteria. This results in these being thoroughly vetted and minimizes unintended consequences.
- The ASC provides assistance to states as needed when the states are drafting rules, and when there are potential changes in legislation that could impact the state's ability to comply with FIRREA.

Suggestions for Improvement

After twenty years of the current system which combines private policy, state enforcement and federal oversight, several areas have shown need for improvement. A few of the larger issues are:

- A representative of the appraisal industry and/or the appraiser regulatory community should be given a seat on the Appraisal Subcommittee. There should also be an appraiser regulator on both the Appraiser Qualifications Board and Appraisal Standards Board of The Appraisal Foundation. Having a state regulator on these groups will allow them to receive direct input as to how their decisions will affect implementation and enforcement of requirements.
- Explore the possibility of having a national repository for each appraiser's records. This would include qualifying education, continuing education, the date and types of examinations passed, a comprehensive background check and licensing history, including

documentation of any disciplinary action. This could be accomplished either through expansion of the ASC National Registry database or a system similar to the National Mortgage Licensing System. An appraiser should only have one record on the National Registry, not a separate one for each state in which the appraiser is licensed and for each credential which the appraiser has held. A similar repository should be established for appraisal management companies (AMCs). Funding for developing and administering such a system may be available through grants from the ASC or as part of a state's licensing and renewal process.

- Current ASC meeting procedures do not encourage attendance by the public and should be changed. In the past, a large portion of each meeting was held in closed session. Recently the meetings have become more open, but there are still impediments to the free flow of information to the ASC at their meetings. Anyone wishing to attend must preregister in advance. Participants must have a valid government issued photo identification, and go through a security screening, in addition to being personally escorted to and from the meeting area. Although it is understandable that some level of security is necessary, meetings should not be held in buildings that require this procedure. These are public meetings, and the public should not be discouraged from attending, even if they choose to attend without advance registration. Registration could be required to address the ASC.
- There needs to be a method where a state can ask the ASC for guidance without fear of repercussions. A state may be reluctant to request assistance or information out of concern that asking a question will be flagged for the next ASC review of the state. It is possible that a state could have had several reviews, but if something is later discovered and the state asks for guidance, the ASC will still cite this as an area of concern in a future review. State boards and appraisers should be able rely on their procedures if a review have found them to be in compliance. If the ASC later determines the state's rules are out of compliance, the state should be able to correct the issue without a finding against the state and the potential removal or suspension of an appraiser's credential.
- Policies that are necessary for consistency across states must be mandatory by federal law. The development of a universal complaint form and of an AMC application form have been discussed, but will be difficult to achieve absent a federal mandate that all states accept a particular form. Some states require that a complaint be notarized and completed on a state-specific form, while others can accept anonymous complaints. If universal forms are truly essential for the oversight of appraisal regulation, this needs to be addressed in federal law. This issue also applies to reciprocity where there are clear mandates for temporary practice, but no such requirements for reciprocal licenses.
- The policies and procedures of the ASC need to be more transparent. There is little or no input allowed by stakeholders, such as state regulatory officials and the appraisal industry. The Appraisal Foundation's Boards, the AQB and the ASB, each have a lengthy and thorough exposure draft and comment system where comments are actively solicited and revised drafts are issued for further comment. ASC Policy Statements, bulletins, memoranda and review criteria should have similar exposure and comment. Currently, we understand that ASC Policy Statements are under review and are in the process of being changed. Although this process has been underway for several months, states and members of the appraisal industry still have not had the opportunity to see a draft or to have an opportunity to comment.

The Appraisal Subcommittee

The Dodd-Frank Wall Street Reform and Consumer Protection Act has given the ASC more enforcement tools, the ability to make grants to the states, and oversight of the AMC registration process. The lack of enforcement tools was a serious omission from FIRREA and created a situation where derecognition was the only penalty available to the ASC for violations. Given the devastation it would have had to a state's real estate industry, the ASC has never used this tool, and states have realized that such drastic a measure was unlikely to be utilized. Now that the ASC has these new tools, it remains to be seen what effect this will have on the oversight of the state appraiser programs.

Thank you again for the opportunity to testify before you today. I will be glad to answer any questions.

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Insurance, Housing and Community Opportunity, Committee on Financial Services, House of Representatives

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RESIDENTIAL APPRAISALS

Regulators Should Take Actions to Strengthen Appraisal Oversight

Statement of William B. Shear, Director
Financial Markets and Community Investment

GAO
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GAO-12-840T

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Highlights

Why GAO Did This Study

What GAO Recommends

June 2012

RESIDENTIAL APPRAISALS

Regulators Should Take Actions to Strengthen Appraisal Oversight

What GAO Found

Data GAO obtained from Fannie Mae and Freddie Mac (the enterprises) and five of the largest mortgage lenders indicate that appraisals—which provide an estimate of market value at a point in time—are the most commonly used valuation method for first-lien residential mortgage originations. Other methods, such as broker price opinions and automated valuation models, are quicker and less costly but are viewed as less reliable. As a result, they generally are not used for most purchase and refinance mortgage originations. Although the enterprises and lenders GAO spoke with did not capture data on the prevalence of approaches used to perform appraisals, the sales comparison approach—in which the value is based on recent sales of similar properties—is required by the enterprises and the Federal Housing Administration. This approach is reportedly used in nearly all appraisals.

Conflict-of-interest policies have changed appraiser selection processes and the appraisal industry more broadly, raising concerns about the oversight of appraisal management companies (AMC), which often manage appraisals for lenders. Recent policies, including provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), reinforce prior requirements and guidance that restrict who can select appraisers and prohibit coercion. In response to market changes and these requirements, some lenders have turned to AMCs. Greater use of AMCs has raised questions about oversight of these firms and their impact on appraisal quality. Federal regulators and the enterprises said they hold lenders responsible for ensuring that AMCs' policies and practices meet their requirements but that they generally do not directly examine AMCs' operations. Some industry participants voiced concerns that some AMCs may prioritize low costs and speed over quality and competence. The Dodd-Frank Act requires state appraiser licensing boards to supervise AMCs and requires the federal banking regulators, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection to establish minimum standards for states to apply in registering them. Setting minimum standards that address key functions AMCs perform on behalf of lenders could provide greater assurance of the quality of the appraisals that AMCs provide. As of June 2012, federal regulators had not completed rulemaking to set state standards.

The Appraisal Subcommittee (ASC) has been performing its monitoring role under Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), but several weaknesses have potentially limited its effectiveness. For example, ASC has not clearly defined the criteria it uses to assess states' overall compliance with Title XI. In addition, Title XI charges ASC with monitoring the appraisal requirements of the federal banking regulators, but ASC has not defined the scope of this function—for example, by developing policies and procedures—and its monitoring activities have been limited. ASC also lacks specific policies for determining whether activities of the Appraisal Foundation (a private nonprofit organization that sets criteria for appraisals and appraisers) that are funded by ASC grants are Title XI-related. Not having appropriate policies and procedures is inconsistent with federal internal control standards that are designed to promote the effectiveness and efficiency of federal activities.

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee:

I am pleased to be here today to discuss our work on residential real estate valuations and the role of the Appraisal Subcommittee (ASC) of the Federal Financial Institutions Examination Council (FFIEC) in monitoring requirements for real estate appraisals and appraisers.[1] Real estate valuations, which encompass appraisals and other value estimation methods, play a critical role in mortgage underwriting by providing evidence that the market value of a property is sufficient to help mitigate losses if the borrower is unable to repay the loan. However, turmoil in the mortgage market raised questions about mortgage underwriting practices, including the quality and credibility of some valuations. An investigation into industry appraisal practices by the New York State Attorney General led to an agreement in 2008 between the Attorney General, Fannie Mae and Freddie Mac (the enterprises), and the Federal Housing Finance Agency (FHFA), which regulates the enterprises, that included the Home Valuation Code of Conduct (HVCC).[2] HVCC set forth certain appraiser independence requirements for loans sold to the enterprises and took effect in 2009. Although the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) declared HVCC no longer in effect, it codified several of HVCC's provisions.[3] The Dodd-Frank Act also amended Title XI of the Financial

[1]FFIEC is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Bureau of Consumer Financial Protection and to make recommendations to promote uniformity in the supervision of financial institutions.

[2]The enterprises purchase mortgages that meet specified underwriting criteria from approved lenders. The enterprises bundle most of the mortgages they purchase into securities and guarantee the timely payment of principal and interest to investors in the securities. On September 6, 2008, the enterprises were placed under federal conservatorship out of concern that their deteriorating financial condition and potential default on $5.4 trillion in outstanding financial obligations threatened the stability of financial markets.

[3]Pub. L. No. 111-203. Congress enacted the Dodd-Frank Act in July 2010. The Dodd-Frank Act stated that HVCC ceased to be effective as of the date the Board of Governors of the Federal Reserve System (Federal Reserve) issued interim final rules covering appraiser independence. Dodd-Frank Act § 1472(a) (codified at 15 U.S.C. § 1639e(j)). The Federal Reserve issued these rules on October 28, 2010. 75 Fed. Reg. 66554. The enterprises have incorporated many of the other provisions of HVCC into their requirements.

Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which made reforms to address the quality of appraisals and appraiser qualifications and created ASC to monitor Title XI's implementation. Among other things, the Dodd-Frank Act gave ASC additional responsibilities and authorities.

The Dodd-Frank Act also directed us to perform two studies concerning real estate appraisals.[4] The first, which we issued in July 2011, included an examination of real estate valuation methods, including appraisals, and conflict-of-interest and appraiser-selection policies.[5] The second, which we issued in January 2012, included an assessment of ASC's monitoring functions and discussed challenges that ASC faces in implementing its new responsibilities and authorities.[6]

My statement today is based on information from those two reports. Specifically, I will discuss (1) the use of different valuation methods for single-family residential mortgages and the advantages and disadvantages of each method, (2) policies on appraiser conflict-of-interest and selection and views on the policies' impact on industry stakeholders and appraisal quality; and (3) ASC's performance of its Title XI functions that existed prior to the Dodd-Frank Act and challenges that it faces in implementing additional responsibilities under the act. To do this work, we analyzed proprietary data we obtained from the enterprises, lenders, and a mortgage technology company on the use of different valuation methods and appraisal approaches.[7] We reviewed academic and industry literature on real estate valuation and examined federal regulations and policies, as well as lenders' and appraisal management companies' (AMC) internal policies on and procedures for selecting

[4]Dodd-Frank Act § 1476.

[5]GAO, *Residential Appraisals: Opportunities to Enhance Oversight of an Evolving Industry*, GAO-11-653 (Washington, D.C.: July 13, 2011).

[6]GAO, *Real Estate Appraisals: Appraisal Subcommittee Needs to Improve Monitoring Procedures*, GAO-12-147 (Washington, D.C.: Jan. 18, 2012).

[7]See GAO-11-653 for more information about the data we obtained for this study.

appraisers.[8] We also reviewed ASC's policies and procedures, including its rules of operation, policy and procedures manual, Title XI policy statements, and compliance review manual. In addition, we reviewed ASC records such as its annual reports to Congress, board-meeting minutes, state compliance review reports, and grant documents. We interviewed a broad range of appraisal and mortgage industry participants and stakeholders, including officials from the enterprises, FHFA, the federal banking regulatory agencies, and ASC. Additionally, prior to this hearing, we interviewed federal regulators to update the status of our recommendations. The work that this statement is based on was performed from July 2010 to June 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Before originating a residential mortgage loan, a lender assesses its risk through the underwriting process, in which the lender generally examines the borrower's credit history and capacity to repay the mortgage and obtains a valuation of the property that will be the loan's collateral. Lenders need to know the property's market value, or the probable price that the property should bring in a competitive and open market, in order to provide information for assessing their potential loss exposure if the borrower defaults.[9] Real estate can be valued using a number of methods, including appraisals, broker price opinions (BPO), and automated valuation models (AVM). Appraisals are opinions of value based on market research and analysis as of a specific date. Appraisals

[8]The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203) defines an AMC as a third party that oversees a network or panel of more than 15 appraisers within a state or 25 or more appraisers nationally in a given year and has been authorized by lenders to recruit, select, and retain appraisers; contract with appraisers to perform appraisal assignments; manage the process of having an appraisal performed; or review and verify the work of appraisers. Dodd-Frank Act § 1473(f)(4) (codified at 12 U.S.C. § 3550(11)).

[9]The enterprises and federal banking regulators define market value as the most probable price that a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus.

are performed by state-licensed or -certified appraisers who are required to follow the Uniform Standards of Professional Appraisal Practice (USPAP).[10] A BPO is an estimate of the probable selling price of a particular property prepared by a real estate broker, agent, or salesperson rather than by an appraiser. An AVM is a computerized model that estimates property values using public record data, such as tax records and information kept by county recorders, multiple listing services, and other real estate records.[11]

In 1986, the House Committee on Government Operations issued a report concluding that problematic appraisals were an important contributor to the losses that the federal government suffered during the savings and loan crisis.[12] The report stated that hundreds of savings and loans chartered or insured by the federal government were severely weakened or declared insolvent because faulty and fraudulent real estate appraisals provided documentation for loans larger than what the collateral's real value justified. In response, Congress incorporated provisions in Title XI of FIRREA that were intended to ensure that appraisals performed for federally related transactions were done (1) in writing, in accordance with uniform professional standards, and (2) by individuals whose competency had been demonstrated and whose professional conduct was subject to effective supervision.[13]

Various private, state, and federal entities have roles in the Title XI regulatory structure:

- *The Appraisal Foundation.* The Appraisal Foundation is a private not-for-profit corporation composed of groups from the real estate industry that works to foster professionalism in appraising. The foundation

[10]USPAP covers both the principles appraisers must apply in developing appraisals and the information the appraisal report must contain.

[11]A multiple listing service is a database set up by a group of real estate brokers to provide information about properties sold and for sale.

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

[13]12 U.S.C. §§ 3331, 3339-3345. Federally related transactions are real estate transactions that require the services of an appraiser and involve financial institutions regulated by the federal government.

sponsors two independent boards with responsibilities under Title XI. The first of these, the Appraisal Standards Board, sets rules for developing an appraisal and reporting its results through USPAP. The second board, the Appraiser Qualifications Board, establishes the minimum qualification criteria for state certification and licensing of real property appraisers.[14] The foundation is funded primarily by sales of publications but also receives an annual grant from ASC.

- *State-level regulatory entities.* Title XI relies on the states to (1) implement the certification and licensing of all real estate appraisers and (2) monitor and supervise appraisers' compliance with appraisal standards and requirements. To assure the availability of certified and licensed appraisers, all 50 states, the District of Columbia, and four U.S. territories have adopted structures to regulate and supervise the appraisal industry.[15] These structures typically consist of a state regulatory agency and a board or commission that establish requirements for education and experience, consistent with or in excess of Appraiser Qualifications Board criteria; license and certify appraisers; and monitor and enforce appraiser compliance.
- *Federal banking regulators.* Title XI places responsibility for regulating appraisals and "evaluations" performed in conjunction with federally related transactions with the Board of Governors of the Federal Reserve System (Federal Reserve), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and the National Credit Union Administration (NCUA).[16] To meet this responsibility, these financial institution regulators have established requirements for appraisals and evaluations through regulations and have jointly issued Interagency Appraisal and Evaluation Guidelines. The federal regulators have developed procedures for examining the real estate lending activities of regulated institutions that include steps

[14]Certified appraisers are qualified to appraise properties of greater complexity and value than licensed appraisers and must meet higher requirements for education and experience.

[15]The four territories are Guam, Northern Mariana Islands, Puerto Rico, and the Virgin Islands.

[16]Evaluations are estimates of market value that do not have to be performed by a state-licensed or -certified appraiser. The federal banking regulators permit evaluations to be performed (consistent with safe and sound lending practices) in certain circumstances, such as mortgage transactions of $250,000 or less that are conducted by regulated institutions.

for assessing the completeness, adequacy, and appropriateness of these institutions' appraisal and evaluation policies and procedures.

- *Appraisal Subcommittee.* ASC has responsibility for monitoring the implementation of Title XI by the private, state, and federal entities noted previously. Among other things, ASC is responsible for (1) monitoring and reviewing the practices, procedures, activities, and organizational structure of the Appraisal Foundation—including making grants to the Foundation in amounts that it deems appropriate to help defray costs associated with its Title XI activities; (2) monitoring the requirements that states and their appraiser regulatory agencies establish for the certification and licensing of appraisers; (3) monitoring the requirements established by the federal banking regulators regarding appraisal standards for federally related transactions and determinations of which federally related transactions will require the services of state-licensed or -certified appraisers; and (4) maintaining a national registry of state-licensed and -certified appraisers who can perform appraisals for federally related transactions. Among other responsibilities and authorities, the Dodd-Frank Act requires ASC to implement a national appraisal complaint hotline and provides ASC with limited rulemaking authority. To carry out these tasks, ASC has 7 board member positions and 10 staff headed by an Executive Director hired by the board. Five of the board members are designated by the federal agencies that are part of FFIEC—the Bureau of Consumer Financial Protection (also known as the Consumer Financial Protection Bureau or CFPB), FDIC, the Federal Reserve, NCUA, and OCC. The other two board members are designated by the U.S. Department of Housing and Urban Development (HUD)—which includes the Federal Housing Administration (FHA)—and FHFA. ASC is funded by appraiser registration fees that totaled $2.6 million in fiscal year 2011.

The Widespread Use of Appraisals for Mortgage Originations Reflects Their Advantages Relative to Other Valuation Methods

Available data and interviews with lenders and other mortgage industry participants indicate that appraisals are the most frequently used valuation method for home purchase and refinance mortgage originations. Appraisals provide an opinion of market value at a point in time and reflect prevailing economic and housing market conditions. Data provided to us by the five largest lenders (measured by dollar volume of mortgage originations in 2010) show that, for the first-lien residential mortgages for which data were available, these lenders obtained appraisals for about 90 percent of the mortgages they made in 2009 and 2010, including 98 percent of home purchase mortgages. The data we obtained from lenders included mortgages sold to the enterprises and mortgages insured by FHA, which together accounted for the bulk of the mortgages originated in 2009 and 2010. The enterprises and FHA require appraisals to be performed for a large majority of the mortgages they purchase or insure. For mortgages for which an appraisal was not done, the lenders we spoke with reported that they generally relied on validation of the sales price (or loan amounts in the case of refinances) against an AVM-generated value, in accordance with enterprise policies that permit this practice for some mortgages that have characteristics associated with a lower default risk.

The enterprises, FHA, and lenders require and obtain appraisals for most mortgages because mortgage industry participants consider appraising to be the most credible and reliable valuation method, for a number of reasons. Most notably, appraisals and appraisers are subject to specific requirements and standards. In particular, USPAP outlines the steps appraisers must take in developing appraisals and the information appraisal reports must contain. It also requires that appraisers follow standards for ethical conduct and have the competence needed for a particular assignment. Furthermore, state licensing and certification requirements for appraisers include minimum education and experience criteria, and standardized report forms provide a way to report relevant appraisal information in a consistent format.

In contrast, other valuation methods such as BPOs and AVMs are not permitted for most purchase and refinance mortgage originations. The enterprises do not permit lenders to use BPOs for mortgage originations and permit lenders to use AVMs for only a modest percentage of mortgages they purchase. Additionally, the federal banking regulators' guidelines state that BPOs and AVMs cannot be used as the primary basis for determining property values for mortgages originated by regulated institutions. However, the enterprises and lenders use BPOs and AVMs in a number of circumstances other than purchase and refinance mortgage originations because these methods can provide a quicker, less expensive means of valuing properties in active markets.

When performing appraisals, appraisers can use one or more of three approaches to value—sales comparison, cost, and income. The sales comparison approach compares and contrasts the property under appraisal with recent offerings and sales of similar properties. The cost approach is based on an estimate of the value of the land plus what it would cost to replace or reproduce the improvements minus depreciation. The income approach is an estimate of what a prudent investor would pay based upon the net income the property produces. USPAP requires appraisers to consider which approaches to value are applicable and necessary to perform a credible appraisal and provide an opinion of the market value of a particular property. Appraisers must then reconcile the values produced by the different approaches they use to reach a value conclusion.

The enterprises and FHA require that, at a minimum, appraisers use the sales comparison approach for all appraisals because it is considered the most applicable for estimating market value in typical mortgage transactions. Consistent with these policies, our review of valuation data from a mortgage technology company—representing about 20 percent of mortgage originations in 2010—indicated that appraisers used the sales comparison approach for nearly all (more than 99 percent) of the mortgages covered by these data.[17] The cost approach, which was generally used in conjunction with the sales comparison approach, was used somewhat less often—in approximately two-thirds of the transactions in 2009 and 2010, according to these data. The income approach was rarely used. Some mortgage industry stakeholders have argued that wider use of the cost approach in particular could help mitigate what they viewed as a limitation of the sales comparison approach. They told us that relying solely on the sales comparison approach could lead to market values rising to unsustainable levels and that using the cost approach as a check on the sales comparison approach could help lenders and appraisers identify when this is happening. For example, they pointed to a growing gap between average market values and average replacement costs of properties as the housing bubble developed in the early to mid-2000s. However, other mortgage industry participants noted that a rigorous application of the cost approach might not generate values much different from those generated using the sales comparison approach. They indicated, for example, that components of the cost approach—such as land value or profit margins of real estate developers—could grow rapidly in housing markets where sales prices are increasing. The data we obtained did not allow us to analyze the differences between the values appraisers generated using the different approaches.

[17]The enterprises and lenders we spoke with did not capture data on the prevalence of approaches used to perform appraisals.

Conflict-of-Interest Policies Have Changed Appraiser Selection Processes, with Implications for Appraisal Oversight

Recently issued policies reinforce long-standing requirements and guidance designed to address conflicts of interest that may arise when direct or indirect personal interests bias appraisers from exercising their independent professional judgment. In order to prevent appraisers from being pressured, the federal banking regulators, the enterprises, FHA, and other agencies have regulations and policies governing the selection of, communications with, and coercion of appraisers. Examples of recently issued policies that address appraiser independence include the now-defunct HVCC, which took effect in May 2009; the enterprises' new appraiser independence requirements that replaced HVCC in October 2010; provisions in the Dodd-Frank Act; and revised Interagency Appraisal and Evaluation Guidelines from the federal banking regulators that were issued in December 2010. Provisions of these and other policies address (1) prohibitions against the involvement of loan production staff in appraiser selection and supervision; (2) prohibitions against third parties with an interest in the mortgage transaction, such as real estate agents or mortgage brokers, selecting appraisers; (3) limits on communications with appraisers; and (4) prohibitions against coercive behaviors.

According to mortgage industry participants, HVCC and other factors have contributed to changes in appraiser selection processes—in particular, to lenders' more frequent use of AMCs to select appraisers. AMCs are third parties that, among other things, select appraisers for appraisal assignments on behalf of lenders. Some appraisal industry participants said that HVCC, which required additional layers of separation between loan production staff and appraisers for mortgages sold to the enterprises, led some lenders to outsource appraisal functions to AMCs because they thought using AMCs would allow them to easily demonstrate compliance with these requirements. In addition, lenders and other mortgage industry participants told us that market conditions, including an increase in the number of mortgages originated during the mid-2000s and lenders' geographic expansion over the years, put pressure on lenders' capacity to manage appraisers and led to their reliance on AMCs.[18]

[18]Although industrywide data on lenders' use of AMCs over time are unavailable, appraisal industry participants told us that between 60 and 80 percent of appraisals were currently ordered through AMCs. They provided varying estimates of AMC use prior to HVCC that ranged from 15 percent to 50 percent of mortgage originations.

Greater use of AMCs has raised questions about oversight of these firms and their impact on appraisal quality. Direct federal oversight of AMCs is limited. Federal banking regulators' guidelines for lenders' own appraisal functions list standards for appraiser selection, appraisal review, and reviewer qualifications. The guidelines also require lenders to establish processes to help ensure that these standards are met when lenders outsource appraisal functions to third parties, such as AMCs. Officials from the federal banking regulators told us that they reviewed lenders' policies and controls for overseeing AMCs, including the due diligence performed when selecting AMCs. However, they told us that they generally did not review an AMC's operations directly unless they had serious concerns about it that the lender was unable to address. In addition, a number of states began regulating AMCs in 2009, but the regulatory requirements vary and provide somewhat differing levels of oversight, according to officials from several state appraiser regulatory boards.

Some appraiser groups and other appraisal industry participants have expressed concern that existing oversight may not provide adequate assurance that AMCs are complying with industry standards. These participants suggested that the practices of some AMCs for selecting appraisers, reviewing appraisal reports, and establishing qualifications for appraisal reviewers—key areas addressed in federal guidelines for lenders' appraisal functions—may have led to a decline in appraisal quality. For example, appraiser groups said that some AMCs selected appraisers based on who would accept the lowest fee and complete the appraisal report the fastest rather than on who was the most qualified, had the appropriate experience, and was familiar with the relevant neighborhood. AMC officials we spoke with said that they had processes that addressed these areas of concern—for example, using an automated system that identified the most qualified appraiser based on the requirements for the assignment, proximity to the subject property, and performance metrics such as timeliness and appraisal quality.

While the impact of the increased use of AMCs on appraisal quality is unclear, Congress recognized the importance of additional AMC oversight in enacting the Dodd-Frank Act by requiring state appraiser regulatory boards to supervise AMCs. The Dodd-Frank Act requires the federal banking regulators, CFPB, and FHFA to establish minimum standards for states to apply in registering AMCs, including requirements that appraisals coordinated by an AMC comply with USPAP and be conducted independently and free from inappropriate influence and coercion.[19] This rulemaking provides a potential avenue for reinforcing existing federal requirements for key functions that may impact appraisal quality, such as selecting appraisers, reviewing appraisals, and establishing qualifications for appraisal reviewers. Such reinforcement could help to provide greater assurance to lenders, the enterprises, and federal agencies of the quality of the appraisals provided by AMCs.

To help ensure more consistent and effective oversight of the appraisal industry, we recommended in our July 2011 report that the heads of the federal banking regulators, CFPB, and FHFA—as part of their joint rulemaking required under the Dodd-Frank Act—consider including criteria for the selection of appraisers for appraisal orders, review of completed appraisals, and qualifications for appraisal reviewers when developing minimum standards for state registration of AMCs.[20] The federal banking regulators and FHFA agreed with or indicated that they would consider our recommendation but as of June 2012 had not issued a rule setting minimum standards for state registration of AMCs.[21]

Several Weaknesses Have Potentially Limited ASC's Effectiveness in Performing Its Title XI Functions

ASC has been performing its monitoring role under Title XI, but several weaknesses have potentially limited its effectiveness. In particular, ASC has not fully developed appropriate policies and procedures for monitoring state appraiser regulatory agencies, the federal banking regulators, and the Appraisal Foundation. In addition, ASC faces potential challenges in implementing some Dodd-Frank Act provisions.

Monitoring States' Compliance with Title XI

ASC has detailed policies and procedures for monitoring state appraiser regulatory programs and has issued 10 policy statements covering different aspects of states' implementation of Title XI requirements. The policy statements cover topics including submission of data to the

[19]Dodd-Frank Act § 1473(f)(2) (codified at 12 U.S.C. § 3353(a)).

[20]GAO-11-653.

[21]CFPB did not receive a draft of our July 2011 report in time to comment on our recommendation.

national registry of appraisers, license reciprocity (which enables an appraiser certified or licensed in one state to perform appraisals in other states), and programs for enforcing appraiser qualifications and standards. ASC primarily uses on-site reviews conducted by ASC staff to monitor states' compliance with the policy statements. ASC's routine compliance reviews examine each state every 2 years or annually if ASC determines that a state needs closer monitoring. These reviews are designed to encourage adherence to Title XI requirements by identifying any instances of noncompliance or "areas of concern" and recommending corrective actions.[22] ASC conveys its findings and recommendations to states through written reports. In 2010, ASC reported 34 findings of noncompliance, the majority of which concerned weaknesses in state enforcement efforts, such as a lack of timeliness in resolving complaints about appraiser misconduct or wrongdoing. At the completion of each review, ASC executive staff and board members deliberate on the findings and place the state into one of three broad compliance categories: "in substantial compliance," "not in substantial compliance," and "not in compliance." According to ASC, in substantial compliance applies when there are no issues of noncompliance or no violations of Title XI; not in substantial compliance applies when there are one or more issues of noncompliance or violations of Title XI that do not rise to the level of not in compliance; and not in compliance applies when "the number, seriousness, and/or repetitiveness of the Title XI violations warrant this finding."[23]

We found that ASC had been using the three compliance categories in its reports to states and annual reports to Congress (which provide aggregate statistics on the number of states in each category). However, it had not included the definitions of the categories in these reports or in its compliance review manual or policy and procedures manual, and its definition of "not in compliance" was not clear or specific.[24] As previously

[22]ASC defines an area of concern as one in which the state is in compliance but could improve.

[23]Because a state only has to have one noncompliance finding to be "not in substantial compliance," this category can encompass a fairly wide range of performance. For example, in 2009, states in this category had from one to seven findings of noncompliance.

[24]In June 2012, ASC officials told us they had begun incorporating the definitions in ASC reports and policies.

noted, the definition states only that the category is to be used "when the number, seriousness, and/or repetitiveness of the violations warrant this finding" and does not elaborate on how these factors are weighed or provide examples of situations that would meet this definition. These shortcomings are inconsistent with our internal control standards, which state that federal agencies should have appropriate policies and procedures for each of their activities.[25] Without clear, disclosed definitions, ASC limits the transparency of the state compliance review process and the usefulness of information Congress receives to assess states' implementation of Title XI. Further, by not incorporating the definitions into its compliance review and policy and procedures manuals, ASC increases the risk that board members and staff may not interpret and apply the compliance categories in a consistent manner. To address these shortcomings, we recommended in our January 2012 report that ASC clarify the definitions it uses to categorize states' overall compliance with Title XI and include these definitions in ASC's compliance review and policy and procedures manuals, compliance review reports to states, and annual reports to Congress.[26] In June 2012, ASC officials told us that they had developed a revised system for rating states that included five compliance categories (ranging from excellent to poor), each with specific criteria. They said that they would soon be publishing the compliance categories in the *Federal Register* to obtain public comments and would include the final categories in appropriate manuals and reports.

In addition to this procedural weakness, ASC has functioned without regulations and enforcement tools that could be useful in promoting state compliance with Title XI. Prior to the Dodd-Frank Act, Title XI did not give ASC rulemaking authority and provided it with only one enforcement option—"derecognition" of a state's appraiser regulatory program. This action would prohibit all licensed or certified appraisers from that state from performing appraisals in conjunction with federally related transactions. ASC has never derecognized a state, and ASC officials told us that using this sanction would have a devastating effect on the real estate markets and financial institutions within the state. The Dodd-Frank Act provides ASC with limited rulemaking authority and authorizes ASC to

[25]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999) and *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: August 2001).

[26]GAO-12-147.

impose (unspecified) interim actions and suspensions against a state agency as an alternative to, or in advance of, the derecognition of the agency.[27] As of June 2012, ASC had not implemented this new enforcement authority. ASC officials said that determining the interim actions and suspensions they would take against state agencies would be done through future rulemaking.

Monitoring the Appraisal Requirements of the Federal Banking Regulators

Although Title XI charges ASC with monitoring the appraisal requirements of the federal banking regulators, ASC has not developed policies and procedures for carrying out this responsibility. While ASC's policy manual provides detailed guidance on monitoring state appraiser regulatory programs, it does not mention any activities associated with monitoring the appraisal requirements of the federal banking regulators. Further, ASC officials acknowledged the absence of a formal monitoring process. The absence of policies and procedures specifying monitoring tasks and responsibilities limits accountability for this function and is inconsistent with federal internal control standards designed to help ensure effectiveness and efficiency in agency operations.

According to ASC officials, ASC performs this monitoring function through informal means, primarily through its board members who are employed by the federal banking regulators. However, minutes from ASC's monthly board meetings and ASC's annual reports to Congress indicate that the monitoring activities of ASC as a whole have been limited. For example, our review of board-meeting minutes from 2003 through 2010 found no instances of the board discussing the appraisal requirements of the federal financial regulators.[28] Additionally, evidence of this monitoring function in ASC's annual reports is limited to a summary of any new appraisal requirements issued by the federal financial regulators and HUD during the preceding year.

[27]The act also gives ASC the authority to remove a state-licensed or -certified appraiser or a registered AMC from the national registry on an interim basis, not to exceed 90 days, pending state agency action on licensing, certification, registration, and disciplinary proceedings. In June 2012, ASC officials told us that they had developed policies to implement this authority and planned to publish the policies in the *Federal Register* to obtain public comment.

[28]The minutes indicated that on at least two occasions, the HUD representative to the ASC board provided updates on appraisal policies for mortgages insured by FHA.

Stakeholder views differ as to how to interpret the Title XI requirement that ASC monitor the requirements established by the federal banking regulators with respect to appraisal standards.[29] Specifically, some ASC board members told us that they understand their monitoring role as maintaining an awareness of the federal financial regulators' appraisal requirements. Further, one ASC board member told us that ASC's monitoring of the federal financial regulators was more limited than its monitoring of states because (1) board members from the federal financial regulatory agencies are knowledgeable of the appraisal requirements of their agencies, (2) the federal regulators' interagency process for developing appraisal guidelines (in place since 1994) has reduced the need for monitoring the consistency of guidelines across agencies, and (3) monitoring the states' appraiser requirements requires in-depth review of state processes for licensing, certification, and enforcement.

In contrast, some appraisal industry stakeholders and observers have proposed a larger ASC role in monitoring the appraisal requirements of the federal banking regulators. An ASC board member who conducted a review of ASC's operations in 2007 recommended a more structured and active monitoring role for ASC. The board member's report—which the board never officially adopted—suggested that ASC staff could be assigned to keep abreast of federal financial regulators' requirements and guidelines; the staff could then assess the impact of the requirements on ASC's operations and policies. Under this proposed recommendation, which ASC did not implement, ASC staff would annually report the results of this work to the ASC board members.[30] A former General Counsel of ASC told us that ASC's monitoring role should include critically assessing the adequacy of the federal financial regulators' appraisal requirements and evaluating how well the requirements are being implemented. He indicated that such assessment might have helped federal financial regulators and policymakers address issues such as appraiser independence, establishing dollar-based exemptions from appraisal requirements, and referral of Title XI violations to state agencies. A representative of an appraisal industry group expressed a similar view

[29] 12 U.S.C. § 3332(a)(2).

[30] ASC adopted some of the report's recommendations, such as creating a Deputy Executive Director position and allowing states to respond to preliminary compliance review findings prior to the issuance of final reports.

and noted that ASC's annual reports did not provide substantive analysis or critique of federal appraisal requirements.

However, appraisal industry stakeholders also noted that implementing a more expansive interpretation of ASC's monitoring role would pose challenges. For example, existing ASC staff may not have the capacity to take on additional monitoring responsibilities. Even if ASC staff were able to independently analyze the federal regulators' appraisal requirements, the analysis would be subject to review by the ASC board, which, because of its composition, is not independent from the agencies that ASC is charged with monitoring.

To better define the scope of its monitoring role and improve the transparency of its activities, we recommended in our January 2012 report that ASC develop specific policies and procedures for monitoring the appraisal requirements of the federal banking regulators.[31] In June 2012, ASC officials told us that they recognized the need for ASC to perform this monitoring function, were deliberating on ways to carry it out, and expected to have policies and procedures in place later in the year.

Monitoring the Appraisal Foundation's Grant Activities

As previously noted, the Appraisal Foundation is a private not-for-profit corporation that sponsors independent boards that set standards for appraisals and minimum qualification criteria for appraisers. ASC approves an annual grant proposal and provides monthly grant reimbursements to the Appraisal Foundation to support the Title XI-related activities of the foundation and its Appraisal Standards Board and Appraiser Qualifications Board. The reimbursements cover the foundation's incurred costs for activities under the grant. From fiscal years 2000 through 2010, ASC provided the foundation over $11 million in grant reimbursements, or about 40 percent of ASC's expenditures over that period.

Although ASC monitors the foundation in several ways, ASC lacks specific policies and procedures for determining whether grant activities are related to Title XI. ASC's policies and procedures manual does not address how ASC monitors the Appraisal Foundation. Instead, ASC uses monitoring procedures contained in a memorandum prepared by a former

[31]GAO-12-147.

Executive Director. The memorandum describes how the Executive Director reviewed the foundation's grant activities but does not provide criteria for deciding what is Title XI-related. When we asked current ASC officials for the criteria they used, they indicated only that ASC staff "review submissions from the Foundation and supporting cost spreadsheets to determine that activities proposed in the annual grant request or the monthly reimbursement processes meet the requirements of Title XI." They said that once staff determine whether or not a submission falls within these parameters, they make a recommendation to the ASC board. However, determinations about what activities are Title XI-related are not always clear-cut. For example, in 2003, the Executive Director at the time recommended that the foundation be reimbursed for certain legal expenses in connection with a complaint filed with the foundation's ethics committee. However, the ASC board rejected the reimbursement request because the expenses "were not sufficiently Title XI-related." ASC's records do not indicate what criteria either the Executive Director or the ASC board used as a basis for their decisions or why they disagreed. Similarly, our review of ASC documents for more recent grants found no supporting explanations for decisions about whether grant activities were Title XI-related. One ASC board member said the board had a common understanding of what activities were eligible for grants but acknowledged that the basis for funding decisions could be better documented. As previously noted, our internal control standards state that federal agencies should have appropriate policies for each of their activities. Without policies that contain specific criteria, ASC increases the risk that its grant decisions will be inconsistent, limits the transparency of its decisions, and lacks assurance that it is complying with federal internal control standards. To address this limitation, we recommended that ASC develop specific criteria for assessing whether the grant activities of the Appraisal Foundation were related to Title XI and include these criteria in ASC's policy and procedures manual.[32] In June 2012, ASC officials told us that they had been developing these criteria and planned to finalize them by August 2012.

Implementing Dodd-Frank Act Provisions

The Dodd-Frank Act contains 14 provisions that give ASC a number of new responsibilities and authorities. Some of the tasks associated with these provisions are complex and challenging, especially for a small

[32]GAO-12-147.

agency with limited resources. One of the more complex tasks for ASC is to establish a national appraisal complaint hotline and refer hotline complaints to appropriate governmental bodies for further action.[33] Appraisal industry stakeholders we spoke with noted that creating and maintaining a hotline could be costly because it will likely require investments in staff and information technology to fully ensure that calls are properly received, screened, tracked, and referred. Stakeholders indicated that screening calls would be a critical and challenging job because frivolous complaints could overwhelm the system and identifying valid complaints would require knowledge of USPAP.

Another complex task for ASC is providing grants to state appraiser regulatory agencies to support these agencies' compliance with Title XI. Appraisal industry stakeholders cited challenges that ASC could face in designing the grant program and the decisions it will need to make. Some noted the challenge of designing grant eligibility and award criteria that (1) do not reward states that have weak appraiser regulatory programs because they use appraisal-related fee revenues (from state appraiser licensing and examination fees, for example) for purposes other than appraiser oversight and (2) will not create incentives for states to use less of their own resources for regulation of appraisers. In addition, ASC officials said they were unsure whether a January 2012 increase in the national registry fee—from $25 to $40 per appraiser credential—would be adequate to fund the grants and oversee them, especially in light of recent declines in the number of appraisers.[34]

As of June 2012, ASC had not implemented either the national hotline or the state grant program but had completed some initial steps. For example, ASC officials told us that they had developed initial protocols for handling hotline complaints and had begun work on a complaint form, website, and call center. In addition, ASC is in the process of hiring a grants manager.

[33]The Dodd-Frank Act first required ASC to determine whether a national hotline existed that received complaints of noncompliance with appraisal independence standards and USPAP. ASC completed this task in January 2011, within the statutory deadline, and reported that no such hotline existed. The Dodd-Frank Act requires ASC to establish and operate such a hotline upon making that determination.

[34]Although the Dodd-Frank Act also authorizes ASC to collect registry fees from AMCs, revenues from this source may not be available for several years because regulations for AMC registration must be developed and implemented first.

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, this concludes my prepared statement. I am happy to respond to any questions you may have at this time.

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Appraisal Oversight: The Regulatory Impact on Consumers and Businesses

Testimony of Sara W. Stephens, MAI, CRE

Before the Subcommittee on Insurance, Housing and Community Opportunity

House Committee on Financial Services

June 28, 2012

June 28, 2012

Madam Chairman Biggert, Ranking Member Gutierrez, and members of the Subcommittee on Housing and Community Opportunity, thank you for the opportunity to share our concerns regarding "Appraisal Oversight: The Regulatory Impact on Consumer and Businesses" on behalf of the more than 23,000 members of the Appraisal Institute, the largest professional association of real estate appraisers in the United States.

Today, residential appraisers face ever-mounting challenges that place the future of residential appraisal at risk. The appraisal regulatory structure has become almost entirely a "rules-based," as opposed to a "principles-based," system. As such, it has become a burden to appraisers and, in our view, has failed to improve overall appraisal quality or appraiser oversight and enforcement.

While appraising arguably is the most heavily regulated activity within the mortgage and real estate sectors, we warn Congress that a new and excessive regulatory regime is on the cusp of being enacted by appraiser regulatory agencies ***without*** Congressional review or authorization. This is a dangerous and unjustified move that risks hamstringing and jeopardizing the real estate appraisal profession altogether.

At a very basic level, the appraiser regulatory structure lacks fundamental accountability measures. In its report to Congress, the Government Accountability Office identified significant violations of internal control standards by entities that claimed such standards were designed to promote effectiveness and efficiency, and to promote accountability. We commend the GAO for these findings, yet, there are even more concerns that require further investigation and action by Congress.

Additionally, residential appraisers report that increased regulatory and investor requirements, coupled with client demands for cheaper and faster appraisals, have forced many highly qualified appraisers out of the mortgage appraisal business, or out of the profession altogether. Failures by bank regulators and financial institutions to enforce and adhere to basic appraiser independence requirements have turned the appraisal procurement system upside-down, revealing core, underlying weaknesses that place a drag on appraisal quality.

We believe that there is a better way forward – but it requires engagement and action by Congress. To date, Congress has chosen to review the appraisal regulatory structure only once in 20 years. This cannot continue, as the regulatory structure of today is nothing like what Congress enacted more than 20 years ago. Professional real estate appraisers throughout the country are united in calling on Congress to enact structural reforms that realign appraisal regulations to focus oversight and declining enforcement resources where they are needed most; to eliminate or curtail rules that hamstring the appraisal process; and to support full consumer disclosure of fees relating to appraisal management processes.

Part 1. The Appraisal Regulatory Structure

Appraisers Are Overwhelmed by Rules and Regulation

Real estate appraisers apparently have the most complicated and convoluted regulatory structure of any profession in the United States. While certification and licensure are common for many industries, in 1989, Congress enacted a federal overlay that created a federal agency called the Appraisal Subcommittee (ASC), and then authorized a private organization, The Appraisal Foundation (TAF), to promulgate federally-funded standards and qualifications. For the past 20 years, every state has established an appraiser regulatory agency to conduct licensing and oversight activities. State appraiser licensing requirements must satisfy those imposed by the Appraiser Qualifications Board of TAF, and states also must enforce appraisers utilizing the Uniform Standards of Professional Appraisal Practice (USPAP), which is codified in every state and published by the Appraisal Standards Board of TAF. To complete nearly all residential mortgage appraisals, an appraiser must be certified or licensed in a state, and must adhere to USPAP. Failure to do so can lead to disciplinary action by state appraisal boards and/or criminal prosecution by law enforcement agencies. Often, a complaint or accusation alone submitted to a state appraisal board is sufficient for a client to remove an appraiser from their approved appraiser list.

On top of these requirements, the Government Sponsored Enterprises (GSEs), Federal Housing Administration (FHA) and other federal agencies maintain supplemental requirements that are imposed on lenders selling or delivering loans to those agencies. For instance, Fannie Mae and Freddie Mac each have Seller/Service Guidelines that contain specific requirements for lenders relating to appraisals. As one example, the Seller/Servicer Guidelines require that comparable sales be no more than 12 months old. These requirements are often supplemented further by individual investor requirements that seek to comply with guidelines issued by the GSEs or FHA, or others in the secondary market. The imposition of several investor requirements has resulted in some lenders now requiring appraisers to include eight or nine comparable sales, where only three are required by the GSE seller/servicer guidelines. These requests for more information often are not found in the original scope of work, and appraisers therefore are not paid for the time and effort involved in conducting additional research. In recent years, appraisers have referred to this phenomenon as "scope creep," and their frustration is heightened given that many of requirements to add comparable sales just to satisfy lender requirements provides little or marginal benefit to the assignment results.

Further, over the past year, Fannie Mae and Freddie Mac have embarked on the Uniform Appraisal Dataset (UAD), which attempts to mine data from appraisals and perform cursory reviews prior to funding decisions. The UAD was established, in part, because the GSE's have admitted that their previous processes relating to appraisals failed. Fannie Mae or Freddie Mac only saw an appraisal if the loan went into foreclosure. While lenders are expected to conduct a thorough review of all appraisals prior to funding loans, that same expectation did not exist for the GSEs. The only information relating to the appraisal that the GSEs obtained prior to making a loan funding decision was the property's address and its market value. In essence, Fannie Mae and Freddie Mac delegated all of the appraisal review functions to lenders who were selling loans to the GSEs, and who were making loan decisions without all of the information relating to the collateral offered. UAD attempts to address this by establishing a system of quick quality control review of appraisals prior to making funding decisions. Additionally, the system is being used to track the performance of appraisers, for example, checking to see if Quality or Condition Ratings of properties used in multiple appraisal reports are consistent.

Of course, the new UAD comes with a set of rules that appraisers must adhere to for the loan to be eligible for sale to Fannie Mae and Freddie Mac. Among other things, the UAD requires appraisers to select responses to predetermined and defined fields within the Uniform Residential Appraisal Report (URAR), a form also established and maintained by Fannie Mae and Freddie Mac that is now considered the industry standard for most residential appraisals delivered to lenders or to the secondary market. For example, the UAD established a new ratings system for property condition and quality. Properties are now rated by appraisers on a scale of 1-6 for both condition and quality. Elsewhere within the URAR, appraisers are asked to make selections from predetermined drop-down boxes, with all of this information being captured by the GSE's for review of the information within the appraisal and performance measures of the appraisers.

Appraisal Practices Board

On top of all of the requirements established above, the regulatory burden for appraisers is on the cusp of being expanded exponentially because of a decision by TAF and the ASC to create something called an "Appraisal Practices Board" (APB). Congress restricted authorizations for TAF to the areas of appraisal standards and appraiser qualifications – Congress **did not** authorize TAF to codify appraisal methods and techniques.This new board's supposed purpose is to establish what TAF claims are "voluntary guidelines" for appraisers and state regulatory agencies. Some state Agencies already may have assumed that they must incorporate the APB positions into law.

The APB concept is a major departure from the consensus between the Federal government and the appraisal profession in the late 1980s. The stakeholders and Congress agreed that Federally Related Transactions needed a mandatory set of standards to increase confidence in the valuation of properties for federally related lending. Leading organizations in the profession contributed their existing standards to form a basis for a mandatory standard to be known as The Uniform Standards of Professional Appraisal Practice (USPAP). The contributed standards still form the core of USPAP. The understanding at that time, between Congress and the stakeholders, was that TAF would maintain the mandatory standards but voluntary guidance and voluntary standards relating to methods and techniques, along with educational offerings related to the body of knowledge would remain in the domain of the profession and academia. This consensus worked for almost 20 years. Unfortunately promotion of the Appraisal Practices Board by ASC and TAF dangerously casts consensus aside.

In order to understand this issue fully, some explanation of the difference between appraisal standards and appraisal methods and techniques is required. Appraisal "standards" are guiding mandatory principles, and they are "standard," meaning their application does not change much, if at all, with the situation. They involve broad, general concepts. Appraisal standards (I.e., USPAP in the United States) define such things as ethics and general steps needed for credible appraisal development and reporting. Conversely, "methods and techniques" are fluid. In other words, what they are and how they are applied is highly dependent on the specific circumstances. Those circumstances may be described as "best practices;" however, by its very definition, "best practices" are voluntary and cannot be codified.

Appraisal methods and techniques require *judgment* by the appraiser. It is assumed that the appraiser has been thoroughly trained to judge appropriate situations. The choice of methods and techniques are the responsibility of the appraiser in the development of his/her scope of work. Whether to use reproduction cost or replacement cost or when and how to adjust for sales concessions are dependent on the actions of the marketplace and should not be mandated by a body such as the APB. Real estate property types and markets are both extremely diverse. As a result, hard "rules of thumb" do not work within real estate appraisal because there always is an exception to the rule. What is more important is for the analysis conducted by the trained appraiser to be *thorough* and *credibly supported*.

Ever since the U.S. real estate appraisal profession was formally established some 80 years ago, appraisal methods and techniques have been limited to the academic community and professional appraisal organizations, not government agencies or those given certain authorizations by Congress. This was an important distinction established by Congress when it enacted the current appraisal regulatory structure in 1989.

Professional Appraiser Concerns
Even if the profession were to adopt a new trend of voluntary standards, TAF does not appear to have the capability to comply with cardinal rules of voluntary standard development. One need only examine the mission of longstanding Voluntary Standards Organizations such as the American National Standards Institute (ANSI), to note significant divergence.

From ANSI:

> ***Q: How does ANSI conduct its business?***
>
> ***A:*** *Overall, the Institute provides and promotes a process designed to protect the rights and interests of every participant through a set of four "cardinal principles."*

- *Openness – The ANSI process is fair and open. Any materially affected and interested party shall have the ability to participate.*
- *Balance – Participants should represent diverse interests and categories, and no single group should have dominance in standards development.*
- *Due Process – All objections shall have an attempt made towards their resolution. Interests who believe they have been treated unfairly have a right to appeal.*
- *Consensus – Agreements are reached when more than a majority, but not necessarily all, of the participants concur on a proposed solution.*

TAF and its APB are severely deficient in these areas.

In July 2011, the Appraisal Institute submitted testimony to this Committee outlining concerns regarding the decision to establish the APB, particularly the involvement of the ASC in its establishment and the virtually limitless authority of the new board. Over the past year, our concern about the negative impact of this board has only grown.

TAF, through its APB, is attempting to assert itself as the ultimate authority over all appraisal methods and techniques. This is problematic because the APB is not authorized by Congress, even though the average person would never know this because TAF consistently mentions it in the same breath as the "Authorized by Congress"

AQB and the ASB. We believe that Congress should exercise oversight over this insidious attempt to confuse the public by subtly abusing existing Congressional authority.

There are several reasons for our concern over the Appraisal Practices Board, as follows:

1. The establishment of the Appraisal Practices Board evidently was directed by the ASC or some of its influential members. When Congress established licensing and certification requirements for appraisers, it did not intend for the valuation process to be dictated by bank regulatory agencies, who, frankly, are not sufficiently staffed to delve into appraisal standards, let alone appraisal methodology. Here, it is worth noting that certification and licensing requirements apply to all types of federally related transactions, including residential and commercial real estate, so the impacts of this new entity truly impacts, and potentially creates a host of unintended consequences for, the entire profession.
2. The Appraisal Practices Board was established, despite strong objection from at least one federal bank examination agency representative on the TAF Task Force on Best Practices. According to a memo from a subject matter expert from the Federal Reserve of Atlanta that was sent prior to the release of the Final Report:

   > *"However, it is neither my recommendation to the Board staff as an assigned "technical resource," nor the Board staff's position that the Federal Reserve would be in favor of the creation of a separate 'Best Practices" Board. The structure of ASB and AQB being solely liaisons to this Board are also problematic and something I would advise against as a "technical resource."*[1]

   We understand that this position was agreed to by at least one other federal agency, in addition to the regional banks of the Federal Reserve. Further, it is worth noting that Federal funds were approved for reimbursement by the ASC to TAF for the purposes of this Task Force's activities.
3. The APB was established under a false premise – that timely guidance materials on appraisal methods and techniques do not exist for appraisers. On the contrary, ample guidance and education materials are widely available to all appraisers in the United States. As just one example, the *Appraisal of Real Estate, 13th Edition* is cited in more than 700 court decisions in the United States. As another, the Appraisal Institute developed a residential seminar – "Appraisal Challenges: Declining Markets and Sales Concessions" – prior to the market crash in 2007, and delivered this seminar to thousands of appraisers throughout the country. Other cutting edge and timely seminars have been developed and made available to the entire profession on such issues as declining commercial real estate valuation and use of statistics and new technology within appraisal practice. While the Appraisal Institute has 23,000 members, our education is available to all appraisers. In fact, the vast majority of appraisers have taken education from the Appraisal Institute is recent years.
4. Codifying appraisal methods and techniques will curtail innovation within the industry, and stunt the development of new methods and techniques, essentially putting the profession at risk. If such requirements had been in place 50 years ago, the development and integration of discounted cash flow techniques within the income approach of appraisal would have been difficult, if not impossible to do, as only those methods that are *recognized* would be allowed by law. This decreases the ability of appraisers to integrate new technological developments and to respond to and develop solutions that address actual market conditions.
5. Codifying appraisal methods and techniques exponentially increases the regulatory burden on appraisers and their clients. Having to adhere to a USPAP that changes every two years is enough, let alone adhering to agency and investor requirements. However, having to follow guideline documents as long as 50 pages in length dramatically increases compliance costs on appraisers and consumers of appraisal services. Further, codification of methods and techniques places far too much emphasis over the *performance of methods and techniques* (following the letter of the law) than applying appraisal principles to given situations.
6. Codifying methods and techniques increases the unlevel playing field real estate appraisers have with other valuation professionals, including CPAs and others involved in business and personal property

[1] Memo from K.C. Conway to David Wilkes regarding "Response to Draft Task Force Report to the Appraisal Foundation Board of Trustees," August 17, 2009. Available at http://www.appraisalinstitute.org/bg-pdfs/aug17-09-memo-aug21-best-practices.pdf

valuation. The guidance documents under development by the Appraisal Practices Board are multi-disciplinary, meaning they may be developed for real estate appraisal, but also, for business and personal property appraisal. Unlike real estate appraisers, CPAs, business and personal property appraisers have no certification or licensing requirements, nor any governmentally enforceable standards. As a result, adding an additional layer of rules and regulations around appraisal methods and techniques serves to place real estate appraisers at a competitive disadvantage where these sectors compete. This includes advisory services, valuation for financial reporting, and the valuation of hotels and motels and special purpose properties, such as convenience stores and car washes.

7. If the APB "Valuation Advisories" to date are any example, at least from a real property perspective, they generally add nothing new to the appraisal body of knowledge. For the most part, APB Valuation Advisories 2 and 3 mostly quote the previously referenced *The Appraisal of Real Estate* and USPAP.
8. Attempting to codify appraisal methods and techniques "flies in the face" of judicial discretion and Supreme Court rulings. By proposing to codify specific methods and techniques within USPAP, TAF is proposing to limit the types of evidence courts and regulatory bodies may consider. This is contrary to a recent Supreme Court ruling which affirmed that courts have the ability to determine whether valuation methodologies are reliable in any given instance or case. Further, this decision correctly states that appraisal is an applied science, even a craft.[2] Further, there is no list of what makes expert testimony credible. Expert testimony exists to educate the court, and courts have the discretion to decide for themselves what credible support for their education is[3].

Role of the ASC in the Creation of the APB

As we stated before this Committee last year, we have firm grounds to believe that the creation of the APB was inappropriately directed by the ASC, a move that is well beyond the statutory authority granted to the ASC by Congress.

Last year, this Committee received testimony from the ASC that it played no role in the establishment of the Appraisal Practices Board[4]. This statement contradicts the plain facts, which establish that the ASC was very much involved and participated in a highly orchestrated and concerted effort to create the Appraisal Practices Board. (A timeline of events may be found below.)

2008

- In December 2008, the ASC held a board meeting where the issue was discussed and at least two members of the board of the ASC encouraged TAF to undertake efforts to address appraisal methods and techniques (effectively driving a wedge between TAF and the Appraisal Institute). The meeting minutes acknowledge that such a move would be viewed negatively by professional appraisal organizations, so TAF successfully sought the support of the ASC in pursuit of the endeavor, stating:

  > *V. Gibbs and S. Gardner discussed their desire to have the USPAP include more direction on appraisal methodology. D. Bunton expressed a concern that encroaching on areas like methodology and instruction could potentially be viewed as "mission creep," particularly by Appraisal Foundation sponsoring organizations. S. Gardner stressed the need to venture into these areas to improve on concerns the ASC member organizations are seeing in the appraisals*

[2] See *CSX Transportation, Inc. v. State Board of Equalization of the State of Georgia*. *"Valuation is not a matter of mathematics, as if the district court could prevent discriminatory taxation simply by double checking the State's assessment equations. Rather, the calculation of true market value is an applied science, even a craft. Most appraisers estimate market value by employing not one methodology but a combination. These various methods generate a range of possible market values which the appraiser uses to derive what he considers to be an accurate estimate of market value, based on careful scrutiny of all the data available." Available at http://www.appraisalinstitute.org/bg-pdfs/CSX.pdf*

[3] See *Daubert v. Merrell Dow Pharmaceuticals*, a rule of evidence regarding the admissibility of expert witness testimony.

[4] At the July, 2011 hearing, Chairman Biggert asked what role, if any, the Appraisal Subcommittee played in the establishment of the Appraisal Practices Board. Mr. Park stated: *"The Appraisal Subcommittee played no role in the creation of the practices board."*

provided to their member banks and institutions. S. Guilfoil requested assurance that the ASC would support ASB efforts in this regard. S. Gardner provided the assurance and indicated the ASC would issue a letter, if necessary, with its specific request for this change in USPAP[5].

2009

- On January 21, 2009, TAF sent an email explaining that the ASC "expressed a strong concern" to TAF that timely guidance to appraisers does not exist. This email also advised that members of the ASC would help comprise a task force to explore the issue[6].
- On January 27, 2009, the TAF President sent an email explaining the make-up of the task force, stating, "Since the genesis of this issue came from the ASC, they will be appointing two representatives.[7]"
- On February 9, 2009, TAF sent a letter warning the Appraisal Institute that inquiries regarding the ASC concerns were a "private matter" involving TAF and the ASC[8].
- In April 2009, TAF advanced an amendment before this Committee for TAF to codify "best practices" and to be the authority for appraisal methods and techniques. The ASC participated in meetings with TAF as it sought the support of AI for the amendment. Ultimately, this amendment was not offered during the Dodd-Frank deliberations and was not considered by the Committee[9].
- In late April or early May 2009, two ASC board members were removed from the task force and replaced by two individuals, one from the Federal Reserve Bank of Atlanta and the other from a regional field office of the Office of Thrift Supervision, reportedly, because of legal and conflict of interest concerns.
- In the summer of 2009, the Federal Reserve Bank of Atlanta official participated in a phone conversation with the executive director of the ASC and the ASC board member from the Federal Reserve to discuss the task force and appraisal methods and techniques. The parties discussed funding options for development of "best practices" and TAF involvement in the development and delivery of education, including coordination for how TAF would issue Requests for Proposals.
- On August 17, 2009, the new task force representative from the Federal Reserve Bank of Atlanta expressed concerns in writing over the recommendations of the task force.
- In September 2009, the task force released its recommendations, which called for a panel to be established by TAF to develop recognized methods and techniques. In September 2009, the ASC approved a funding reimbursement request for activities related to the task force that led to the Appraisal Practices Board. In addition, the TAF chairman of the board presented to the ASC a grant funding request to fund methods and techniques activities for $275,000 in 2010. According to the Public Meeting Minutes, *"D. Bunton said that the grant request should be finalized by the Foundation Board of Trustees in November and available for approval by the ASC meeting in December. He said that the Foundation is estimating the grant request will be in the area of $2.3 million. This is an increase of approximately $335,000 over the 2009 grant. Approximately $275,000 of this increase will be for the Recognized Methods and Techniques Panel (RMAT) on real property valuation."*[10]
- In October 2009, TAF Board of Trustees approved the establishment of a third board – the Appraisal Practices Board – ignoring the task force's recommendation to establish a Recognized Methods and Techniques panel[11]. According to the Task Force's report, *"At this time, and for purposes of*

[5] From the ASC Meeting Minutes, December 2008, https://www.asc.gov/Documents/MeetingMinutes/ASC%20Bd%20Mtg%20Minutes%2012.11.2008.pdf
[6] From the ASC Meeting Minutes, December 2008, https://www.asc.gov/Documents/MeetingMinutes/ASC%20Bd%20Mtg%20Minutes%2012.11.2008.pdf
[7] From Email from David Bunton. Available at http://www.appraisalinstitute.org/bg-pdfs/GenesisASC.pdf
[8] Letter from Appraisal Foundation to Appraisal Institute, February 9, 2009. Available at http://www.appraisalinstitute.org/bg-pdfs/privatematter.pdf
[9] From Appraisal Foundation Letter to the Subcommittee on Capital Markets. April 22, 2009. Available at http://www.appraisalinstitute.org/newsadvocacy/downloads/TAFbestpracticesproposal.pdf
[10] From the Task Force Report to the Board of Trustees, September 11, 2009, available at http://www.appraisalinstitute.org/newsadvocacy/downloads/TaskForceMemo_BOT_091109.pdf
[11] Memo from Paul Welcome, Chair of TAF Board of Trustees to Sponsoring Organizations, October 26, 2009. Available at http://www.appraisalinstitute.org/bg-pdfs/diversion.pdf

expediency, we suggest that the RMAT be constituted in the form of a panel; with time and proper funding, the panel may develop into or report to a third "board" under BOT oversight (similar to AQB and ASB) that oversees recommended methods and techniques in various appraisal disciplines."

- Further, leaders of the Appraisal Institute were informed directly by the TAF President that TAF was "told to do it" by the ASC. Appraisal Institute leadership will provide affidavits to these comments, if deemed to be helpful.
- On September 15, 2010, the 2010 TAF Chairman conducted a media interview where he stated to "The Housing Helix" podcast, "The Appraisal Practices Board is a good example... we were asked by the ASC to do this, not informally, but its members expressed an interest in the Foundation doing this at least."

In November 2009, TAF officially commenced the Appraisal Practices Board with a solicitation for members of this board. In July 2010, the Appraisal Practices Board began its operations and, on December 22, 2011, released its first exposure draft. In May 2011, the ASC reported to this Committee that TAF had established the Appraisal Practices Board.

Appraisal Subcommittee Authority

Any directive by the ASC and its members to establish a new board – without Congressional authorization – goes beyond the ASC's legal mandate to monitor and review activities of TAF related to standards and qualifications as authorized under Title XI. The ASC does not have the authority to direct TAF to take certain actions. Specifically, according to correspondence from the Appraisal Subcommittee, *"Although Title XI does mandate that the ASC 'monitor and review the practices, procedures, activities, and organizational structure of the Appraisal Foundation' and the AQB, Congress did not provide the ASC with the authority or the power to direct or overrule the operations or structure of these private entities.*[12] Our organization is not aware of the ASC advising Congress of any concerns regarding areas of appraisal practice and recognized methods and techniques, as well as any perceived disconnect between appraisal standards and appraisal practice. Expression of such concerns in the ASC's Annual Report or in other forms of correspondence would have been an appropriate conveyance of the ASC's monitoring and review authorization; yet none can be found in any public Report to Congress[13].

Regardless of whether the ASC directed or only expressed interest in the establishment of the Appraisal Practices Board, we believe Congress should be concerned that such orchestration would continue to occur without any authorization in this area. In our view, this orchestrated event is enabled by a regulatory structure that lacks appropriate Congressional oversight and accountability.

GAO Findings and Recommendations

In January 2012, the Government Accountability Office (GAO) released a report citing the need for the ASC to establish policies and procedures related to TAF funding eligibility. Specifically, the GAO report cited the ASC for not having specific policies for determining whether activities of TAF (a private nonprofit organization that sets criteria for appraisals and appraisers) that are funded by ASC grants are Title XI-related. Not having appropriate policies and procedures is inconsistent with federal internal control standards designed to promote effectiveness and efficiency and limits the accountability and transparency of the ASC's activities.

The GAO report cites a concem that the Appraisal Institute has shared for many years – that the relationship between the ASC and TAF has insufficient accountability measures. Outside of preparing an annual report to Congress, oversight of the ASC is virtually non-existent. We note that the agency does not have an inspector general who can conduct independent assessments of the ASC's programs and operations.

Further, it is interesting to note that one day after the public release of the GAO report, the former chair of the ASC was replaced. Although no explanation has been given to date, the timing of these replacements implies a direct relationship with the public release of the GAO report.

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[12] From Appraisal Subcommittee correspondence with George R. Harrison, Ph.D., September 11, 2002, available at https://www.asc.gov/documents/othercorrespondence/ltr%20harrison%20request%2009.11.02.pdf

[13] ASC Annual Reports are available at https://www.asc.gov/About-the-ASC/AnnualReports.aspx

In essence, the ASC reshuffled its board, but the basic lack of fundamental oversight and accountability measures remains. By the actions described above, the relationship between the ASC and TAF has become far too cozy and perhaps even a bit incestuous. As an example, a former TAF employee – who worked directly for the TAF president – was hired as the ASC executive director and is now charged with overseeing/monitoring its operations, including its relationship with TAF.

Original Plan of the ASC/TAF Advances Without Congressional Authorization
Even though Congress did not authorize TAF to be the source for appraisal methods and techniques, or "best practices," during the Dodd-Frank deliberations, this has not impeded that plan from being executed. Over the past six months, the Appraisal Practices Board has begun publishing "valuation advisories," which claim to produce "voluntary guidance" for appraisers on such issues as what types of comparable sales are used or how to adjust for sales concessions in the market.

During the exposure draft period for the valuation advisories, we requested that the Appraisal Practices Board clarify and confirm that the advisories are **purely voluntary** in scope and canot be used for discipline or enforcement purposes. To date, this request has been plainly ignored or denied. In addition to TAF's proposal to Congress to codify "best practices," the basis for this concern is that the Appraisal Practices Board is speaking inconsistently. On the one hand, TAF claims the documents are voluntary; while on the other, they invite their codification. Specifically, the valuation advisory documents state: *Compliance with such guidance is voluntary, unless mandated through applicable law, regulation, or policy.*

Meanwhile, TAF representatives now are encouraging states to make valuation advisories from the Appraisal Practices Board compulsory. At the April 2012 meeting of the Appraisal Qualifications Board, representatives from TAF encouraged state appraiser regulatory agencies to use the valuation advisories when bringing enforcement actions against appraisers. Additionally, appraisers were warned at the April 2012 meeting of the Association of Appraiser Regulatory Officials (AARO) that veering from the valuation advisories could result in a disciplinary action.

Further, the Appraisal Standards Board of TAF released a proposal on May 24, 2012, that effectively would codify the works of the Appraisal Practices Board within USPAP itself. Specifically, the Appraisal Standards Board has proposed to define appraisal methods and techniques within the USPAP Scope of Work Rule, citing the Appraisal Practice Board directly. USPAP has been published for more than 20 years without any specific reference to appraisal methods and techniques. Is it simply a coincidence that the first time this is advanced is immediately following the first release of valuation advisories from the Appraisal Practices Board? Comparatively, the *Appraisal of Real Estate, 13th Edition*, the most widely published text in the world illustrating appraisal methods and techniques, has never been referred to within USPAP, despite strong recognition throughout the judicial system.

The USPAP proposal raises serious concerns and questions about the independence of the Appraisal Standards Board which, according to TAF's bylaws, is not to take any direction from the TAF Board of Trustees[14]. This proposal shows that the Appraisal Standards Board now may be doing the bidding of the TAF Board of Trustees to assert control over the entire appraisal process.

This is not the first time that we have seen or heard such a concern regarding the independence of the Appraisal Standards Board. Specifically, several former members of the Appraisal Standards Board (ASB) privately have expressed concern that the independence of the ASB may have been compromised by TAF's Board of Trustees in recent years. According to TAF By-Laws, the ASB is to operate independently from TAF's Board of Trustees with regard to the terms and content of USPAP.[15] Former members of the ASB report that members of TAF's Board of Trustees directly interfered with the ASB's duties and obligations, directing it to take certain actions or avoid taking others. We believe it is worth noting that members of the Board of Trustees and executive-level staff

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[14] *"Except as otherwise provided in these Bylaws or by resolution of the Board of Trustees, the Standards Board shall have and exercise all authority and power and perform all functions of the Foundation and the Board of Trustees in respect to establishing improving and promulgating the terms and content of the Uniform Standards of Professional Appraisal Practice." Available at* http://www.appraisalinstitute.org/bg-pdfs/tafbylaws.pdf
[15] *Ibid*

of TAF and the ASC attend meetings of the Appraisal Standards Board that are closed to the public. Regarding this practice, as well as the situation involving the Task Force on Best Practices, we encourage Congress to speak with former members of the ASB to determine whether any actions by the ASC or TAF's Board of Trustees may have jeopardized or compromised the independence of the ASB.

Potential Explanations for the APB
There are several potential explanations for the establishment of the Appraisal Practices Board, as follows:

1. Federal funding. An original intent behind establishing the Appraisal Practices Board appeared to have been to position TAF to receive additional federal funding from the ASC, as a funding request immediately was made of the ASC by TAF. TAF revenues have declined substantially in recent years, so new funding streams had been sought by TAF to help offset recent losses. TAF leadership openly expressed its desire to seek federal funding for the APB, having advanced a legislative amendment to this effect that sought specific funding from the ASC in September 2009. TAF leadership also stated publicly that federal funding of the APB could follow a course similar to that of the ASB and AQB, which were created prior to Congressional authorization in Title XI[16].
2. Education Development. Ultimately, it has been AI's long-held view that TAF's main goal was to enter into direct competition with private organizations in offering appraisal education. When TAF was formed in the 1980s, it was done with the understanding that it would not offer education, delegating that responsibility to professional appraisal organizations and academia. Contrary to any assertions made by TAF and the ASC, this process has worked well, as professional appraisal organizations have delivered timely education and guidance to the market. For example, courses relating to valuation in declining markets, sales concessions, and the valuation of "green" and/or energy-efficient features in properties were developed by the Appraisal Institute to fully prepare appraisers for emerging issues[17]. TAF's current policies appropriately limit TAF's development or delivery of education to appraisers on methodological issues. However, these policies are on the cusp of being dramatically revised. This follows a previous move into the USPAP education arena, a step taken by TAF approximately 10 years ago. At that time, TAF embarked on an initiative to develop education relating to USPAP. It was explained that this course was developed as a "benchmark" to which TAF could compare other organizations' courses for consistency with USPAP. Yet TAF does not require such "comparison" for any other courses developed by other organizations.

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[16] Presentation by David Bunton, President of TAF before the Association of Appraiser Regulatory Officials, May 1, 2010.
[17] We believe that Congress should be aware of a recent Memorandum of Understanding (MOU) between TAF and the Department of Energy (DOE) regarding "green" appraisal issues. This MOU helps to illustrate concerns regarding TAF's involvement in appraisal education and practice issues, while being the exclusive standards-setting organization for the appraisal profession. Among other things, the MOU outlines how DOE plans to develop an education course curriculum for appraisers based on works of the APB. A recent article from *Valuation Review* highlights what is planned with the APB:

> *The Department of Energy wants to develop educational course curriculum for appraisers in valuating energy performance and sustainability in buildings. The appraiser practices board issues guidance in that area, which it would use as the basis for the course and then send it through the AQB course-approval program.The program would likely be an extra certification, in the way of continuing education offered by the Appraisal Qualifications Board (AQB). The board has added green buildings as one of its continuing education topics, and it may include green building valuation as a part of the primary qualifications criteria down the line, according to Bunton. After all that, it's not hard to imagine lenders engaging appraisers who have completed the Department of Energy curriculum.*

It is important to note that professional appraisal organizations already have responded with green appraisal education and credentialing programs. For instance, the Appraisal Institute has invested considerable resources to develop a three-part series, professional development program that specifically focuses on high performance (green) building valuation. The program provides appraisers with various methods and techniques that then can be utilized to analyze energy-efficient features in buildings.

Procedurally, TAF, despite numerous public denials, currently develops online USPAP education in concert with a private education provider, issuing a request for proposals and then licensing the education through this entity. While other organizations are welcome to develop their own USPAP courses, if they can afford it, such USPAP courses are judged in comparison to TAF's "benchmark," often resulting in cost-prohibitive changes. Thus, if the cost of trying to develop such proprietary courses is not cost-effective, TAF will "license" its benchmark course to that organization, provided that TAF receives compensation for each individual use. Please note that all appraisers ***must*** take a USPAP update course at least every two years.

Of greater concern is that TAF also is on the cusp of expanding its education to ***all*** areas of appraisal, including appraisal methods and techniques. It is apparent that TAF intends to pursue a path similar to what it did in entering USPAP education with regard to appraisal methods and techniques. Specifically, TAF recently formed another task force to help it develop a strategic plan. This task force, according to a verbal report delivered by the TAF President earlier this month, has recommended that TAF "develop education for appraisers."

This development is not surprising, given that one apparent motive to create an Appraisal Practices Board is to develop a "body of knowledge" of its own, even though one already exists within academia and the private sector. Twenty years ago, TAF did not develop guidance related to appraisal methods and techniques beyond any advice of the Appraisal Standards Board, nor did it offer education. It now does both, competing directly with private professional organizations that do not have the advantage of a Congressional imprimatur. TAF has done so while confusing and abusing authorizations from Congress, claiming implied consent from Congress that TAF is the source for appraisal methods and techniques. Such abusive behavior confuses the public and stands to further harm the appraisal profession.

We believe that Congress must establish limitations or parameters regarding TAF's work outside of its standards and qualifications responsibilities. Limitations relating to the APB should ensure that the appraisal profession is not handcuffed by procedural rules. Appraisers do not need more rules, but rather a return to fundamental principles that support market expertise and sound judgment. Conversely, if appraisers are going to have more rules to follow, clarity is needed for the roles of the parties involved in establishing those rules, how those rules are to be developed, and what limitations need to be imposed for TAF's involvement in other areas of professional activity and practice. As a private organization, we do not have the privilege or benefit of a "stamp of approval" from Congress, and yet we are faced with the proposition of having to compete in the area of education with such an entity. This is grossly unfair and not contemplated, nor authorized, by Congress.

Enhancing Oversight and Enforcement

One of the purported intentions for the establishment of the Appraisal Practices Board was to assist state regulators with conducting oversight and enforcement. According to the Final Report of the Task Force that led to the creation of the Appraisal Practices Board, "We also believe that this name will encourage appraiser regulatory agencies to reference the work product of this group."[18] However, even here, we believe that relying on the Appraisal Practices Board to conduct enforcement is misguided, and ignores more significant issues that impede enforcement processes by states.

In fact, while the APB has only begun to publish guidance materials, we already have identified at least one error that would result in inappropriate disciplinary action against appraisers. Further, should appraisers treat the document as if it were *compulsory*, it actually would lead to a rash of inaccurate appraisals[19].

[18] From the Task Force Report to the Board of Trustees, September 11, 2009, available at http://www.appraisalinstitute.org/newsadvocacy/downloads/TaskForceMemo_BOT_091109.pdf

[19] Specifically, the valuation advisory, *"Adjusting Comparable Sales for Seller Concessions,"* explains that if sales concessions are paid by the seller in ***virtually all sales transactions*** (bold for emphasis), an adjustment may not be necessary since it would be typical of the market. This is referenced on pages 9, 10, 13 and 14 within the document. The purpose of adjusting comparable sales for concessions is to provide an indication of value of the subject property based on the definition of value. Even though the sales concession might be "typical" of the market and paid by the seller in virtually all transactions, the sale price is impacted by the concession. Furthermore, if the concessions are related to financing, the properties purchased with cash are atypical of the market and must be adjusted accordingly. Failing to adjust for sales or financing concessions, even though (cont).

In reality, the biggest challenge facing state appraiser regulatory officials is the lack of financial resources to hire qualified investigators to review complaints against appraisers and assist with prosecution. Often today, investigators share time with other licensing boards, ranging from barbers and beauticians to home inspectors and morticians. This places limitations on investigations involving appraisers, diluting the effectiveness of the state appraiser regulatory agencies in conducting oversight and enforcement.

One way to address this is to ensure that appraiser licensing fees are used by state appraiser regulatory agencies for appraiser oversight and enforcement through dedicated funds. Often, appraiser licensing fees are swept by state governors to help fill budget shortfalls or support non-appraiser oversight functions. Over the past year, the Appraisal Institute led an effort in the state of Maryland to dedicate appraiser licensing fees to appraiser oversight and enforcement. We have established model legislation for other states – approximately 15 – that are at risk of having funds swept for other uses.

Beyond state budgeting complexities, under the current structure, state appraisal boards send $40 for every licensed appraiser to the ASC, which uses this money to fund its operations and grants to TAF. The Dodd-Frank Act authorized the ASC to provide grants to state appraiser regulatory agencies for enforcement purposes, however, no details for that program have been released. It would appear to us that appraiser licensing fees would be better spent directly by state appraiser regulatory agencies to hire qualified investigators and review appraisers to enforce and regulate.

Other challenges for oversight and enforcement include ensuring that those who oversee state regulatory boards, particularly their enforcement staff members, have the necessary appraisal education and/or familiarity with the appraisal body of knowledge. In some cases, members of these staffs do not have the qualifications to review appraisals submitted for enforcement. Those who oversee state regulatory agencies ("Policy Managers" at the ASC) should have the ability to determine not only the adequacy of enforcement in terms of expedition, but also the quality of the work being reviewed and the reviews themselves. While this may or may not require state licensure or certification, it should include the necessary education to achieve a license.

Also, both the standards-setting entity (i.e., ASB) and the oversight and enforcement agency need to monitor state regulatory boards so that enforcement over appraisers is consistently applied in every state/territory where USPAP is in effect. There is more than sufficient anecdotal evidence that different regulatory boards enforce USPAP in different ways.

We believe that Congress must establish laws that empower state appraisal boards to do thorough and fair investigations and to prosecute meaningful complaints involving appraisers. However, too often, it appears that the state appraisal regulatory agencies simply are attempting to clear a backlog of complaints to pass inspection by the ASC. State regulators appear to focus more on ministerial violations than on harder-to-prove ethics and competency violations. Here, we believe codifying the works of the Appraisal Practices Board compounds these problems, as it is likely that state appraisal boards will turn to these documents to demonstrate compliance to the ASC. Again, so-called voluntary guidance materials are at risk of being misused by enforcement agencies to the detriment of the appraisal profession and the public.

This challenge is not unique to real estate appraiser regulatory agencies, as appraisers are in fact well beyond most in the real estate and mortgage sector in actually establishing and maintaining an enforcement regime. However, other industries have established more efficient systems that share resources amongst agencies and focus financial resources where they are needed most. One such system is the National Mortgage Licensing System established by the Conference of State Bank Supervisors. This system is a cooperative amongst state licensing agencies for mortgage brokers and mortgage loan officers. Now recognized by Congress, the system enables mortgage originators to fill out a single application and to apply for licensure in multiple states. On the enforcement side, the NMLS allows state agencies to share information and track individuals moving or doing

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seller-paid concessions might be prevalent in the market, is not proper guidance when the definition of value includes a price unaffected by sales or financing concessions. Further, it is a strong example for why voluntary guidance materials should never be used as compulsory documents.

business across state lines. And it does this without convoluted federal layers that drain precious resources that could be used for state oversight and enforcement.

Part 2. Appraisal Independence and Procurement

We often hear from real estate agents, home builders and others that appraisals are "killing deals," and/or holding back the economic recovery. These accusations are unfounded and misguided, as appraisers do not "make the market," but rather "reflect or report the market." To this point, appraisals are an important risk management activity to be conducted by banks in making safe and sound lending decisions. Appraisals are not meant to simply support contracts – they are obtained to help lenders assess their overall risk. Fundamentally, it does neither the borrower nor lender any good to enter into a mortgage for more than the value of the property.

Still, there is a significant inconsistency found in Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989. FIRREA requires certification or licensure for appraisers, but it also prohibits banks from establishing appraiser hiring policies that recognize credentials beyond the minimum requirements. In a time when home builders and others are requesting the use of professionally designated appraisers, lenders are actually prohibited by law from seeking out the most qualified appraisers. One purpose behind this provision was to help establish certification and licensure by states. At the time of enactment, some were concerned that allowing lenders to require certain professional designations would impede development of a pool of appraisers. This provision has long out-lived its useful purpose, and we believe it should be reconsidered in an effort to promote higher quality appraisals.

Beyond this, to the extent that there is a crisis of confidence regarding appraisals, this is a direct result of the way in which lenders, under the oversight of bank regulatory agencies, procure appraisals today. Here, the predominant factors in the appraiser hiring decision often are price and turnaround time of the appraisal, not quality of service, or geographic or market competency of the appraiser. Mortgage lenders have it within their ability to address these concerns, and we urge them to do so immediately.

However, we remain deeply concerned with the overall approach taken by federal regulatory agencies and financial institutions in supporting independent appraisal functions within financial institutions and procedures utilized by lenders to procure appraisals. Several significant problems are apparent:

1. Federal regulatory agencies are deeply understaffed to deal with examination issues involving appraisals. At one point in the 1990s, each federal regulatory agency had competent appraisers on staff helping to support examination teams. Today, there are a total of two professional designated real estate appraisers supporting examination functions in all four of the major examination agencies. While the OCC recently published an appraisal support position at headquarters, the response of other bank regulatory agencies is woefully deficient and must be enhanced to deal with the various collateral valuation challenges facing regulators and financial institutions today.
2. Federal bank examiners have identified widespread problems with the way in which many banks have handled appraisal administrative duties. A recent review by the Appraisal Institute of Material Loss Reports indicates that 75 percent of now-failed banks had been previously cited for various appraisal violations, often failing to obtain appraisals where required, or having insufficient resources within the bank to manage and oversee the appraisal function.
3. Generally, most banks have failed to take responsibility or ownership of the appraisal function, electing to outsource appraisal operations to mortgage brokers, who have a vested interest in the transaction, or to third party appraisal management companies, that offer a layer of insulation from coercive pressure, but apply new business pressures that put constraints on appraisal quality. This is evidenced by a slew of lawsuits, settlements and other regulatory actions that cite widespread deficiencies regarding appraisal independence and appraisal quality, including the Ameriquest settlement with 48 state attorneys general; the Home Valuation Code of Conduct, resulting from a settlement agreement with the New York Attorney General's office; various lawsuits from the Federal Housing Finance Agency and Federal Deposit Insurance Corporation; and out of court settlements with "whistleblowers" who attempted to report apparent violations of appraisal rules within banks, but faced threats and retaliation from their employers.

As a result of these and other issues, the natural reaction of many banks and financial institutions has been to establish a hard firewall between loan production and risk management functions and appraisal. Such a firewall inhibits communication between the underwriting staff and the appraiser to the point that causes more damage to the process than it helps. Many are under the mistaken impression that federal rules now require the use of appraisal management companies (AMCs) to comply with basic appraisal independence requirements. This is not the case, as banks can manage the appraisal ordering and review internally. Many banks, upon learning that federal rules allow banks to take back the appraisal function, have reestablished appraisal departments with independent reporting structures as an alternative to utilizing appraisal management companies. Depending on the size of the bank, this can be accomplished with a functioning appraisal department, or hiring an appraiser on staff, or utilizing several available software programs in the market that enable risk management staff to oversee appraisal orders and reviews.

This is a best practice that more banks should follow. Too few resources have been devoted to appraisal staff within financial institutions, as evidenced by Material Loss Reports, which often cite banks for failure to devote staff to obtaining credible appraisals. Moving forward, we believe that incentives, such as higher marks on CAMELS ratings, should be established for banks to maintain rigorous risk management positions in support of collateral risk management.

This is not to say that *all* AMCs are performing poorly, because some place the quality of service at the forefront of their business model; it is just that the business model employed by many appraisal management companies has significant failures. Our biggest concern is the propensity to make appraiser hiring decisions on speed (or turnaround times) or price, rather than quality or competency (both market and geographic). Here, many institutions appear to ignore federal guidelines that clearly state that price and turnaround time should not be the predominant factor in the appraiser hiring decision. Yet, as cited above, bank regulatory agencies appear understaffed to enforce this provision, helping to enable substandard appraisal procurement by banks.

The viability of the predominant business utilized by appraisal management companies may not be sustainable. In fact, several large appraisal management companies have failed recently, stiffing appraisers for millions of dollars in appraisal fees. Last month, a Phoenix judge concluded that a large AMC failed to pay appraisers in Arizona at least 171 times within the past 18 months. The judge recommended that the Arizona Board of Appraisal fine the company $850,000 and revoke the company's registration as an appraisal management company.

One positive from this situation was that a major client of the failed appraisal management company (Appraiser Loft) made good on the appraisal fees that were owed to appraisers, paying appraisers who had unpaid invoices. Commendably, the chief appraiser of this bank (MetLife) was quoted in a media report as follows:

> *It's not the appraiser's fault that AppraiserLoft didn't pay them. If an appraiser did the work and we made a decision based on the appraisal provided - the appraiser should be paid*[20].

Unfortunately, it's more common that these bills go unpaid when an appraisal management company fails. One infamous case involves Taylor Bean Whitaker (TBW), who once was one of the largest wholesale lenders in the country, but ceased its operations after a raid by the Federal Bureau of Investigation and a suspension by the FHA. TBW owned an appraisal management company – Security One Valuation Services – which left numerous appraisers with unpaid invoices. This trend does not appear to be ceasing, as evidenced by a letter that we received from a member earlier this week.[21]

It should be noted that many banks are using the AMC as profit centers at the expense of the appraiser. Some of the largest AMCs are owned by banks. Prior to the recent advent of AMCs, banks either reviewed all appraisals by staff or outside contract. Now, the banks establish an AMC, order and review all appraisal through the AMC, and reduce the fee to the appraiser while keeping the AMC fee (typically as much as half of what they pay appraisers) for themselves.

[20] From Appraiser Talkback Blog, March 15, 2012, available at http://www.orep.org/wordpress-2.7/wordpress/?p=521

[21] Letter to Sara Stephens from Stephen P. Kurilchyk, SRA, June 20, 2012. Available at http://www.appraisalinstitute.org/bg-pdfs/kurilchyk-sra-letter.pdf

Interim Final Rule & Customary and Reasonable Fees

The Dodd-Frank Act contains a provision requiring "customary and reasonable" fees be paid to appraisers to reflect what an appraiser would typically earn for an assignment absent the involvement of an appraisal management company (AMC). Under the Act, evidence for such fees may be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys. This issue is extremely important given evidence that indicates wide divergence between fees paid to appraisers through appraisal management companies and those retained directly by financial institutions. While some AMCs pay full fees and charge for their services on a "cost-plus" basis, many do not.

This provision required the Federal Reserve to develop a rule within a very short time period. The Federal Reserve published an Interim Final Rule for comment, but took no action there further. As a result, the Interim Final Rule became effective on April 1, 2011. We do not believe the Interim Final Rule is consistent with the plain language and intent of the Dodd-Frank Act.

Under the Interim Final Rule amending Regulation Z (Truth in Lending), lenders and their agents are provided with two presumptions of compliance. The first option states that lenders will be presumed to comply if the amount of compensation is reasonably related with recent rates (last 12 months) for appraisal services performed in the geographic market of the property. The creditor or its agent must identify recent rates and make any adjustments necessary to account for specific factors, such as the type of property, the scope of work, and the fee appraiser's qualifications; and the creditor and its agent do not engage in any anticompetitive actions in violation of state or federal law that affect the rate of compensation paid to fee appraisers, such as price- fixing or restricting others from entering the market. The Fed's commentary on the first presumption states that AMC fees are an acceptable component of the factors used by creditors and their agents to establish compliance with the statute's customary and reasonable mandate. As stated above, our organizations strongly object to this feature of the IFR and have urged its removal.

Under the second presumption of compliance, a lender or agent is presumed to comply if it establishes a fee by relying on rates in the geographic market of the property being appraised or established by objective third-party information, including fee schedules, studies and surveys prepared by independent third parties such as government agencies, academic institutions and private research firms. The interim final rule follows the statute in requiring that fee schedules, studies and surveys, or information derived from them, used to qualify for this presumption of compliance must exclude compensation paid to fee appraisers for appraisals ordered by appraisal management companies.

We believe that the two presumptions of compliance are inconsistent with one another. While the second presumption specifically excludes assignments ordered by known appraisal management companies, the first presumption specifically does not require that a creditor use third-party information that excludes appraisals ordered by AMCs. While this statement could be read to clarify the previous comment found in that paragraph that stipulates use of a fee survey or study is not required, a literal interpretation of this statement would create a significant departure from the intent of the legislation defining customary and reasonable fees as appraisal assignments absent the involvement of AMCs.

As such, we are not surprised to hear that the first presumption of compliance has been initially interpreted by some large banks and AMCs to mean the current business model employed by many banks and AMCs today is thought to be satisfactory. Unfortunately, all available evidence suggests this arrangement is totally inconsistent with the second presumption of compliance, as explained below.

The Interim Final Rule is inconsistent, ineffective and contrary to the spirit of the Dodd-Frank Act. The very existence of the customary and reasonable fee provisions of Dodd-Frank, together with the mandated exclusion of AMC fees in calculating what's customary and reasonable, results from Congressional recognition of the influences of AMCs on fee appraisers and their harmful impact on appraiser independence and the integrity of valuations in our mortgage lending markets.

Consumer Disclosure Form/HUD-1

These problems are masked by consumer disclosure rules that currently allow co-mingling of appraisal and appraisal management company fees on the Appraisal line of the HUD-1 Settlement statement. Recent consumer research indicates that consumers are paying higher costs for appraisal fees as reported on the Appraisal line of the HUD-1 statement[22]. This co-mingling mistakenly confuses consumers into believing that they are paying appraisers more for services today, when in fact, compensation has declined as much as 40 percent.

As you know, the Dodd-Frank Act authorized separation of appraisal and appraisal management fees. We support this provision and believe separate disclosure should be required to fully inform borrowers of actual costs paid with regard to the appraisal process. This includes both the performance of the appraisal and any administrative and review functions. We see no consumer benefit with continuing to bundle two separate services, as is current practice today.

Traditionally, appraisal management fees were allocated as part of *loan processing or administration* fees or through the interest rate. However this has changed over the years as more lenders have outsourced appraisal functions to third party management companies. This is enabled by interpretations of the Real Estate Settlement Procedures Act, the foundation of which dates back to the origins of the HUD-1 in 1974, long before the current appraisal management business model was established. This allows the bundling of appraisal and appraisal management expenses when appraisal management companies are used. A change here is long overdue.

However, the CFPB, through the establishment of a new Consumer Disclosure Form and as authorized by the Dodd-Frank Act, has a unique opportunity to improve transparency for borrowers by requiring full disclosure of costs incurred for appraisal services and costs for appraisal management services. The CFPB has issued several drafts of the proposed Consumer Disclosure Form. We applauded a recent draft that was posted to the CPFB website for review in February, which includes clear disclosure of any fee paid to a "Local Appraisal Company" and to an "Appraisal Management Company" ("AMCs") (found in both the "Hemlock" and "Butternut" versions).

Part 3. Legislative Reform Options

As Congress reviews appraisal issues, we suggest several reforms to help improve appraiser oversight and enforcement, as well as the overall quality of appraisals.

With regard to the appraisal regulatory structure, we offer the following suggestions:

1. **Realign the appraisal regulatory structure with those of other industries in the real estate and mortgage sectors. One model to turn to is the National Mortgage Licensing System (NMLS), which is a cooperative amongst state agencies overseen as a last resort by the Consumer Financial Protection Bureau (CFPB).**

   Comments: This is not a proposal to turn the appraisal regulatory structure over to a self-regulatory organization (SRO). SROs typically mean a regulatory scheme that is administered by *industry*. Here, the NMLS is owned and operated by *regulators*. In addition, the entire NMLS is overseen by a federal agency (the CFPB).

   This would simplify the appraisal regulatory structure and make it consistent with others in the real estate and mortgage sectors. Authorizing the appraisal profession to utilize the NMLS for its certification and licensing regime would enable state appraiser regulatory agencies to benefit from enhanced communication with other state agencies, including those outside of appraisal, such as state banking regulatory agencies. This enhanced communication among state licensing agencies has been sought after for many years by Congress and other observers. Such a system would help state licensing agencies track individuals and firms that may be moving in and out of states after a disciplinary action.

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22 See "*NAR Survey Shows HVCC Impacting Housing Markets*," available at http://www.realtor.org/wps/wcm/connect/b83165804ef0b3338f18af2db4a1e62f/government_affairs_hvcc_research_results.pdf?MOD=AJPERES&CACHEID=b83165804ef0b3338f18af2db4a1e62f

For example, state appraiser regulatory agencies in Illinois would be alerted immediately if an appraiser was applying for licensure after a disciplinary action was taken in Connecticut. Likewise, state appraiser regulatory agencies would be alerted if a mortgage broker lost his or her license and was subsequently applying for licensure as an appraiser.

Realigning the appraisal regulatory structure with the NMLS also would provide a common system in which appraisers and appraisal management companies could submit applications for licensure in multiple states. Today, appraisers and AMCs that wish to earn and carry licenses in multiple states must apply in each state separately, significantly adding to administrative requirements and obligations. For instance, appraisers with multiple state licenses must adhere to each state's unique timing requirements and often take the 7-hour USPAP class three or four time a year in order to comply with all the state's requirements. Unlike the appraisal regulatory structure, the NMLS has a common application protocol which is accessed by all of the applicable state licensing authorities.

Interestingly, other industries besides mortgage loan originators are utilizing the NMLS for the very purpose described here. We understand that the NMLS is now accepting other state regulatory agencies into the NMLS. This is because state regulatory information-sharing is not unique to appraisal, but is a widespread problem with many industries. The NMLS has addressed this by offering a solution that can be used by multiple industry regulators.

Lastly, should the NMLS fail in its responsibilities to manage appraisal oversight, the CFPB could step in and administer the appraisal oversight functions, just as it is authorized to do for mortgage loan originators today. This provision established a strong incentive for the NMLS to maintain meaningful programs and operations.

2. **Congress must protect the independence of the appraisal standards-setting process and require that appraisal standards for federally related transactions be issued by an entity that does not directly or indirectly develop or offer education to appraisers.**

   Comments: Standards-setting organizations typically go to great lengths to protect the independence of the standards-setting process. However, the decision now before TAF to enter into competition with private education providers would jeopardize the independence of this process, as changes made to standards may have additional motivations beyond those serving the profession or users of professional appraisal services. It is worth noting that TAF is not the only appraisal standards-setting organization in the world. In fact, the International Valuation Standards Council, based in London, produces the International Valuation Standards, which are adopted in more than 70 countries and are required for Appraisal Institute members conducting appraisal work internationally. In contrast to TAF, the IVSC does not currently directly or indirectly develop education for appraisers[23]. This is similar to other standards-setting organizations such as the Financial Accounting Standards Board and the International Accounting Standards Board, both of which also restrict them in the area of direct education.

3. **Congress must establish limitations around the Appraisal Practices Board of TAF.**
   a. **No tax dollars should be used to fund this venture.**
   b. **Voluntary guidance should be just that – voluntary.**
   c. **States should be restricted from codifying voluntary guidance into state law or regulation and the Appraisal Standards Board should be prohibited from specifically referencing works of the Appraisal Practices Board within USPAP.**
   d. **Establish meaningful oversight over the de facto regulatory actions of TAF.**

[23] "*Tom Boyle suggested a new project relating to real estate and the misunderstanding of nonconforming uses and the highest and best use principle. However other Board members considered that this would bring the IVSC into an educational role, which is not its remit.*" From Minutes of the Meeting of the IVSC Standards Board Held in Hong Kong on 3 November 2011. Available at: http://www.ivsc.org/meetings/2011/1103/sb/minutes_ivsb_20111103.pdf

Comments: The prohibition of treating voluntary guidance as compulsory should apply to the Appraisal Practices Board and any "Advisory Opinions" or "Frequently Asked Questions" published by the Appraisal Standards Board. Already, at least seven (7) states have inappropriately adopted Advisory Opinions and Frequently Asked Questions issued by the Appraisal Standards Board into their regulations; even though both clearly state that they are to be voluntary and to be used for information purposes only. Barring action by Congress, a similar course has been laid out for the Appraisal Practices Board.

4. **Congress should reiterate that TAF does not have legislative authorization in the area of "methods and techniques" and "appraiser education." Congress should not allow TAF to abuse the authorities granted to it for appraisal standards and qualifications, nor should TAF be allowed to compete with private education providers in the area of appraisal methods and techniques.**

   Comments: There is a precedent for Congress to establish limitations in the area of education for private organizations that have direct authorizations from Congress. When it authorized the National Mortgage Licensing System, Congress established a limitation for the NMLS not to directly or indirectly develop or offer any qualifying or continuing education to those whom they oversee[24]. This is an appropriate comparable to the situation involving TAF, not just because it maintains a Course Approval Program that enables education providers to seek a single approval of education in all 50 states, but also because of the imprimatur as "the source" for appraiser standards and qualifications. We encourage Congress to enact similar parameters for the appraisal profession.

5. **Congress should establish laws that empower state appraisal boards to do thorough and fair investigations and to prosecute meaningful complaints involving appraisers. Further, Congress should ensure that appraiser licensing fees are used by state appraiser regulatory agencies for appraiser oversight and enforcement through dedicated funds.**

   Comments: Often, appraiser licensing fees are swept by state governors to help fill budget shortfalls or support non-appraiser oversight functions. Over the past year, the Appraisal Institute led an effort in the state of Maryland to dedicate appraiser licensing fees for appraiser oversight and enforcement. We have established model legislation for other states – approximately 15 – that are at risk of having funds swept for other uses.

6. **Authorize Fannie Mae, Freddie Mac and other agencies, such as the Federal Housing Administration and the Veterans Administration, to halt purchase or guarantees of loans in states that maintain deficient appraiser regulatory regimes. This would serve as a strong incentive for states to maintain meaningful appraiser oversight and enforcement systems.**

   Comments: Today, the ASC has the authority to "de-certify" a state appraiser regulatory structure if it finds states are not able to enforce Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989. The ASC has never used this authority for a variety of reasons. The Dodd-Frank Act authorized the ASC to establish intermediate sanctions, such as fines and suspensions. To date, it has not established any policies in this area.

7. **Congress also should prepare for the future of Fannie Mae and Freddie Mac with regard to appraisal policy. Any ongoing federal support or role for either agency or a future related organization should maintain consistent appraisal rules like sister agencies such as FHA and VA. Further, we support the establishment of a rulemaking process that would clarify how appraisal services may be used in "subsequent transactions" such as refinancing and loan modifications.**

   Comments: Today, loan servicers often utilize alternative valuation services, such as broker price opinions, out of confusion or a lack of understanding regarding the flexibility of appraisal standards. At the same time, agencies appear unable or unwilling to establish procedures for lenders or loan servicers to

[24] The SAFE Act limits the National Mortgage Licensing System established by the CSBS from directly or indirectly offering education for qualifying or continuing education for mortgage originators. See 12 U.S.C. 5104(c)(3) http://www.law.cornell.edu/uscode/html/uscode12/usc_sec_12_00005104----000-.html.

engage qualified real estate appraisers to perform more streamlined, or "limited scope" appraisal assignments. Many believe that there is only one type of "appraisal," when, in fact, there are an unlimited number of the types of appraisals, given the ability to tailor the scope of work to a particular client need. If lenders only require a quick update of an original appraisal, appraisers can do this. If obtaining both the market value and the liquidation value of the property would assist with loan review and determining whether to foreclose or work out the loan that too can be completed by an appraiser in a cost-effective manner. The agencies should have the ability to establish parameters for obtaining such services from appraisers.

With regard to appraisal procurement, we encourage Congress to:

1. **Eliminate the Section 1122(d) of Title XI of FIRREA regarding member if nationally recognized professional appraisal organizations**

   Comments: This would eliminate one more requirement imposed on lenders, while promoting professional development and participation in ethics and counseling programs that serve as additional layers of oversight and enforcement.

2. **Monitor the expected proposed rule from the Consumer Financial Protection Bureau on the Consumer Disclosure Form regarding implementation of Sec. 1475 of the Dodd-Frank Act, which authorizes the separation of appraisal and appraisal management company fees.**

   Comments: We believe that the separation of appraisal and appraisal management company fees is a central component of efforts to improve appraisal quality. We hope the upcoming proposed rule from the CFPB provides for a separation of the Appraisal and Appraisal Management Company fees with a requirement for its disclosure. Barring this, we urge Congress to utilize its oversight function in this area.

3. **Monitor the implementation of the Interim Final Rule on Truth in Lending/Appraisal Independence.**

   Comments: We also believe that it is central to the related provision in Dodd-Frank requiring the payment of customary and reasonable fees to appraisers. In this regard, we also call on Congress to utilize its oversight functions should a final rule regarding appraisal independence by the Consumer Financial Protection Bureau fail to commence in the coming year. We believe that Congress should demand that the CFPB issue a final rule that makes consistent the two presumption of compliance regarding compliance with customary and reasonable fee requirements.

Subcommittee on Insurance, Housing and Community Opportunity
House Financial Services Committee
Hearing: Appraisal Oversight: The Regulatory Impact on Consumers and Businesses

Reengineering the Appraisal: A Return to Market Fundamentals

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Resident Fellow

American Enterprise Institute

6.28.12

The views expressed are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

Part 1: Real Estate Cycles and Bubbles

Part 2: Government Interventions Are Almost Always Pro-cyclical and Exacerbate the Nature and Duration of the Real Estate Boom - Bust Cycle

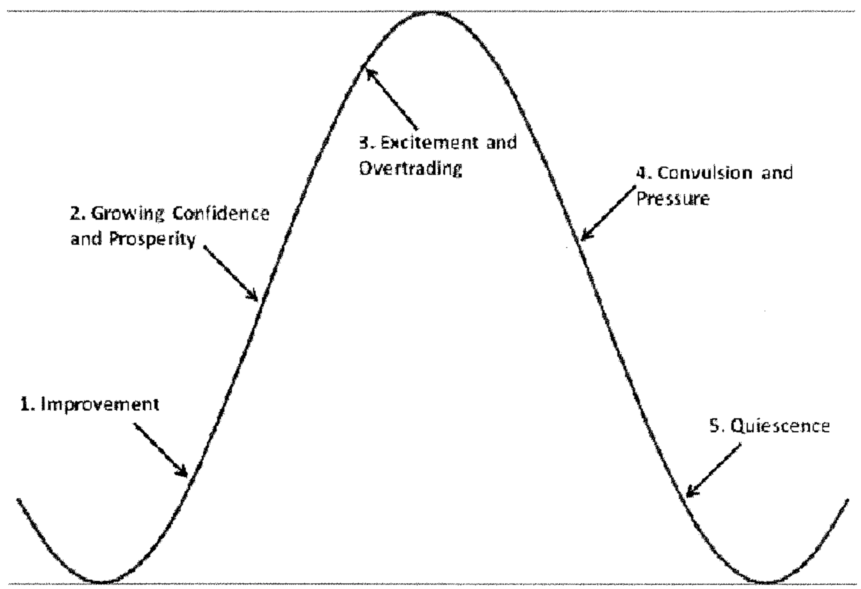
Part 3: In Property Valuation, Market Fundamentals Matter

Part 4: Property Valuation: A Return to Market Fundamentals

Part 5: Recommendations

Part 1: Real Estate Cycles and Bubbles

The real estate cycle in five stages:



Sources: S. J. Loyd (Lord Overstone), "Tracts and Other Publications on Metalic and Paper Currency,", 1858
Edward Chancellor, "Between Errors of Optimism and Pessimism", GMO White Paper, 2011

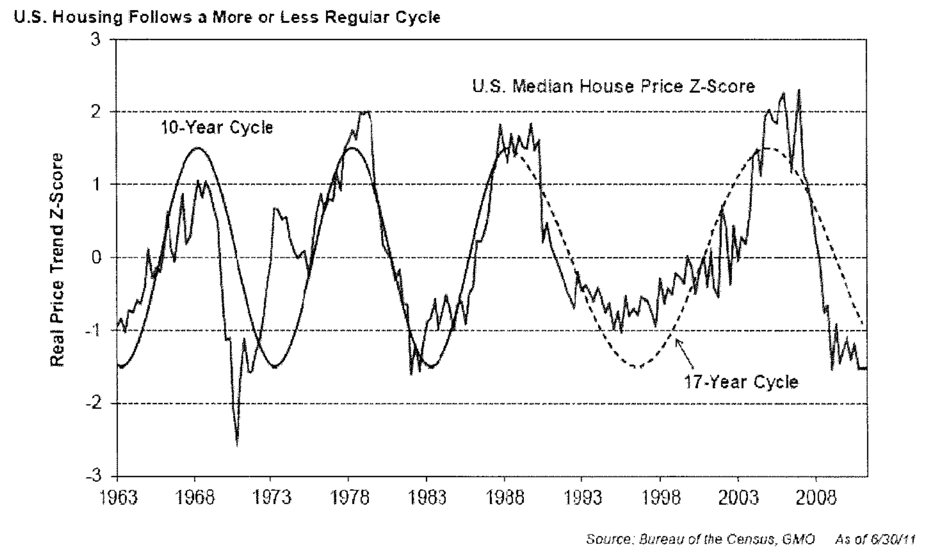
What is a bubble?

- "A bubble is when current home prices (or price of any asset) substantially deviates from its fundamental value."*
- "A sharp rise in the price of an asset or range of assets in a continuous process, with the initial rise generating expectations of further rises and attracting new buyers—generally speculators interested in profits from trading rather than its use or earnings capacity. The risk is then followed by a reversal of expectations and sharp decline in price, often resulting in severe financial crisis—in short, the bubble bursts.** 203

*FRB of San Francisco Economic Letter, October 1, 2004
** Charles Kindleberger, "Bubbles," 1987

Observation: Real estate is cyclical

- Except for the Great Moderation, over the last 60 years real house prices have followed 10 year cycles:



The 17-year cycle's peak is at 2.3 standard deviations or the 98th percentile.

Source: Edward Chancellor, "Between Errors of Optimism and Pessimism", GMO White Paper, 2011

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Observations: Length of real estate upturns and downturns

- Internationally upturns last an average of 6 years (U.S. 3.5 years) and downturns an average of 4.5 years (U.S. 5 years).

		Duration (quarters)		Amplitude (%)	
	Sample	Mean	StDev	Mean	StDev
Complete upturns	49	24.1	14.8	61.3	56.3
Complete + ongoing upturns	55	28.0	20.6	66.7	60.1
Complete downturns	49	18.2	8.7	30.7	28.4
Complete + ongoing downturns	62	18.4	12.5	28.8	27.5

- The U.S.' last upturn lasted 11.75 years. IMF Working Paper, How Long Do Housing Cycles Last?, October 2011

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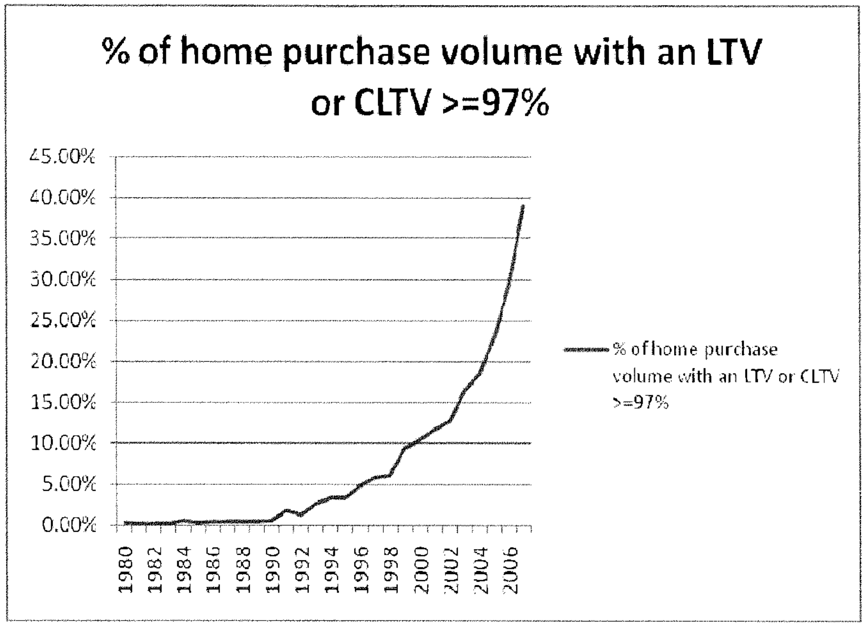
Part 2: Government Interventions Are Almost Always Pro-cyclical and Exacerbate the Nature and Duration of the Real Estate Boom - Bust Cycle

U.S. – the world leader in distortionary housing policy interventions

- **An alphabet soup of institutions -FHA, GNMA, Fannie, Freddie, and FHLBs**
- **Affordable housing mission - FHA, Fannie/Freddie affordable housing goals, National Homeownership Strategy, CRA, and HUD's Best Practices Initiative**
- **Overleverage and excessive reliance on debt:**
  - National Homeownership Strategy: eliminate downpayments, promote loosened credit
  - FHA's low down payment lending
  - HUD, a social welfare agency, as regulator of the GSE's affordable housing mission.
  - Fannie/Freddie's leverage, preferred stock advantages, and favorable risk based capital rules
  - Favorable rules for 2nd lien lending (as to capital and 1st mortgage lender can't prohibit)
  - Tax deductibility of interest
  - 30 year fixed rate mortgage/interest only loans/negatively amortizing loans
  - Over reliance by the Fed on lower rates as its weapon of choice
- **Miscellaneous**
  - Limited use of prepayment penalties
  - De jure and de facto limits on recourse/deficiency judgments
  - Liberal capital gains exemption
  - Pro-cyclical loan loss reserving and FDIC premium policies
  - Widespread use of the GSEs' automated underwriting systems
  - Nationalization of the GSEs' emasculated appraisal principles
  - Extensive use of ARMs as an affordability tool
  - Extensive reliance on originate to distribute and securitization
  - Freely pre-payable 30 year fixed rate loan promoted huge volatility in origination volume.
    - In 2000 originations totaled $1 trillion versus $4 trillion in 2003. About 50% of all mortgages outstanding on 12.31.03 were originated in 2003. Delinquency rates were suppressed by raising prices and refinances. Homes became ATMs.

An explicit policy to eliminate downpayments



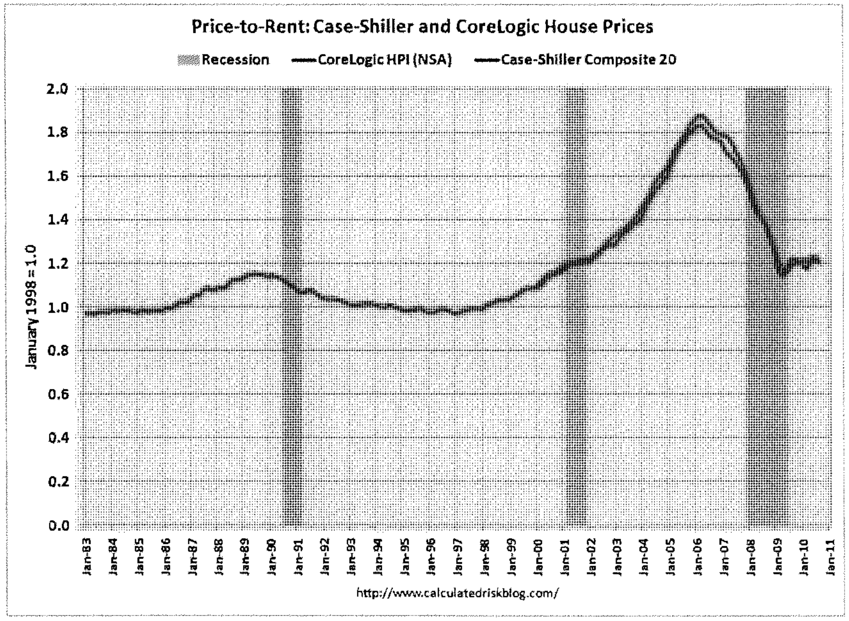
- A loan's equity represents the margin provided by a borrower.
  Debt/equity = leverage

Part 3: In Property Valuation, Market Fundamentals Matter

A return to market fundamentals is needed precisely because real estate is cyclical

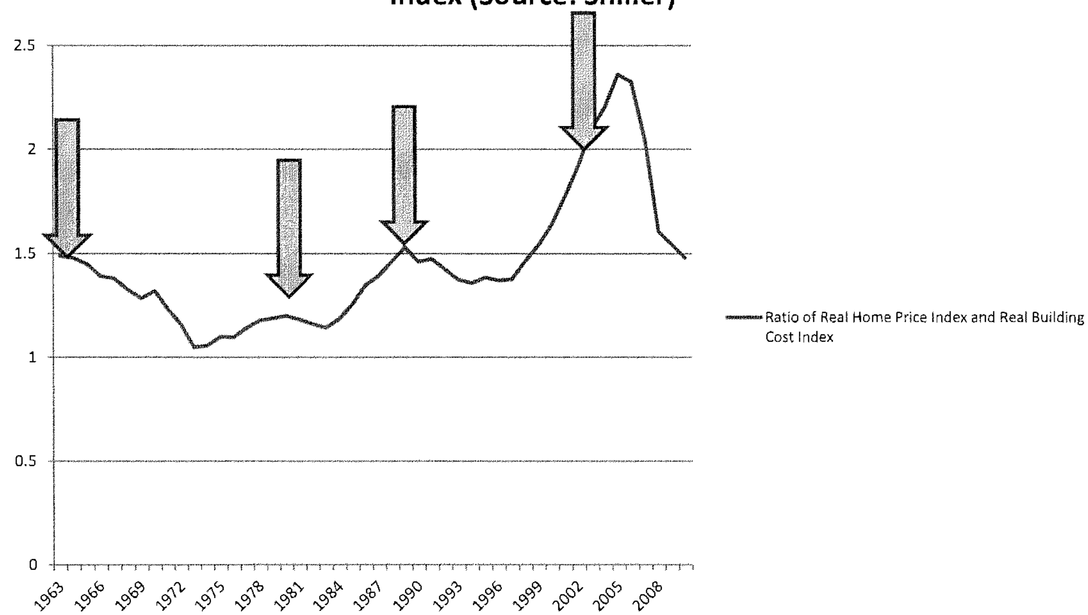
- Drivers of the real estate cycle:
  - Demand created by population growth and family formation
  - Growth in income and jobs:
  - Natural lags – demand tends to grow faster than supply
- Problem areas
  - Accelerating growth and ease of credit
  - Pro-cyclical government policies
  - Human psychology and bubbles
  - A view of this time is different
  - Current value practices have devolved; no longer adding value to the financial transaction
- Unique market events cause price bubbles
  - While policies promoting the elimination of downpayments and increased investor leverage, delinquencies were muted.
  - Homes as ATMs supported the Great Moderation
- While a bubble's deviation from fundamental value relationships is difficult to observe, benchmarks provide valuable insight:
  - Market value-to-rent ratio
  - Market value-to-replacement cost
  - Home price-to-median income ratio

Market-value-to-rent ratio: deviation from fundamental value

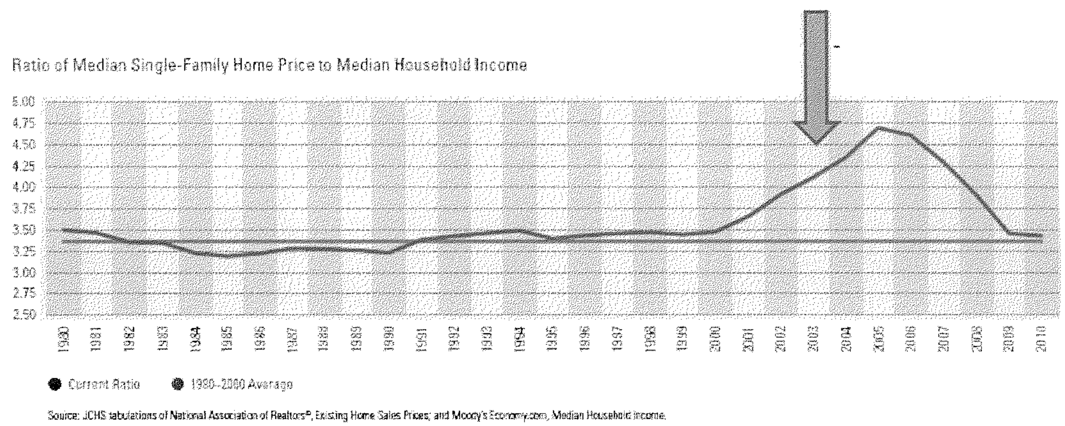


Market value-to-replacement cost ratio: deviation from fundamental value

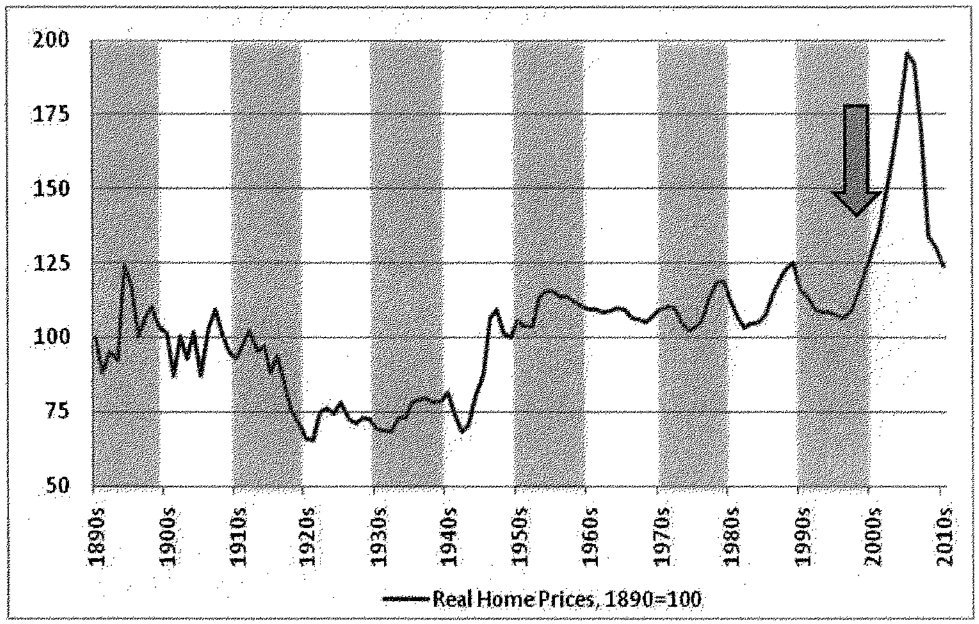
Ratio of National Real Home Price Index and Real Building Cost Index (Source: Shiller)



Media home price-to-median income: deviation from the mean



Market value: deviation from the mean

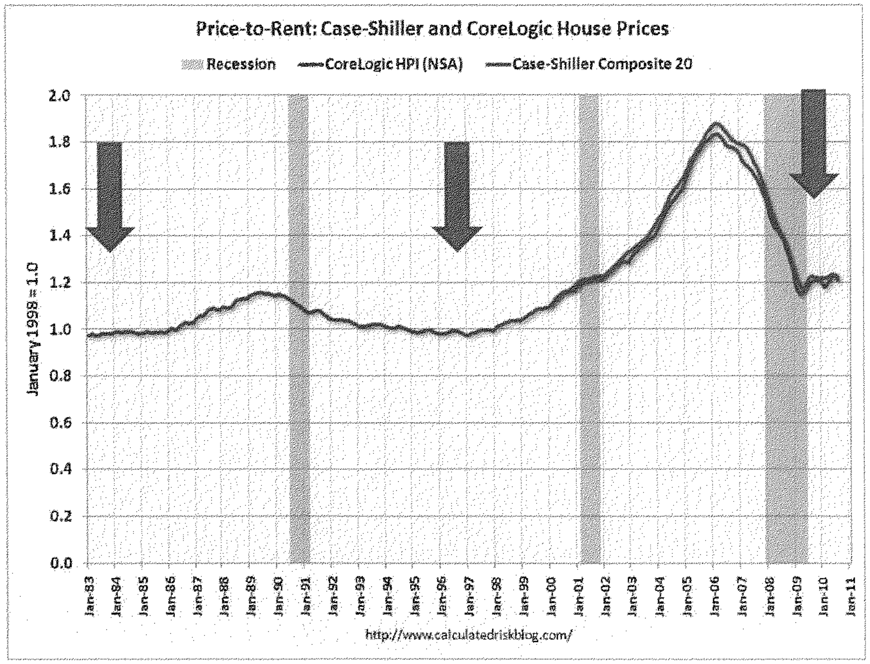


- Compiled from Robert Shiller's updated historical housing market data used in his book, *Irrational Exuberance* (Princeton University Press, 2000; Broadway Books, 2001; 2nd edition, 2005). Data available at www.econ.yale.edu/~shiller/data.htm.

Booms and busts: reversion to the mean

- It impossible to predict **when** a real estate peak will be reached with certainty, only that a reversion to mean will likely occur.
- Common characteristics include:
  - Real estate valuations two standard deviations above the long-term trend
    - Market value-to-rent and market value-to-replacement cost deviations from mean are indicators
    - Median home sales price-to-median household income is also an indicator.
  - Above trend credit growth
    - This serves to perpetuate growth
  - Appearance or reappearance of new or more leveraged forms of lending
  - High levels of construction
  - Speculative purchases that ignore fundamentals like rents vs. expenses
  - Increasing levels of fraud
  - Rising early payment defaults – this can be late in the game

Market value-to-rent ratio: reversion to the mean



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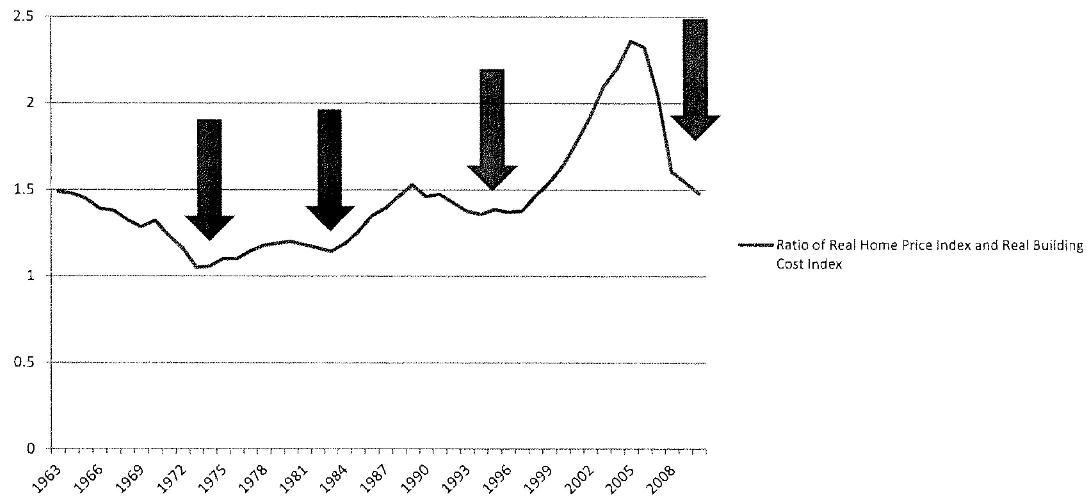
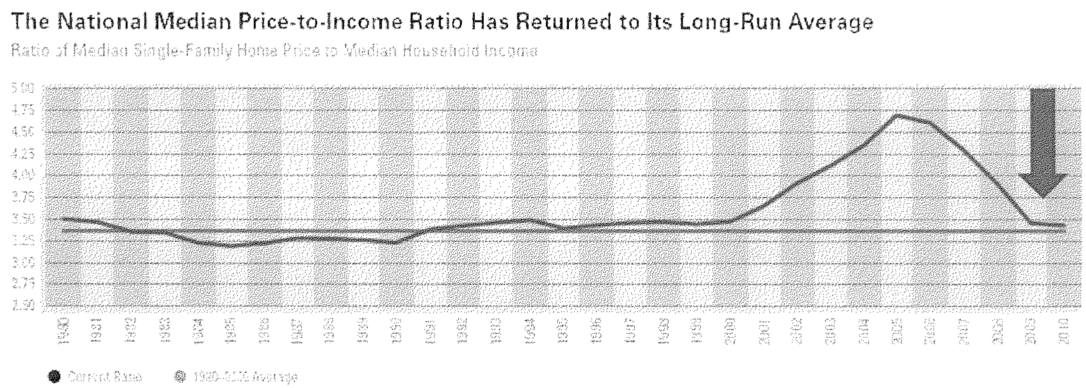
Market value-to-replacement cost: reversion to the mean

Ratio of National Real Home Price Index and Real Building Cost Index (Source: Shiller)



Media home price-to-median income: reversion to the mean



Source: JCHS tabulations of National Association of Realtors®, Existing Home Sales Prices; and Moody's Economy.com, Median Household Income.

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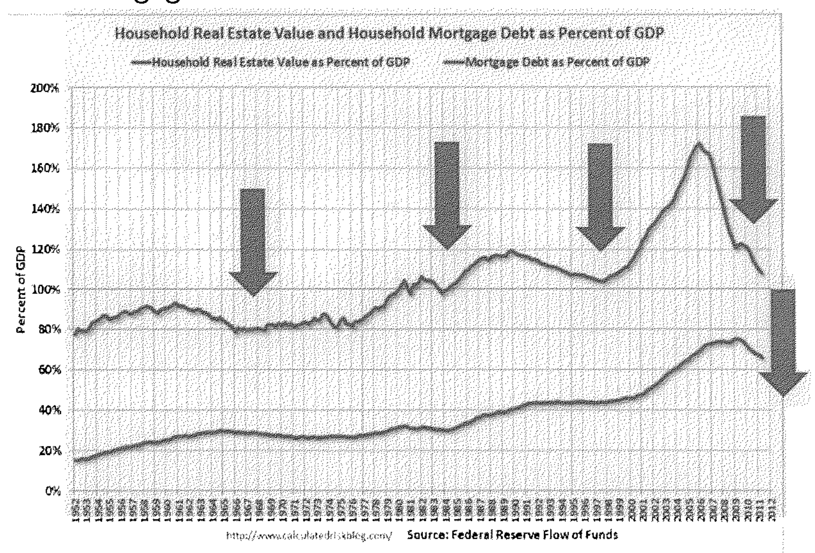
Market value and mortgage debt: reversion to the mean

- Reversion to the mean: we are getting close on house prices but have a long way to go on mortgage debt:



- Will the losses be massive? Yes. The remaining questions are *when* will they be taken, in *what* form, and by *whom?*

Booms and busts: feedback loops and reversion to the mean

- The role of feedback loops:
  - Feedback loop definition: the return to the input of a part of the output.*
    - A self-reinforcing loop, that steadily grows in strength, supporting the up or down trend.
      - An event influenced by positive feedback will tend to deviate from a mean.
      - If only positive feedback mechanisms are governing a system, this positive loop is called "exploding".
      - Uncontrolled feedback - a boiler without a thermostat
    - A self-correcting or limiting loop, that reduces in strength until the trend system comes to rest.
      - An event influenced by negative feedback will tend toward a mean.
      - All other things being equal, negative feedback loops are auto-regulating.
      - Needs to be self-correcting, not reliant on an ad hoc decision
      - Controlled feedback – a boiler with a thermostat
- Policies need to be evaluated as to whether they are pro-cyclical (positive or self-reinforcing feedback)or counter-cyclical (negative or limiting feedback):
  - Pro-cyclical policies reinforce both a boom and a bust.
  - Counter-cyclical policies dampen both a boom and a bust.
    - During this bubble all policies were pro-cyclical.

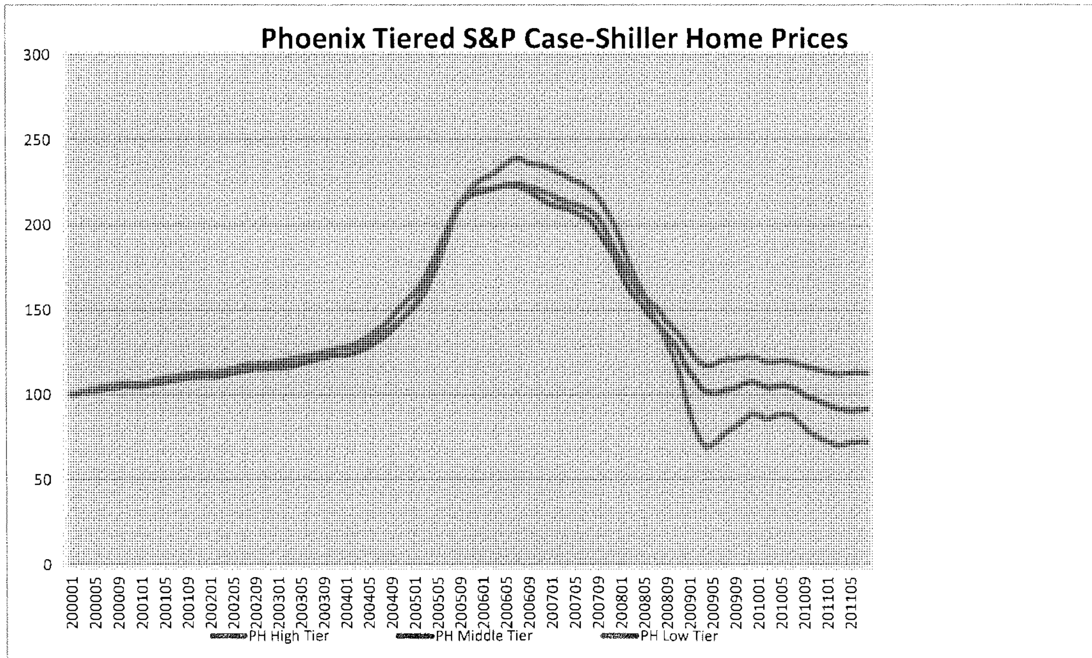
* http://www.economicswebinstitute.org/glossary/feedback.htm

The role of pro-cyclical policies:

- Supports/reinforces the cycle
- Generally:
  - Underwriting standards and loan products
  - Loan loss reserve provisioning
  - Deposit insurance premiums
  - Fair value accounting rules – marked-to-market of illiquid assets
    - Economic or intrinsic value
  - "An increase in house prices, whether driven by demand momentum or the effects of governmental policies or institutional changes, can have a collateral feedback effect: once collateral values increase, lenders are willing to lend even more to households, feeding the housing price boom."*
    - In the U.S. "relaxation in lending standards was higher in areas with faster rates of house price appreciation."*
- Appraisals
  - Market value – if prices rising, values are rising, if prices are falling, values are falling
  - Between new sales and cash out refinances, a large portion of the market (including illiquid refinances)is constantly being "marked-to-market"
    - Stabilized or mortgage lending value based on price trends, fundamentals, and economic value (value as a rental and replacement cost)

*IMF Research Bulletin March 2010

This policy had unintended consequences: it hurt those it was intended to help the most



- Phoenix is representative of the 20 markets tracked by Case-Shiller

Part 4: Property Valuation: A Return to Market Fundamentals

Fundamentals of modern appraising:

- When modern appraisal practice was developed in the 1930s and 1940s, determining a property's value required the reconciliation of four valuation principles:
  - "**The principle of replacement:** The estimated cost of replacement fixes an upper limit of valuation.
  - **The principle of substitution:** the cost of acquiring an equivalent substitute [or comparable] property fixes the upper limit of valuation whether accomplished by (1) constructing identical or equivalent improvements on an equivalent site or (2) purchasing an already completed equivalent property at a price at which an effective supply of equivalent properties is available on terms assumed in the valuation [today this is called comparable value].
  - **The principle of income capitalization:** A properly made capitalization of expected income [rents] fixes an upper limit of valuation.
  - **The principle of suitability or appropriateness:** Unless proposed new building improvements will be appropriate to the site and neighborhood, valuation cannot be as high as replacement cost."

Leverage and valuation methodologies

- Property valuation is not unique in the challenges it faces and must learn from other disciplines and relearn from its past:
  - Margin requirements on stocks and other securities.
  - Common stock valuation
    - Current stock price vs. price to earnings vs. balance sheet/cost to replicate
  - Valuing securities holdings
    - Mark-to-market vs. stream of income

Appraisal methodology has morphed into a positive feedback loop divorced from fundamentals

- Over time the principles of replacement and income capitalization came to be relied on less and less until they were made optional and eventually ignored, leaving comparable sales as the sole determinant of value.
  - Even when used, they were largely derived from market value
- In the lead up to the mortgage meltdown, appraisal methodology had but one input leading to one inevitable output:
  - Boom induced comparable sales prices led to a predictable output: a boom induced value for the subject property.
    - The appraiser is left with determining "the price at which a property may be sold", not its value or more importantly, its value for lending purposes.
- Capacity to generate rental income and a property's replacement cost are fundamental determinants of stabilized value.
  - The long-term relationship of market value to key fundamentals should be tracked, evaluated, and stabilized.

Fundamentals of appraising: feedback loops, and reversion to the mean

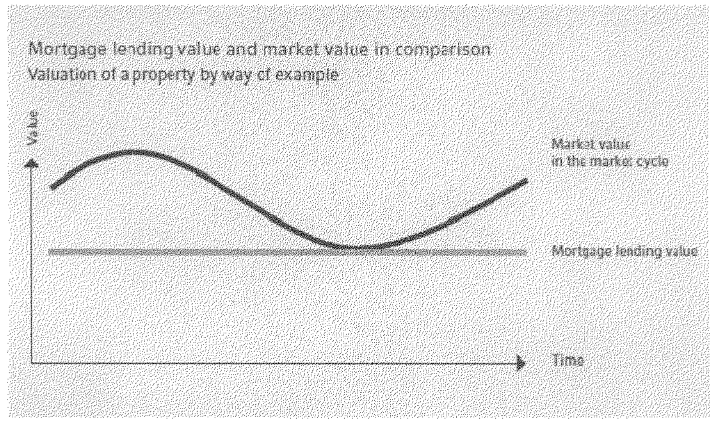
- Experience demonstrates that a high percentage of the correction needed to revert to the mean is the result of price drops, not increasing rents, rising incomes, or higher replacement costs.
- Alternatively, a stabilized value could also be provided.

  "[t]he value of a property as determined by a prudent assessment of future marketability of a property taking into account long term sustainable aspects of a property, the normal and local market conditions, and the current use and alternative appropriate uses of a property. Speculative elements shall not be taken into account in the assessment of the mortgage lending value. The mortgage lending value shall be documented in a clear and transparent manner."*

  - Unlike market value, stabilized value cannot be determined solely on the basis of comparable sales.
  - Speculative elements tie directly to excessive speculation, market value-to-rent deviations, and market value-to-construction cost deviations.
  - Tracking fundamental relationships over time is the key to determining a stabilized or non-speculative value.

* Source: Definition of Mortgage Lending Value: International Valuation Standards Council, Implementation of Basel Standards in the EU, 2006

Mortgage Lending Value (MLV)



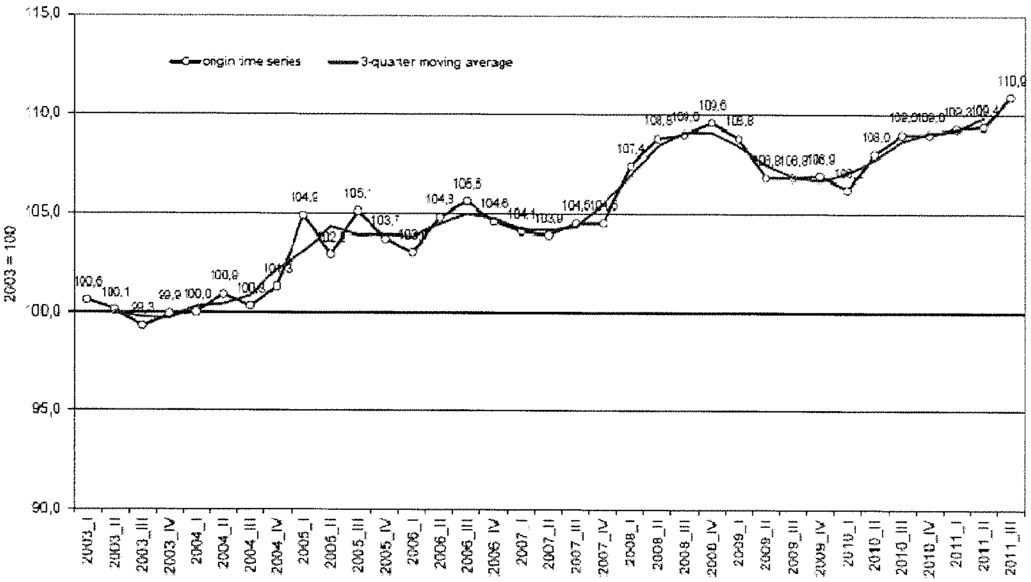
- Conservative valuation of real estate
  - Assessment of the MLV on the basis of detailed statutory and regulatory criteria
  - Based on long-term sustainable features of the property
  - Market value (comparable method) is the upper limit for the MLV
  - Considers normal regional and local market conditions and fundamentals
    - Does not take into account economically induced fluctuations in value or speculative elements
  - Takes into account long-term nature of property loan
    - MLV applies throughout the entire life of the loan.
    - Market value relates to a point in time
    - MLV and market value are two different value concepts and are calculated independently.

Grateful thanks to Reiner Lux , Managing Director, HypZert GmbH, Berlin for MLV background material

Mortgage Lending Value (MLV)

vdp Price Index for Single Family Houses in Germany

vdp VERBAND DEUTSCHER PFANDBRIEFBANKEN



Source: vdp transaction database, evaluation by vdpResearch, November 2011

Role played by market value-to-rent relationship

- Practical basis – the price of housing is determined by supply and demand:
  - All things being equal - a rising population, income growth, supply limitations, and geographic desirability affect rents and home prices in a similar manner
    - "The fundamental value of a house is the present value of the future housing service cash flows [in lieu of rents] that it provides to the marginal buyer. In a well-functioning market, the value of the housing service flow should be approximated by the rental value of the house." FRB of San Francisco, October 1, 2004
    - The direct substitution for owning a home is renting
    - The price to rent ratio measures this relationship. As standards loosen during a boom, marginal households switch from renting to owning, driving up home prices & reducing rental demand.
    - When a deviation in the ratio occurs: "The majority of the movement of the price-rent ratio come from future returns, not rental growth rates. This [is not comforting], as it implies that price-rent ratios change because prices are expected to change in the future, and seemingly out of proportion to changes in rental values.... If the ratio is to return to its average level, it will probably do so through slower house price appreciation." FRB of San Francisco, October 1, 2004

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Role played by market value-to-rent relationship

- Practical basis – the market value of housing is determined by supply and demand:
  - When things are not equal:
    - Low rates, readily available credit and loosened credit standards (higher leverage) can increase home purchase demand
      - Increased leverage causes a greater effect on home prices than rents
        - » The same amount of savings can by a more expensive house
        - » The same income can buy a more expensive house
        - » These stimuli do not increase the ability to pay higher rents
        - » By moving demand from rentals to purchase, rents can be kept low
    - Owner occupied homes have an "ownership premium"
      - This premium goes up when owning or investing in a home is viewed favorably compared to renting. This psychological change can help promote a bubble.
    - High levels of speculative investing – either by disclosed investors or through fraud
      - An investment based on fundamentals or speculation based on departure from fundamentals.
      - If the back up plan is renting out, does it cash flow or require a subsidy?
      - Ultimately rents determine value – "rush to the exits"

Role played by market value-to-rent relationship

- Theoretical basis:
  - Asset valuation (such as a security): two fundamental measures of value
    - Economic or intrinsic value
      - Challenges: estimating future cash flows and calculation of a discount rate
    - Current market value
      - Challenges: may not be fungible or liquid, subject to "artificial" supply/demand imbalances, and liquidity squeeze
  - Normally these give substantially similar results, but they can and do diverge, sometimes by substantial amounts
    - Valuation of "opaque" securities during illiquid distressed markets: Fair value accounting (FVA or mark-to –market) rules force the liquidation at fire sale prices, creating a vicious cycle. Cash flow was initially ignored, causing market prices to fall below long-term realizable economic value.
    - During bubbles credit spreads tighten and higher risk assets gain value, allowing FVA to feed the expansion of bubbles. More leverage increases demand for risky assets and can further narrow spreads. All of these effects are highly pro-cyclical.
  - By decoupling market values from rents, a similar result occurred during the bubble. Market values greatly exceeded economic value.

Role played by market value-to-rent relationship

- Theoretical basis:
  - Over time, the value of an asset is determined by the income it can generate
    - While the relationship between price and rent can deviate, overtime this relationship is fairly consistent, meaning it reverts to the mean
      - Automatically corrects for normal inflationary distortions
    - When a deviation in the ratio occurs: "The majority of the movement of the price-rent ratio come from future returns, not rental growth rates. This [is not comforting], as it implies that price-rent ratios change because prices are expected to change in the future, and seemingly out of proportion to changes in rental values.... If the ratio is to return to its average level, it will probably do so through slower house price appreciation." FRB of San Francisco, October 1, 2004
  - The ratio of market values to rents has reverted to its long-run average four times between 1970 and the mid-1990s [1970, 1975, 1983, and 1995]. Between 2000 and 2006, the ratio rose dramatically above the long-run average and has been moving back toward it ever since then. IMF Research Bulletin, March 2010

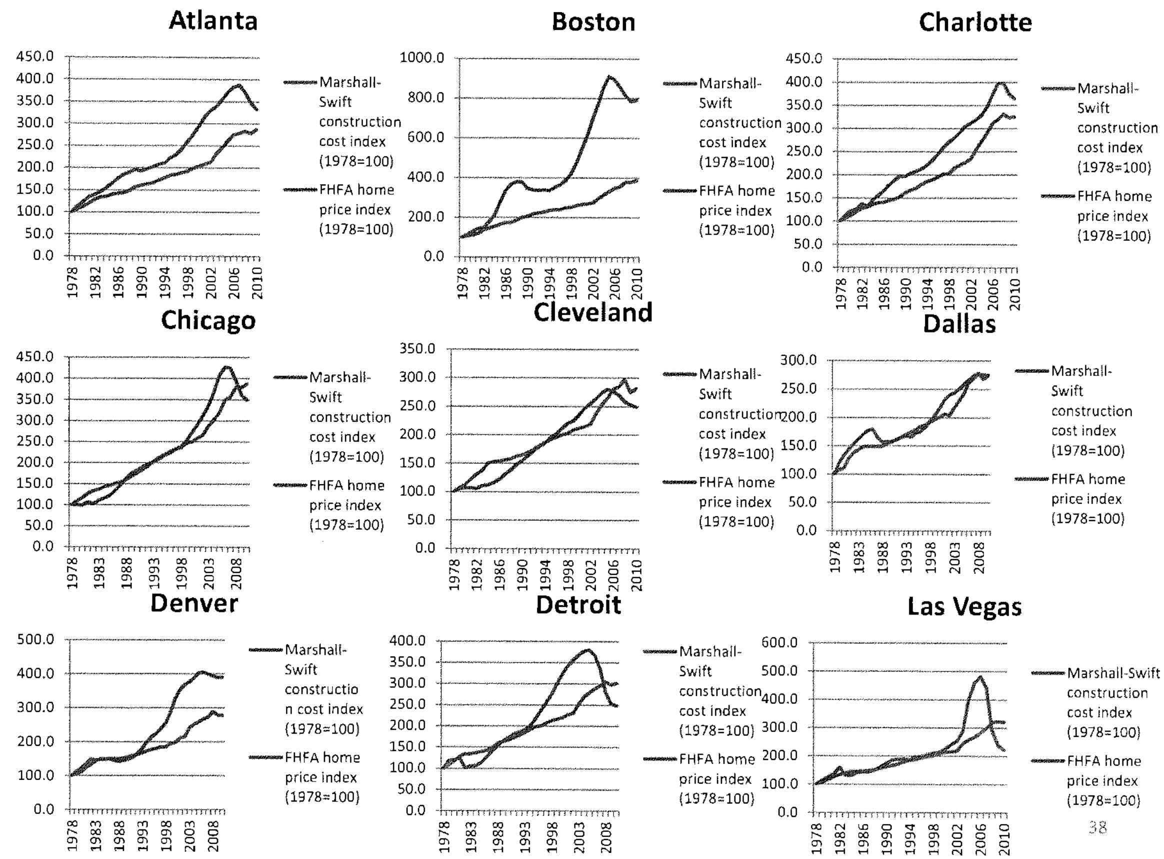
Market value-to-rent relationship: empirical evidence

MSA	San Mateo (San Fran)	Orange Co. (Santa Anna)	LA	Boston	San Bern CA	Chic IL	NO, LA	Dallas	Atl., GA	Ind., IN
Annual Rent/ Sales Price (2005)*	3.1%	4.1%	4.6%	4.9%	5%	6.1%	7.6%	9.3%	9.5%	10.4%
HPI Change **	-21%	-31%	-32%	-14%	-47%	-22%	-5%	+1%	-18%	-3%
Nat City (2005) ***	+35	+44	+54	+18	+65	+21	+12	-16	+2	-5

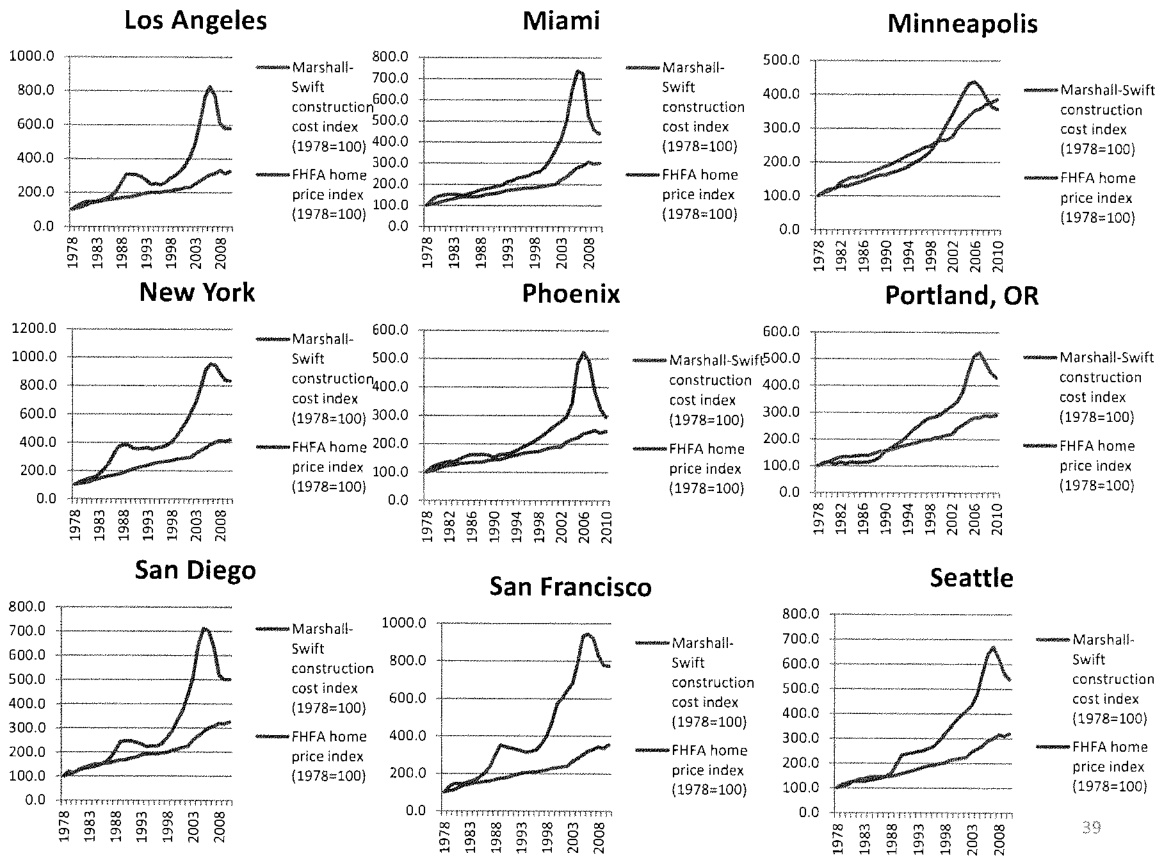
*Smith & Smith, 2006, "Bubble, Bubble, Where's the Housing Bubble?" Comparable properties with sales price and rent info.
** OFHEO/FHFA MSA HPIs Q2:2006-Q2:2011, http://www.fhfa.gov/Default.aspx?Page=216&Type=summary
*** National City"s over value/under value index based on a regression analysis of house prices, income, density, and interest rates as reported in "Bubble, Bubble, Where's the Housing Bubble?"

Role played by market value-to-replacement cost relationship

- "**The principle of replacement:** The estimated cost of replacement fixes an upper limit of valuation.
  - While the relationship between sales price and construction replacement cost (excluding land) can deviate, overtime this relationship is fairly consistent, meaning it reverts to the mean.
  - When a boom induced deviation in the market value-to-replacement cost ratio occurs, it is followed by reversion to the mean.
    - After a boom induced deviation, the majority of a reversion comes from house price declines, not replacement cost declines (unless the boom is followed by a broad based deflationary period)."
- On a national indexed basis the ratio of house prices to replacement costs reverted to its long-run average three times between the early 1970s and the mid-1990s [1973-74, 1983, and 1994]. In the early- to mid-2000s, the ratio rose dramatically above the long-run average and since 2005-2006 has been reverting to this average.



Atlanta
Boston
Charlotte
Chicago
Cleveland
Dallas
Denver
Detroit
Las Vegas
Marshall-Swift construction cost index (1978=100)
FHFA home price index (1978=100)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San Francisco
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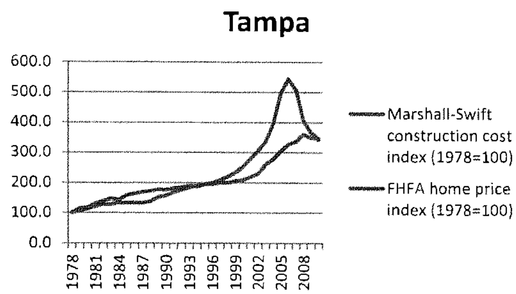
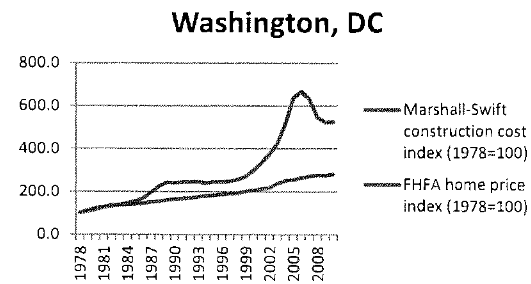
Marshall-Swift construction cost index (1978=100)
FHFA home price index (1978=100)





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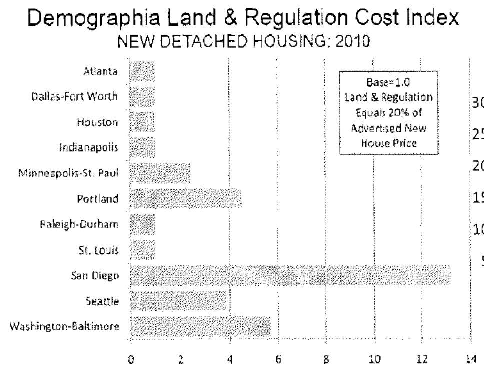
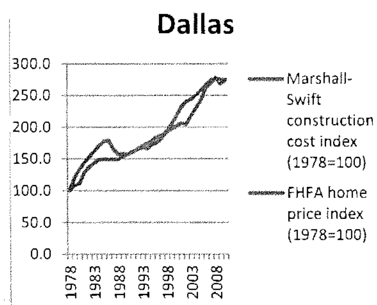
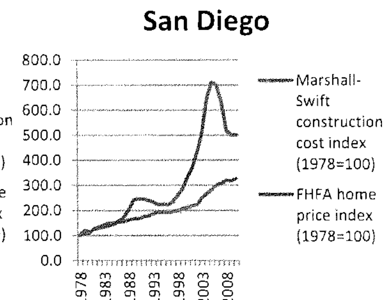
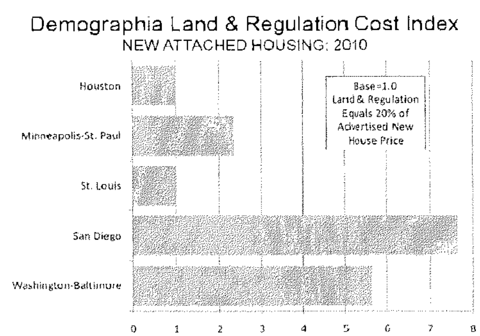
Source for construction cost data: *Marshall & Swift/Boeckh's Residential Construction Cost Index provided to author by Marshall & Swift*

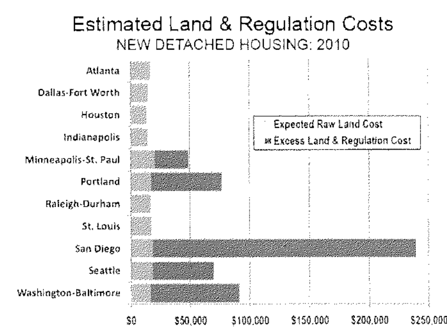
Land use restrictions may keep HPI/Cost relationship above the norm











Using fundamentals to estimate overvaluation

- IHS Global Insight's Over/Under Valuation Index (formerly Nat City Index) demonstrates the correlation between fundamentals and home prices at the MSA level using:
  - House prices, interest rates, household incomes, population densities, and any historical premiums or discounts over time.

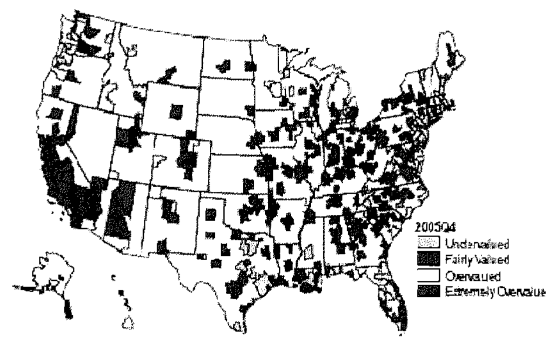
	Over Valuation 2005Q4	Price Change (%) 2005 to 2009
Los Angeles, CA	55.9	-29.8
Sacramento, CA	54.5	41.9
Miami, FL	49.4	35.8
Oakland, CA	46.7	39.9
San Jose, CA	41.6	-20.0
Phoenix, AZ	38.9	-30.5
Washington, DC	38.3	-18.1
San Diego, CA	36.8	-31.5
Las Vegas, NV	35.3	-57.1
Detroit, MI	34.2	-36.6

Source: HIS Global Insight, House Prices in America: 4th Quarter 2009 Update

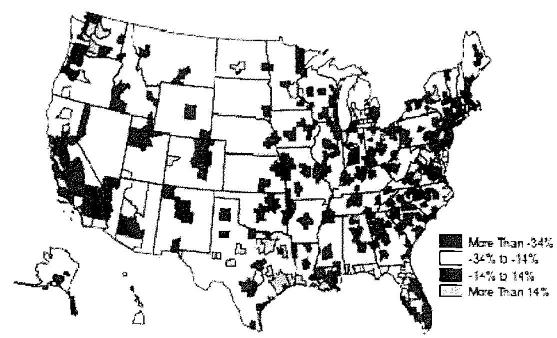
Using fundamentals to estimate overvaluation

- For 330 tracked MSA, overvaluation and price change was highly negatively correlated at -0.82, with higher valuations closely associated with larger price declines.

Map 1: House Price Valuation, Fourth Quarter 2005



Map 2: Change in Median Price, 2005Q4 to 2009Q4



Source: IHS Global Insight, House Prices in America: 4th Quarter 2009 Update

Comparing fundamentals

	ATLANTA	BOSTON	CHARLOTTE	CHICAGO	CLEVELAND	DALLAS	DENVER	DETROIT	LAS VEGAS	LOS ANGELES	MIAMI	MINNEAPOLIS	NEW YORK	PHOENIX	PORTLAND	SAN DIEGO	SAN FRAN	SEATTLE	TAMPA	WASH DC
Spread between FHFA HPI/ Marshall-Swift Cost Index	110	580	56	88	15	16	[illegible]	100	193	476	384	94	546	261	183	427	633	293	192	381
IHS Global Over Value	-3	25	-11	16	4	21	8	34	35	56	49	22	26	39	34	37	32	24	30	38
Annual rent/ sales price	9.5	4.9	n/a	6.1	n/a	9.3	n/a	n/a	n/a	4.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
FHFA HPI Change	-13	-13	-8	-18	-11	-1	-3	-35	-54	-30	-40	-19	-13	-43	-18	-30	-18	-10	-37	-21

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FHFA HPI/Marshall & Swift Cost Index: 14 positives for price drops>=10%, 2 positives for minor price drops, 3 misses. 1 false positive

IHS: 15 positives for price drops>=10%, 2 positives for minor price drops, 2 misses, 1 false positive

Rent/sales price: 4 positives, 1 miss

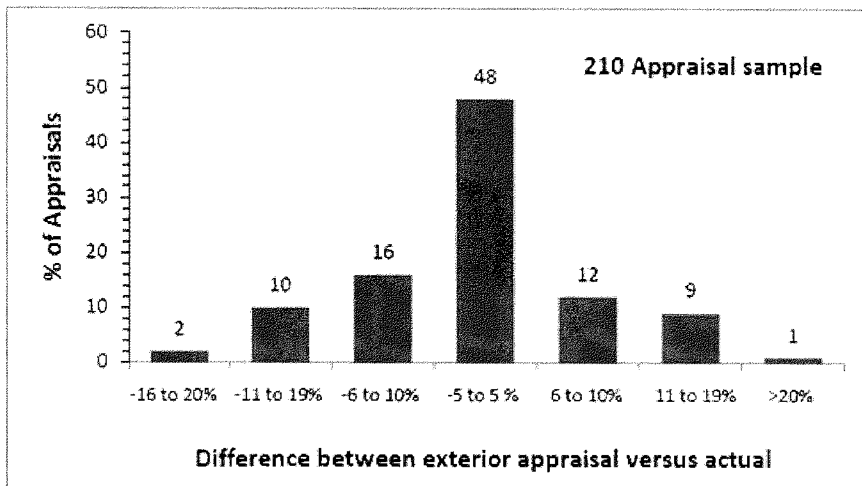
Spread data as of Q4:05, Rent/Price data as of 2005, FHFA HPI percentage change from peak to Q4:10

Part 5: Recommendations

Where and how to start: reporting a sales price range

- Conclusion: in order to not start with the answer (sales price) requires reporting a sales price range:

  In a 1990 field test, 210 exterior valuations were conducted on recently sold homes. The evaluator was not provided with the sales price, but was given a broad range of reference sales with a similar bedroom count from the same subdivision. Eighty percent were performed by non-appraisers. The distribution was normal and 48% were within +/-5% & 76% were within +/-10%.



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Where and how to start: comparable selection process

- Comparable (comp) selection process must be transparent to the users.
  - The current process starts with the sales price and uses it to narrow the selection of appropriate comps – generally ending up with 3 properties.
    - Under the best of circumstances, this process eliminates many of the most appropriate comps.
    - In unscrupulous hands, this allows the use of inappropriate comps to support an inflated value.
      - In a 1991 study of industry appraisal practices investigated whether selected comps were appropriate.
        - » In a review of 14 appraisals, a total of 48 comps were selected and used by the appraisers. After a thorough database search, 65 potential appropriate comps were found. Each appraisal was desk and field reviewed for appropriateness of the 48 appraiser selected comps. Only about half of the appraiser selected comps were found among the 65. The rest (23) were found to be clearly inappropriate (if in doubt it was rated appropriate).
          - Information was shared with Fannie Mae's credit policy department. They had just conducted a similar review and also found a high degree of inappropriate comps used
      - In 2002 Fannie Mae issued Guide Announcement 02-02 pointing out the most common appraisal deficiencies. Virtually all involved the selection or reporting of comps:
        - » Unsupported opinions of value;
        - » Improper selection (or creation) of comparable sales;
        - » Unsupported adjustments in the sales comparison approach;
        - » Inadequate reporting of the sales history for the subject property and comparable sales; and
        - » Misrepresentation of the physical characteristics of the subject property, improvements, and comparable sales.
      - In 2011 (CRN), Fannie states the biggest problem continues to be inappropriate comp selection.
- Use statistical techniques to help the appraiser select and reconcile all appropriate comps (and in the process eliminate inappropriate comps).

Where and how to start

- Market value using comparable method sets the upper limit for mortgage lending value
  - Report a sales price range
  - More robust and transparent comparable selection process
- A stabilized value should also be provided:
  - Consider normal regional and local market conditions and fundamental relationships
  - Growing investor share would also be an indicator of increasing speculative activity – however this tends to be a symptom of a bubble, not a predictor.
- A collateral expert at the lender should determine loan terms based on a review and analysis of market and stabilized values.

Conclusion

- Only by taking steps such as these can property appraising be returned to its status as a profession and to its core function:
  - Assisting lenders in determining the maximum amount that may be prudently lent on a property.

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mschneider@gsblaw.com TEL EXT *1787*

February 21, 2012

The Honorable Ben Bernanke
Chairman, Board of Governors of the Federal Reserve System
20th St. and Constitution Avenues, NW
Washington, D.C. 20551

Richard Cordray
Director, Consumer Financial Protection Bureau
1500 Pennsylvania Ave. NW
(Attn: 1801 L Street)
Washington, DC 20220

Re: Petition for Reconsideration and Rulemaking: Interim Final Rule Implementing the Appraisal Independence Provisions of Section 1472 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Chairman Bernanke and Director Cordray:

We represent the American Guild of Appraisers, a membership organization of real estate appraisers. We write to you in connection with the interim final rule ("IFR", 75 Fed. Reg. 66554) implementing the appraisal independence provisions of section 1472 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). As explained in detail in the attached "Petition for Reconsideration and Rulemaking", the Federal Reserve Board has contradicted the clear intent of Congress and failed to comply with the basic requirements of the Administrative Procedures Act.

Briefly, Congress intended to insure that appraisals would be free from undue influence and competently performed, in part, by requiring that appraisers be compensated fairly with "customary and reasonable fees." The law prohibits using studies or surveys of fees paid to appraisers by Appraisal Management Companies as a basis to determine what a customary and reasonable fee is. Yet, the IFR implementing this provision of Dodd Frank appears to permit that which is prohibited in the law. As the GAO has found, while lenders generally pay AMCs and appraisers at the same rate, the rates paid to appraisers by AMCs are lower by at least 30%. Up to 80% of appraisals are ordered through AMCs. Congress could not have intended to establish two alternate methods of compliance that result in "customary and reasonable" fee standards for the same properties in the same geographic areas that differ by 30% or more. Moreover, in failing to provide prospective notice and opportunity to comment and response to comments in connection with the promulgation of the IFR, the Federal Reserve Board

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acted in violation of the requirements of the Administrative Procedures Act. In this case, the defect goes to the heart of the requirements of the Administrative Procedures Act.

The issuance of the IFR in its current form, without reasonable prior opportunity for notice and comment, has resulted in degradation in the quality and reliability of appraisals and injury to the appraisal industry. Pursuant to 5 U.S.C. § 553(e), and for the reasons set forth in the attached Petition, the American Guild of Appraisers hereby requests that immediate action, as set forth in the Petition's request for relief, be taken to prohibit reliance on information about fees paid by AMCs in determining what fees are customary and reasonable, consistent with the intent of Congress.

Sincerely,

Matthew R. Schneider

Attachment

Petition for Reconsideration and Rulemaking
Submitted to
The Federal Reserve Board and Consumer Financial Protection Bureau
On Behalf of
The American Guild of Appraisers

<u>**Executive Summary**</u>

Over the course of the last decade, as the volume of home mortgages increased, the percentage of appraisals ordered through Appraisal Management Companies (AMCs) dramatically increased. Currently, between 60 to 80% of all residential appraisals are ordered through AMCs, rather than directly from appraisers.

When an appraisal is ordered through an AMC, the fees for the appraisal paid by lenders, and ultimately passed on to the borrower, are generally the same as when the appraisal is ordered directly from an appraiser. However, a significant portion of the fee is retained by the AMC middleman. As a result, the fees actually paid to the appraiser by AMCs are on average more than 30% lower than when the appraiser is hired by a lender directly, despite the fact that the effort required of the appraiser is the same in either case. In addition, AMCs frequently require inordinately short turn-around times for appraisals, placing an additional burden on appraisers, and often utilize appraisers from different locations who are unfamiliar with the subject property's neighborhood. As the percentage of appraisal orders passed through AMCs has increased, appraisers have been forced to do more for less under conditions that compromise the integrity and quality of the appraisal process and threaten to drive many qualified appraisers from the profession.

In response to concerns about the effect this situation was having on the reliability of home valuations, when Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank") it required the Federal Reserve Board (the "Board") to promulgate appraisal independence regulations that include a mandate that creditors and their AMC agents "compensate fee appraisers at a rate that is customary and reasonable for appraisal services being performed in the market area being appraised." In particular, while Dodd Frank permitted customary and reasonable fees to be determined based upon objective third party information such as fee studies, it explicitly provided that these studies exclude rates paid by AMCs. This provision reflected Congress' concern that the lower fees paid by AMCs, who have a dominant share of the market, would distort the determination of what fees are customary and reasonable, thereby undermining the intent of the requirement.

Pursuant to Dodd Frank's direction, on October 28, 2010 the Board published its interim final rule on appraisal independence (the "IFR"), which took effect December 27, 2010. In addressing the Dodd-Frank mandate that appraisers be paid a customary and reasonable fee for appraisals, the Board created two alternate presumptions of compliance with this requirement. Under one presumption of compliance, creditors and their agents are presumed to comply if the fee they pay an appraiser is based on objective third-party information, provided that this information excludes fees paid by AMCs as required by Dodd-Frank.

Under the other presumption of compliance, creditors and their agents are presumed to comply if the rates paid are "reasonably related" to recent rates paid for services in the same geographic market. In order to determine the rates recently paid in a geographic market, the IFR specifies that creditors and their agents may, but are not required to, perform a fee survey. However, this provision does not explicitly require that such a survey exclude rates paid by AMCs. In fact, in the preamble to the IFR, the Board specifically stated that "qualifying for this presumption of compliance does not require that a creditor use third-party information that excludes appraisals ordered by AMCs." In other words, under this presumption of compliance AMCs appear to be permitted to rely on the very same, significantly lower fees that they themselves pay appraisers—the very fees excluded under the first presumption of compliance and excluded by Congress in Dodd-Frank. The inclusion of this presumption of compliance as it currently is interpreted in the preamble to the IFR is, therefore, arbitrary, capricious and contrary to law.

In addition, in issuing the IFR, the Board did not follow the standard notice-and-comment procedure required by the Administrative Procedure Act. Instead, the Board claimed that there was "good cause" to forgo the notice-and-comment requirements and, instead, provided a post-promulgation period in which the public was invited to submit comments. In response, the Board received over 1000 comments, many of which addressed the two conflicting presumptions of compliance with the customary and reasonable fee provisions. However, to date neither the Board nor any of the other federal agencies charged with development and oversight of the appraisal independence rules have responded to the comments received. Furthermore, there has been no indication when, if ever, the IFR will be revised or replaced by a non-interim, final rule.

In failing to provide prospective notice and opportunity to comment the Board acted in violation of the requirements of the Administrative Procedure Act. Moreover, the promulgation of a presumption of compliance that permits AMCs to rely on the low rates they themselves pay appraisers, which is contrary to law, is a defect that could have been timely cured if the Board had permitted the affected appraisal industry opportunity to provide meaningful input on the rules prior to their implementation. This is exactly the sort of misguided rulemaking that the notice-and-comment requirements are designed to avoid.

In light of these concerns, pursuant to 5 U.S.C. § 553(e) the American Guild of Appraisers respectfully requests that the IFR be revised immediately to prohibit reliance on information about fees paid by AMCs in determining what fees are customary and reasonable, consistent with the intent of Congress.

I. Background

Generally, with a few specified exceptions, federal regulations require that an appraisal conducted by a state licensed or certified appraiser be performed for real estate related transactions. *See, e.g.,* 12 C.F.R. § 323.3 (applicable to FDIC-regulated institutions). Historically, lenders have obtained appraisals either by using in-house appraisers, contracting with independent appraisers or appraisal firms, contracting with third party appraisal management companies ("AMC"s) who in turn subcontract with appraisers, or by relying on appraisals contracted for by the borrower's mortgage broker. United States Government Accountability Office *Residential Appraisals: Opportunities to Enhance Oversight of an Evolving Industry* 7 (July 2011) ("GAO Report"). The cost of these appraisal services are generally then charged to the consumers obtaining the mortgages. *Id.* at 22. *See also* 12 C.F.R. § 226.4(b)(4).

In the mid-2000s, allegations arose that mortgage brokers and loan officers were pressuring appraisers into overvaluing properties in order to secure mortgage approvals. *Id.*, at 1. In the midst of the burgeoning foreclosure crisis, the Attorney General of New York filed a lawsuit alleging that Washington Mutual had inappropriately pressured an AMC to ensure that appraisers were used that would inflate property values. *Id.* The associated investigation ultimately led to an agreement between the New York Attorney General, Fannie Mae and Freddie Mac—who had purchased many of the Washington Mutual mortgages—and the Federal Housing Finance Agency ("FHFA"), which regulates Fannie Mae and Freddie Mac. *Id.*, at 2. As a part of this agreement, the Home Valuation Code of Conduct ("HVCC") was adopted, specifying that loans sold to either Fannie Mae or Freddie Mac must meet certain requirements for appraisal independence. *Id.*

Under the HVCC, either the lenders themselves or specifically authorized third parties, such as an AMC, were responsible for selecting and compensating appraisers, meaning that mortgage brokers and real estate agents were not permitted to select or compensate appraisers. In addition, the lenders' loan production staffs were prohibited from:

> (1) selecting, retaining, recommending, or influencing the selection of any appraiser for a particular appraisal assignment or for inclusion on a list or panel of appraisers approved to perform appraisals for the lender or forbidden from performing such work; and (2) having any substantive communications with an appraiser or appraisal management company relating to or having an impact on valuation, including ordering or managing an appraisal assignment.

HVCC, § III (B).

Though some lenders, as a result of capacity and operational pressures, had already switched to relying on AMCs prior to the HVCC becoming effective, the percentage of appraisals ordered through AMCs prior to 2009 when the HVCC went into effect was less than half. GAO Report, *supra*, at 32. After the advent of the HVCC, however, compliance concerns by lenders have increased the percentage of appraisals ordered through AMCs to somewhere between 60 and 80%. *Id.* Historically, independent appraisers and appraisal firms relied on local relationships with loan originators in order to secure appraisal jobs, but, in the post HVCC-era, most appraisals are now assigned through AMCs. *Id.*; see also letter from Daniel Drelich, President, NJ Chapter of the American Guild of Appraisers OPEIU/AFL-CIO, to the Federal Reserve Board (Dec. 23, 2010), http://www.federalreserve.gov/SECRS/2011/January/20110120/R-1394/R-1394_122910_58913_332574998363_1.pdf. As a result of this shift, many small appraisal firms went out of business, some independent appraisers joined AMC panels in order to make a living, while others switched to performing nonresidential appraisals or left the industry entirely. GAO Report at 32-33.

While the fees paid by consumers for appraisals can vary significantly based upon the complexity of the appraisal and the regional market, industry estimates suggest that the average costs fall between \$300 and \$450 depending on location. *Id.* at 22. According to the mortgage industry, however, appraisal fees paid by borrowers are generally the same, regardless of whether the appraisal is ordered through an AMC. *Id.*, at 24. In the case of appraisals for which appraisers are engaged by lenders directly, the entirety of the fee goes to the appraiser or appraisal firm. *Id.* When appraisals are ordered through AMCs, however, AMCs keep at least 30% of the fee. *Id.* As a result, appraisers forced to join AMC panels in order to obtain sufficient work found themselves being asked to perform the same amount of work for significantly less money. *Id.* at 33. In addition, in some cases, AMCs apply pressure on the appraiser to guide the appraiser's value conclusion and insist on their meeting unreasonable deadlines. *Id.*

In testimony before the House of Representatives Committee on Financial Services, Jim Amorin, President of the Appraisal Institute, characterized the effect of the AMC industry (then, largely unregulated) on the appraisal process, stating:

> AMCs charge 'appraisal management fees,' the details of which are not fully disclosed to the consumer. Consumers unwittingly believe that this includes a quality appraisal when in fact it is typically a cut-rate substitute. Because AMCs and lenders cram into these fees other undisclosed management charges, consumers are short-changed by quick valuations by AMC contractors paid a fraction of the normal compensation.

H.R. 1728, The Mortgage Reform and Anti-Predatory Lending Act of 2009: Hearing Before the H. Committee on Financial Services, 111th Cong. 72 (2009) (statement of Jim Amorin, President, Appraisal Institute).

II. Dodd-Frank Act Provisions

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010) ("Dodd-Frank"), revised Chapter 2 of the Truth In Lending Act, 15 U.S.C. § 1631 *et seq*, to add requirements intended to ensure appraisal independence. Dodd-Frank § 1472. When the bill was introduced and passed by the House of Representatives in 2009, it included a provision requiring the Director of the proposed Consumer Financial Protection Bureau ("CFPB") to lead a Negotiated Rulemaking Committee to promulgate appraisal independence requirements for residential loan purposes. H.R. 4173, 110th Cong. § 4312 (as introduced in the House of Representatives, Dec. 2, 2009). This provision required that the regulations promulgated pursuant to § 4312 "shall include a requirement that lenders and their agents compensate appraisers at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised." *Id.*, § 4312(b)(2).

When the Senate considered the House-passed version of H.R. 4173, it approved an amendment in the nature of a substitute, which substituted a substantially different Senate version of the bill which did not contain a provision similar to § 4312. H.R. 4173, 110^{th} Cong. § 4312 (as engrossed in the Senate with amendment, May 20, 2010). When the joint conference met to reconcile differences between the House and Senate versions of the bill, however, the conference added a substantially lengthier and more detailed section on appraisal independence. H.R. 4173, 110^{th} Cong. § 1472 (enrolled bill, final as passed both House and Senate.) The conference provisions specified that:

> Lenders and their agents shall compensate fee appraisers at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised. Evidence for such fees may be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys. Fee studies shall exclude assignments ordered by known appraisal management companies.

Id. § 1472 (i)(1), Pub. Law 124 Stat 2192, § 129E(i)(1) *codified at* 15 U.S.C. § 1639e. Under subpart (3) of this provision, in the case of complex assignments, the required reasonable and customary fee should "reflect the increased time, difficulty, and scope of the work required for such an appraisal and include an amount over and above the customary and reasonable fee for non-complex assignments." *Id.* § 1472 (i)(3).

The appraiser independence provisions of Dodd-Frank reflect Congress' cognizance that AMCs that order the vast majority of appraisals are agents of the lenders, and that the fees AMCs and lenders pay to independent, non-AMC employee appraisers for their appraisal services have an important bearing on the integrity and competence of appraisals. Accordingly, the legislation's definition of "Appraisal Management Company" reflects the AMCs' agency relationship with lenders (AMC defined as ". . . external third party authorized either by a creditor . . . . or underwriter or other principal in the secondary mortgage market" to "recruit, select and retain" and "contract" with appraisers)(*id.*, § 1124(f)(4)(11)), and the term "fee appraiser" for purposes of the "reasonable and customary" fees provisions "means a person who is not an employee of the mortgage loan originator or appraisal management company engaging the appraiser." *Id.* § 1472 (i)(3). Further, the legislation reflects that Congress was aware of the fact that fees charged for appraisals coordinated by AMCs typically include more than just the fees paid by AMCs to appraisers. Accordingly, Congress amended RESPA to provide that the standard disclosure form may include clear disclosure of both the "fee paid to the appraiser" and the "administration fee" paid to the AMC. *Id.* § 1475.

Thus, in adopting "reasonable and customary fee" requirements as an integral part of provisions intended to assure appraisal independence, Congress recognized the potential for harm to the public interest inherent in the AMCs' power: to retain and contract with appraisers; to determine how much to pay them; to disfavor individual appraisers who are independent and unwilling to bow to pressure; and to determine what to charge their principals for the "package" of appraisal services performed by independent appraisers and "administrative" services performed by the AMC itself. Section 1472(i)(3)'s exclusion of appraisal assignments ordered by AMCs as the basis of fee studies relied upon to establish compliance with "customary and reasonable" fee requirements can only be understood as reflecting Congress' awareness of the potential for harm inherent in the facts that the AMCs' current position as the major source of appraisal engagements gives AMCs an ability to control fees actually being paid to appraisers and degrade the appraisal process and that AMCs are essentially agents of their lender principals.

To assure robust enforcement of the appraisal independence provisions, section 1472 authorized the Federal Reserve Board (the "Board"), the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Consumer Financial Protection Bureau (the "Bureau") to "jointly issue rules, interpretive guidelines, and general statements of policy with respect to acts or practices that violate appraisal independence," within the meaning of § 1472. *Id.* § 1472(g)(1). However, in addition to this permissive authority, section 1472 required the Board to:

> prescribe interim final regulations no later than 90 days after the date of enactment of this section defining with specificity acts or practices that violate appraisal independence in the provision of mortgage lending services for a consumer credit transaction secured by the principal dwelling of the consumer or mortgage brokerage services for such a transaction and defining any terms in this section or such regulations. Rules prescribed by the Board under this paragraph shall be deemed to be rules prescribed by the agencies jointly under paragraph (1).

Id. § 1472(g)(2).

III. **Interim Final Regulations**

a) Procedural History

Pursuant to the statutory requirements of Dodd-Frank § 1472(g)(2), on October 28, 2010 the Board published an interim final rule ("IFR") implementing the appraisal independence provisions of section 1472. *See* Truth In Lending: Interim Final Rule, 75 Fed. Reg. 66554 (Oct. 28, 2010) (codified at 12 C.F.R. pt. 226.42). The Federal Register notice specified that "[t]his interim final rule is effective December 27, 2010." *Id.*, at 66654. However, it also provided that "[t]o allow time for any necessary operational changes, compliance with this interim final rule is optional until April 1, 2011," at which time the pre-existing appraisal independence rules at 12 C.F.R. § 226.36(b) would be removed. *Id.*

While the IFR would become effective as published, the Board nevertheless requested public comments, which it stated "must be received on or before December 27, 2010." *Id.* In justifying its issuance of the IFR without complying with the notice and comment requirements of the Administrative Procedure Act, 5 U.S.C. §553, the Board relied upon the good cause exception at 5 U.S.C. §553(b)(B). Truth In Lending: Interim Final Rule, 75 F.R. at 66556.

Specifically, the Board found "that for this interim rule there is 'good cause' to conclude that providing notice and opportunity to comment would be impracticable and, therefore, is not required." *Id.* Its rationale was based on the faet that "Congress imposed a 90 day deadline for issuing the interim final rule" and that "90 days does not provide sufficient time for the Board to prepare and publish proposed regulations, provide a period for comment, and publish in the Federal Register before the statutory deadline." *Id.* The Board further expressed its belief that:

> the Dodd-Frank Act's mandate that the Board issue interim final rules that will be effective before the issuance of permanent rules also supports the Board's determination that notice and comment are impracticable. If the legislation had contemplated a notice and comment period, the rules issued by the Board could have been referred to as "final rules" rather than "interim final rules.

Id.

b) Fair Compensation Provisions

In order to implement the requirement in section 1472(i)(1) of Dodd-Frank that appraisers be paid a customary and reasonable fee, the IFR provides that:

> In any covered transaction, the creditor and its agents shall compensate a fee appraiser for performing appraisal services at a rate that is customary and reasonable for comparable appraisal services performed in the geographic market of the property being appraised. For purposes of paragraph (f) of this section, ''agents'' of the creditor do not include any fee appraiser as defined in paragraph (f)(4)(i) of this section.

Truth In Lending: Interim Final Rule, 75 F.R. at 66582 (codified at 12 C.F.R. 226.42(f)(1)).

The IFR provided that, in order to comply with the "customary and reasonable" fee requirement, creditors and their agents could rely on two alternative presumptions. Under the first, a creditor and its agents are presumed to comply if they "compensate the fee appraiser in an amount that is reasonably related to recent rates paid for comparable appraisal services performed in the geographic market of the property being appraised." *Id.*, (codified at 12 C.F.R. 226.42(f)(2)). The IFR further specified that, in determining this amount, creditors shall take into account the type of property, the scope of work, the time in which the appraisal services are required to be performed, the appraiser's qualifications, the appraiser's experience and professional record, and the appraiser's work quality" and shall make adjustments as necessary to ensure that compensation is reasonable. *Id.*

In the supplement to part 226 providing the Board's staff interpretations, the Board clarified that for the purposes of meeting this presumption of compliance, creditors and their agents:

> may gather information about recent rates by using a reasonable method that provides information about rates for appraisal services in the geographic market of the relevant property; a creditor or its agent may, but is not required to, use or perform a fee survey.

Id. at 66586 (codified at Supplement I to Part 226, Comment 42(f)(2)(i)(2)).

In order to be eligible for this first presumption of compliance, neither creditors nor their agents may "engage in any anticompetitive acts in violation of state or federal law that affect the compensation paid to fee appraisers." *Id.* Examples of the sort of prohibited anticompetitive acts include price fixing, market allocation, restricting individuals from entering the relevant geographic market or causing individuals to leave the relevant geographic market. *Id.*

In addition to this first presumption of compliance, the IFR also provides a second alternative presumption, under which creditors and their agents are presumed to comply with the fee requirements if they base their determination on information about rates that:

> (i) Is based on objective third-party information, including fee schedules, studies, and surveys prepared by independent third parties such as government agencies, academic institutions, and private research firms;
>
> (ii) Is based on recent rates paid to a representative sample of providers of appraisal services in the geographic market of the property being appraised or the fee schedules of those providers; and
>
> (iii) In the case of information based on fee schedules, studies, and surveys, such fee schedules, studies, or surveys, or the information derived therefrom, excludes compensation paid to fee appraisers for appraisals ordered by appraisal management companies, as defined in paragraph (f)(4)(iii) of this section.

Id., (codified at 12 C.F.R. 226.42(f)(3)). This presumption of compliance is consistent with the statutory language of section 1472 of Dodd-Frank which permits the use of objective, third-party evidence of reasonable and customary fees, such as studies, provided that "studies shall exclude assignments ordered by known appraisal management companies." Dodd-Frank § 1472 (i)(1).

Under these two alternatives then, the information about fee appraisal rates on which creditors and their agents—including AMCs acting on creditors' behalf—rely may either be related to recent rates in the area, including those paid by AMCs, under presumption 1, or, under presumption 2, be based on aggregated third party data that excludes rates paid by AMCs. This discrepancy between the two presumptions was made explicit in the Board's explanation to Comment 42(f)(2)(i)-2 in the preamble to the IFR, which stated regarding the first presumption:

> As indicated by this comment, qualifying for this presumption of compliance does not require that a creditor use third-party information that excludes appraisals

> ordered by AMCs, for example, as required to qualify for the presumption of compliance available under § 226.42(f)(3), discussed below.

Truth In Lending: Interim Final Rule, 75 F.R. at 66572.

Thus, the interim final rule promulgated by the Board appears to permit reliance under the first presumption of compliance on fees paid by AMCs to appraisers, which is expressly prohibited under the second alternative.

c) Post-Publication

Following publication of the IFR, the Board received approximately 1300 public comments. Federal Reserve Board, Comments: Regulation Z - Truth In Lending Act [R-1394], http://www.federalreserve.gov/generalinfo/foia/index.cfm?doc_id=R-1394&doc_ver=1&ShowAll=Yes (last accessed December 5, 2011). In addition to hundreds of submissions by appraisers from across the country, these submissions included comments from Daniel Drelich, President of the New Jersey Chapter of the American Guild of Appraisers, which detailed the reduction in average appraiser fees that have accompanied AMC dominance of the market for appraisal services. Letter from Daniel Drelich to Federal Reserve Board, 1-2. In expressing the Guild's concern regarding the fee provisions of the IFR, he stated his agreement with the statement of Ann O'Rourke and Appraisal Buzz that:

> The existence of Presumption 1 is in conflict with the Congressional intent of Title 14 of the Dodd-Frank Act. In order to protect lenders and consumers, Congress recognized the critical importance of engaging appraisers at a fee that allows for thorough analysis and diligence by the most competent appraiser. Not engagement based on lowest fee and rushed completion expectations.

Id., at 3. In order to reconcile the Board's regulations, Mr. Drelich recommended either removing presumption 1, or if that was not an option, clarifying that 100% of the charge to the consumer for an appraisal be paid to the appraiser, with any additional fees for AMC services paid by the lender. *Id.*

Following the close of the comment period, though the regulations became effective December 27, 2011 and mandatory on April 11, 1 2011, the Board has not responded to public comments, nor initiated any follow-up rulemaking processes for the purpose of promulgating a final rule. On July 7, 2011, the Board published its "Semiannual Regulatory Flexibility Agenda" in the Federal Register, which provided a timetable for further action on the IFR by "06/00/11". Semiannual Regulatory Flexibility Agenda, 76. F.R. 40201 (July 7, 2011). Subsequently, however, primary responsibility for these regulations was transferred to the Consumer Financial Protection Bureau. See Identification of Enforceable Rules, 76 F.R. 43569, 43570 (July 21, 2011). The Board and the other named agencies still retain joint rulemaking authority under Dodd-Frank. Dodd-Frank § 1472(g)(1). The Board has indicated, however, that given the current volume of other pending regulatory action required by Dodd-Frank, several of which have statutory deadlines in January of 2013, it is unlikely that any further action will with regard to the IFR will be forthcoming in the near future. Email from Lorna Neill, Division of Consumer and Community Affairs, Federal Reserve Board to Peter Vidi, National President, American Guild of Appraisers (Jan. 13, 2012) (on file with author).

III. **The Board's Issuance of Interim Final Rules Without Notice and Comment Violates the Administrative Procedure Act**

The Administrative Procedure Act (the "APA") requires that, prior to the promulgation of rules by a federal agency, "[g]eneral notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law." 5 U.S.C. § 553(b). Furthermore, the APA requires that:

> After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose.

5 U.S.C. § 553(c). The purpose of these requirements is to ensure the ability of affected parties to participate in the rulemaking process. As the Circuit Court of Appeals for the D.C. Circuit has explained:

> Section 553's notice and comment requirements are essential to the scheme of administrative governance established by the APA. These procedures reflect Congress' "judgment that ... informed administrative decisionmaking require[s] that agency decisions be made only after affording interested persons" an opportunity to communicate their views to the agency... Equally important, by mandating "openness, explanation, and participatory democracy" in the rulemaking process, these procedures assure the legitimacy of administrative norms.

Air Transport Ass'n of America v. Department of Transp., 900 F.2d 369, 375 (D.C. Cir. 1990) (quoting *Chrysler Corp. v. Brown*, 441 U.S. 281, 316 (1979)).

Section 553 of the APA provides limited exceptions to the requirement for notice and comment, which permit agencies to forego this process "when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." 5 U.S.C. § 553(b)(B). However, as

> [t]he Senate Committee responsible for the APA warned:

> "The exemption of situations of emergency or necessity is not an "escape clause" in the sense that any agency has discretion to disregard its terms or the facts. A true and supported or supportable finding of necessity or emergency must be made and published. "Impracticable" means a situation in which the due and required execution of the agency functions would be unavoidably prevented by its undertaking public rule-making proceedings."

State of N. J., Dept. of Environmental Protection v. U.S. Environmental Protection Agency, 626 F.2d 1038, 1046 (D.C. Cir. 1980) (quoting S.Doc. No. 248, 79th Cong., 2d Sess. 200 (1946)).

Consistent with this intent, in reviewing the use of these exceptions courts have repeatedly emphasized that "circumstances justifying reliance on this exception are 'indeed rare' and will be accepted only after the court has examined closely proffered rationales justifying the elimination of public procedures." *Council of Southern Mountains, Inc. v. Donovan*, 653 F.2d 573, 580 (D.C. Cir. 1981) (internal quotes omitted). *See also New Jersey, Dep't of Environmental Protection v. United States Environmental Protection Agency*, 626 F.2d 1038, 1045 (D.C. Cir. 1980) ("it should be clear beyond contradiction or cavil that Congress expected, and the courts have held, that the various exceptions to the notice-and-comment provisions of section 553 will be narrowly construed and only reluctantly countenanced."); *Coalition for Parity, Inc. v. Sebelius*, 709 F.Supp.2d 10, 19 (D.D.C. 2010) ("the 'good cause' exception to notice and comment rulemaking is to be 'narrowly construed and only reluctantly countenanced'") (quoting *Jifry v. FAA*, 370 F.3d 1174, 1179 (D.C. Cir. 2004); *NRDC v. Evans*, 316 F.3d 904, 911 (9^{th} Cir. 2003) ("the good cause exception goes only so far as its name implies: It authorizes departures from the APA's requirements only when compliance would interfere with the agency's ability to carry out its mission").

In issuing the IFR the Board based its finding that there was good cause to bypass notice and comment procedures on the fact that "Congress imposed a 90 day deadline for issuing the final rule." 75 F.R. 66556. This fact alone is not sufficient justification for bypassing notice and comment procedures. Rather, a long history of federal court cases:

> make clear that the exception is confined to emergency actions which are indeed rare and that the mere existence of deadlines for agency action does not in itself constitute good cause. In fact, courts have routinely declined to sanction recourse to the exception because of an impending deadline.

Union of Concerned Scientists v. Nuclear Regulatory Com'n, 711 F.2d 370, 382 (D.C. Cir. 1983) (internal quotes and citations omitted). *See also Methodist Hospital of Sacramento v. Shalala*, 38 F.3d 1225, 1236 (D.C. Cir. 1994) ("as a general matter, strict congressionally imposed deadlines, without more, by no means warrant invocation of the good cause exception." (quoting *Petry v. Block*, 737 F.2d 1193, 1203 (D.C Cir 1984)); *Air Transport Ass'n of America v. Department of Transp.*, 900 F.2d 369, 379, (D.C. Cir. 1990) ("we have explained that statutory time limits do *not* ordinarily excuse compliance with the APA's procedural requirements") (emphasis in original); *U.S. Steel Corp. v. U.S. E.P.A.*, 595 F.2d 207, 213 (5^{th} Cir. 1979) ("the mere existence of deadlines for agency action, whether set by statute or court order, does not in itself constitute good cause for a 553(b) (B) exception").

In those cases in which courts have sustained agencies' use of the good cause exception there have been significant other factors, beyond simply the difficulty of meeting a statutory deadline. For example, in *Philadelphia Citizens In Action v. Schweiker*, 669 F.2d 877 (3d Cir. 1982), the court upheld a challenge to a Department of Health and Human Services ("DHHS") interim final rulemaking implementing cuts made to family welfare benefits as a part of the Omnibus Budget and Reconciliation Act of 1981 ("OBRA"). Under the OBRA, passed on August 13, 1981, these cuts became effective October 1, 1981. *Id.*, at 878. In sustaining the DHHS' use of the good cause exception the court relied on a number of contextual factors including: a) the urgency expressed by both Congress and the President in passing OBRA, b) the requirement for the states that administer the program to have clear federal guidance prior to the effective dates of the cuts, c) the stringency of the 49-day time period between passage of the act and the effective date, d) the fact that delay in issuing interim final regulations would postpone nationwide implementation of the budget cuts beyond the Congressionally determined date, e) the fact that DHHS had specified that the interim final rules would only be in place until a final rule was issued on November 20, 1981, during which time public comments would be solicited and considered, and e) the fact that DHHS was only obligated to follow notice and comment procedures by virtue of its own internal policy, as rulemakings regarding public benefits are expressly excluded from the APA notice and comment provisions under 5 U.S.C. § 553(a)(2). *Id.*, at 881-886.

Similarly, in *Coalition for Parity, Inc. v. Sebelius*, 709 F.Supp.2d 10 (D.D.C. 2010), the court upheld a challenge to joint interim final regulations issued by DHHS and the Departments of Labor and Treasury (the "Departments") without notice and comment, in order to implement provisions of the Mental Health Parity and Addiction Equity Act of 2008 ("MHPAEA"). The primary basis given by the Departments for bypassing notice and comment procedures was the need for prompt guidance to the regulated industry in light of the effective date of the MHPAEA. *Id.*, at 20. In scrutinizing the use of the good cause exception in this context, the court made note of the fact that the Departments had first issued a request for information ("RFI"), in response to which they had received over 400 comments, including comments from plaintiff organizations expressing the same concerns at issue in the lawsuit, which were considered by the Departments prior to issuing the interim final rules. *Id.* at 14-15. The court further noted that, subsequent to the receipt of responses to the RFI, the Departments received a letter from 26 senators, as well as a similar letter from 73 members of the House of Representatives urging the Departments to quickly consider the comments received in response to the RFI and issue implementing regulations "to avoid misrepresentation of the law and to ensure access to these critical services." *Id.*, at 22.

Similarly, additional justifying factors, beyond a mere statutory deadline, have generally been necessary to sustain use of the good cause exception in other cases where statutory timelines were at issue.[1] In the case of the appraisal independence IFR, however, no such additional factors support suspension of notice and comment procedures.

Unlike, the cases described above, the regulations at issue do not implement significant statutory revisions to complex, state-implemented federal benefit programs subject to a statutory compliance deadline. Neither is there potential for disruption to critical services without prompt issuance of regulations. Nor is there in this case any "surrogate" for notice and public comment, which was a factor in other cases. The Board did not issue a public Request For Information to solicit public input which it considered prior to issuing the IFR, nor did it make clear that the IFR would only be effective for a limited, specified time frame, after which it would promulgate replacement final rules. (In fact, to date there is no indication when, or even if, the IFR will be displaced by a final rulemaking.) The sole factor upon which the Board based its determination that the notice and comment process should be dispensed with as "impracticable" is its belief that the notice and comment process is too cumbersome for it to execute in the context of a 90 day deadline. This is clearly insufficient to meet the narrow construction of section 553(b)(B) intended by Congress and consistently reinforced by the courts.

The Board observed that Section 1472 of Dodd-Frank "mandates that the Board issue interim final rules that will be effective before the issuance of permanent rules." Truth In Lending: Interim Final Rule, 75 F.R. at 66556. But this point lends no additional support to the Board's justification for dispensing with public notice and comments. The only rulemaking expressly mandated by Congress is contained in the section requiring to promulgation of the IFR. All other rulemaking referenced is not mandatory, but rather general and discretionary authority granted jointly to the Board, Bureau, FDIC, etc. providing that they "may issue rules, interpretive guidelines and general statements of policy with respect to the acts or practices which violate appraisal independence." Dodd-Frank § 1472(g)(1).

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[1] *See e.g Methodist Hospital of Sacramento v. Shalala*, 38 F.3d 1225 (D.C. Cir. 1994) (upholding DHHS bypass of notice and comment procedures when bypass was specifically authorized by Congress in order to "prepar[e] regulations to implement a complete and radical overhaul of the Medicare reimbursement system" in slightly over four months); *Petry v. Block*, 737 F.2d 1193 (D.C. Cir. 1984) (upholding Department of Agriculture regulations implementing OBRA cuts to administrative reimbursements under a child food benefit program based on the complexity of the reimbursement program, short time-frame in which the regulations were to be promulgated, and urgency and volume of collective requirements placed on the Department by OBRA); *National Women, Infants and Children Grocers Association v. Food and Nutrition Services*, 416 F. Supp.2d 92 (D.D.C. 2006) (upholding an interim final regulation implementing cost containment provisions of a federal food program's reauthorization act, where the interim regulation was needed to provide states with guidance by the deadline for state implementation, Food and Nutrition Services acted with due diligence, and the interim final regulations would only be in effect for 6 months due to Congressionally mandated a deadline for a final regulation).

In any event, the mandate to promulgate an interim rule along with a grant of authority to promulgate other rules does not amount to an express indication of Congress' intent that the agency dispense with public notice and comment. A "statutory deadline [does] not constitute good cause to forgo notice and comment absent "'any express indication'" by Congress to this effect." *Air Transport Ass'n*, 900 F.2d at 379 (quoting *New Jersey* v. *EPA*, 626 F.2d at 1043, and Sharon Steel Corp. v. EPA, 597 F.2d 377, 380 (3d Cir. 1979)). *See also Asiana Airlines* v. *FAA*, 134 F.3d 393, 397 (D.C. Cir. 1998)("the Supreme Court has held that exemptions from the terms of the Administrative Procedure Act are not lightly to be presumed in view of the statement in [§ 559] that modifications must be express") (*quoting Marcello* v. *Bonds*, 349 U.S. 302, 310 (1955)).

The bare requirement that the Board issue interim final rules within 90 days, accompanied by no other requirements or procedural specifications stands in stark contrast to cases where courts have found express indications that Congress intended to alter the standard notice and comment requirements. For example, *Asiana Airlines* concerned regulations issued under a provision of the Federal Aviation Reauthorization Act enacted on October 9, 1996 in which Congress required that the Federal Aviation Administration "shall publish in the Federal Register an initial fee schedule and associated collection process as an interim final rule, pursuant to which public comment will be sought and a final rule issued." *Asiana Airlines*, 134 F.3d at 395 (quoting 49 U.S.C. § 45301). Similarly, the regulations at issue in *Methodist Hospital of Sacramento* were issued pursuant to a provision of the Social Security Amendments of 1983 which stated that:

> [t]he Secretary shall cause to be published in the Federal Register a notice of the interim final DRG prospective payment rates ... no later than September 1, 1983, and allow for a period of public comment thereon. Payment on the basis of prospective rates shall become effective on October 1, 1983, without the necessity for consideration of comments received, but the Secretary shall, by notice published in the Federal Register, affirm or modify the amounts by December 31, 1983, after considering those comments.

Methodist Hospital of Sacramento, 38 F.3d at 1236, n.18 (quoting Pub. L. No. 98-21 § 604(c)).

In each of these cases Congress not only required issuance of an interim final rule, but expressly specified a procedure other than the standard notice and comment period and explicitly required that it be followed by a final rule to either confirm or displace the provisions of the interim rule. This clearly demonstrates that when Congress wishes to require an interim final rulemaking process that forgoes standard notice and comment procedures it knows how to do so.

In the case at hand, however, Congress said nothing to indicate that it wished to waive notice and comment requirements. Rather, it simply set a deadline for promulgation of interim final rules. Dodd-Frank § 1472(g)(2). Moreover, in *Coalition for Parity* the Court rejected the argument "that Congress must have intended to displace the APA's normal procedures because otherwise the grant of interim final rulemaking authority is meaningless." *Coalition for Parity*, 709 F.Supp.2d at 19:

> the grant of interim final rulemaking authority is not susceptible to only one construction. The statute may be read to require that interim final rules be promulgated either with notice and comment or with "good cause" to forego notice and comment.

Id. Applicable decisions suggest that when Congress intends to override APA notice and comment requirements it will do so expressly. Absent such expression, the normal standards for evaluating use of the good cause exception apply.

Finally, in the preamble to the IFR, the Board suggested that its failure to provide the public with a notice and comment period is mitigated because "[i]nterested parties will still have an opportunity to submit comments in response to this interim final rule before permanent final rules are issued." Truth In Lending: Interim Final Rule, 75 F.R. at 66556. While this may have been asserted in all good faith at the time the IFR was published, it seems wholly without merit in light of the facts that a) it is unclear whether a final rulemaking process has been, or even will be, initiated, and b) over a year has passed and neither the Board, nor the Bureau, nor any of the other jointly tasked parties have provided any response to the public's comments. As noted by the D.C. Court of Appeals, "dialogue is a two-way street: the opportunity to comment is meaningless unless the agency responds to significant points raised by the public." *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35-36 (D.C. Cir. 1977) (citing *Portland Cement Ass'n v. Ruckelshaus*, 486 F.2d 375, 393-394 (D.C. Cir. 1973)).

Moreover, in general, a period for submission of post-promulgation comments is not an adequate substitute for an agency's failure to allow pre-promulgation notice and comment procedures. *See e.g. Sharon Steel*, 597 F.2d at 381 ("a period for comments after promulgation can not substitute for the prior notice and comment required by the APA [because] [i]f a period for comments after issuance of a rule could cure a violation of the APA's requirements, an agency could negate at will the Congressional decision that notice and an opportunity to comment must precede promulgation.")

In some circumstances, courts have found that a post-promulgation comment period can partially mitigate failure to follow standard procedures, where a final rule is issued in a prompt fashion which responds to submitted comments. *See e.g. Universal Health Services of McAllen, Inc. v. Sullivan*, 770 F.Supp. 704, 721 (D.D.C. 1991) (finding that the Secretary's failure to engage in pre-promulgation notice and comment was at least partially cured by allowing the opportunity for post-promulgation comment, where final rules were issued within 9 months along with a response to comments received). Furthermore, the Administrative Conference of the United States has recommended that, when an agency has properly invoked the good cause exception, it should provide a post-promulgation comment period and

> should then, and *as expeditiously as possible*, respond to any significant adverse comments and make any changes that it determines are appropriate. Agencies should consider including in the initial notice either a deadline by which they will

> respond to comments and make any appropriate changes or a "sunset" or termination date for the rule's effectiveness.

Adoption of Recommendations, Recommendation 95-4, Procedures for Noncontroversial and Expedited Rulemaking, 60 F.R. 43110 (August 18, 1995) (emphasis added). In this case, however, more than a year since publication of the IFR no final rule has been issued and the agency has not only not considered or responded to any comments critical of the IFR it received, but has indicated that it has no intention to do so, for an indefinite period of time. Instead, despite the fact that the Board justified dispensing with notice and comment requirements, in part, on its assurance that there would be a permanent final rule, prior to which affected parties would be afforded an opportunity to be heard, the regulated parties are currently—and for the indefinite future will be—subject to substantive regulations upon which they have not been afforded an opportunity to provide meaningful input. This runs completely contrary to the affected parties' rights under the APA.

Moreover, the harm caused by the agency's improper deviation from the APA's notice and comment rulemaking requirements goes far beyond a mere procedural defect. Because, for the reasons stated below, the IFR is contrary to law and Congress' intent, the agency's failure to solicit, consider and address the comments of appraisers, coupled with its intention not to propose a permanent final rule for an indefinite period, have now converged to produce immediate and substantial injury to appraisers. As a direct result of IFR's failure to implement properly the mandate of the legislation, appraisers are not receiving the "reasonable and customary fee" Congress required.

IV. <u>The Customary and Reasonable Fee Provisions' First Presumption of Compliance is Contrary to Legislative Intent</u>

When Congress enacted section 1472(i)(1) requiring that lenders and their agents pay fee appraisers at a rate that is customary and reasonable, it explicitly provided a method for establishing what rates were customary and reasonable—reliance on objective third-party information. Dodd-Frank § 1472(i)(1). Notably, this method required that the information relied upon must exclude rates paid by AMCs. *Id.* At a minimum, this reflected a concern and Congress' conclusion that rates paid by AMCs would distort the information relied upon and, hence, the fees ultimately paid to appraisers would be less than the "customary and reasonable" rates the law requires. This is consonant with appraiser concerns expressed at a hearing before the House Committee on Financial Affairs that:

> appraisal management companies usually focus on two things, who can do it the quickest and who can do it the cheapest. We believe corners will be cut as a result of that. At the end of the day, the consumers are going to be getting lesser quality appraisals than they should.

H.R. 1728, The Mortgage Reform and Anti–Predatory Lending Act of 2009: Hearing Before the H. Committee on Financial Services, 111th Cong. 82 (2009) (testimony of Jim Amorin, President, Appraisal Institute).

As noted previously, the marketplace realities the Board confronted in promulgating the IFR included that AMCs: (a) are the predominant source of engagements of independent appraisers; (b) generally include charges for their own "administrative" services in the "appraisal" fees charged to lenders; and (c) act under authority of lenders, as their agents. The potential for AMCs to use their power to select appraisers and attempt to retain for the AMC the greatest portion possible of the appraisal fee charged, thus driving down below "reasonable and customary" rates the fees actually paid to AMC-selected appraisers is manifest.

Excluding, as a matter of federal law, fees for AMC-assigned appraisals from data used to determine "customary and reasonable" rates reflects Congress' understanding that countenancing reliance on the fees AMCs pay to appraisers they select, under conditions currently prevailing in the mortgage marketplace, could result in depression of fees paid to independent appraisers, below the reasonable and customary rates Congress deemed essential to ensure the integrity and quality of independent appraisals. Confronted with lower rates caused by AMCs increasingly retaining a greater portion of customary appraisal fees for themselves, appraisers have little choice but to either exit the market, or increase their dependence on AMC assignments to generate the volume necessary to survive, thus reinforcing a cycle resulting in depression of fees actually paid to "independent" appraisers and comprising the integrity of the integrity of the appraisal process.

Accordingly, in issuing the IFR, the Board recognized that "the statute supports a presumption of compliance if the creditor or agent based the fee paid to a fee appraiser on objective, third party market information regarding recent rates for appraisal services that meet the statutory requirements." Truth In Lending: Interim Final Rule, 75 F.R. at 66569. The Board further understood that section 1472's prescription that "[f]ee studies shall exclude assignments ordered by known appraisal management companies", Dodd-Frank § 1472(i)(1), extended to fee surveys and fee schedules as well, as it was "not aware of a rationale consistent with the statute that would treat fee studies differently from fee surveys or fee schedules." Truth In Lending: Interim Final Rule, 75 F.R. at 66574.

Consistent with this, the Board implemented correctly the clear intent of Congress in the form of a presumption of compliance at 12 C.F.R. § 226.42(f)(3) for lenders and their agents who base their fees on objective third-party information so long as "any fee schedule, survey or study relied on to qualify for this presumption of compliance may not include fees for appraisals ordered by companies that publicly hold themselves out as appraisal management companies." *Id.*, at 66569.

At the same time, however, in direct contradiction to the intent of Congress, the Board also created another presumption of compliance, which permits lenders and their agents to rely on fee surveys that do not exclude rates paid by AMCs. Specifically, the Board created a presumption of compliance at 12 C.F.R. § 226.42(f)(2), which requires that the rates lenders and their agents pay appraisers are "reasonably related to recent rates for services performed in the geographic market of the property being appraised." *Id.*, at 66582 (codified at 12 C.F.R. § 226.42(f)(2)). In order to determine the recent rates to which payment must relate, the Board clarified that "[f]or purposes of the presumption of compliance under paragraph (f)(2) [...] a creditor or its agent may, but is not required to, use or perform a fee survey," *id.*, at 66586 (codified at Supplement I to Part 226, Comment 42(f)(2)(i)(2)), and that that "qualifying for this presumption of compliance does not require that a creditor use third-party information that excludes appraisals ordered by AMCs," *id.* at 66572.

In other words, although Congress specified a method of compliance that explicitly excluded from consideration rates paid to appraisers by AMCs, the Board has adopted a presumption of compliance that permits lenders and their AMC agents to consider those very same fees. This stands in direct conflict with the statutory requirement prohibiting reliance on fee information that includes rates paid by AMCs.

As noted in the July 2011 GAO report to Congress on appraisal oversight, while lenders generally pay appraisers and AMCs the same rate, the rates paid to appraisers by AMCs are lower by "at least 30%." GAO Report at 24. The effect of this is that, in a geographic area where 60 to 80% of lenders' appraisals are ordered through AMCs, (*id.* at 32), in order to meet the second presumption of compliance, an AMC would be required to rely on studies that include only rates paid directly to appraisers by lenders. Obviously, those rates would not have been diminished by AMCs retaining a portion of the fees for their own "administrative" services, which currently exceed 30% of the appraisal fee charged to the lender. However, under the IFR as issued, the AMC may alternately opt to conduct its own fee survey or some less formal analysis, which includes the rates paid by it and other AMCs. This would allow the AMC to establish a presumption, under alternative 1, ***that a rate more <u>than 30% lower</u> than the rates paid to appraisers by non-AMCs*** complies with the mandate of Dodd-Frank. Congress can certainly not have intended to establish two alternate methods of legal compliance that result in "customary and reasonable" fee standards for the same properties in the same geographic area that differ by 30% or more.

The fact that Congress explicitly excluded AMC-paid rates from consideration in the objective third party information on which it authorized creditors to rely in determining customary and reasonable rates clearly evinces its intention to prevent cut-rate AMC fees from being the basis for a "customary and reasonable" determination. If this was not its intent, there would simply be no reason for such exclusion. It would completely defeat the purpose of excluding these fees from objective third party data if creditors and their AMC agents could simply choose to base their determination of what is "customary and reasonable" on the diminished fees that AMCs have paid to appraisers. For this reason, the first presumption of compliance under the IFR as it currently stands runs manifestly contrary to the statutory scheme enacted in Dodd-Frank § 1472(i) and must be revised to prohibit use of the fees paid by any AMC as a reference point for what is deemed reasonable and customary.

V. <u>Conclusion and Relief Requested</u>

In adopting the appraisal independence provisions of Dodd-Frank, Congress was seeking to ensure the quality and integrity of the appraisals on which the underwriting of home mortgages are based. As a part of this effort, Congress included provisions requiring that appraisers be paid fairly for their services, which specify that any objective information relied upon to establish these rates can not include the substantially lower rates that most AMCs currently pay appraisers. Implemented properly, this provision can help to mitigate the distorting effect on the appraisal services market that, in the wake of the HVCC, the growth of AMCs has had. With the inclusion of the first presumption of compliance in its current formulation, however, the IFR issued by the Board fails to accomplish this, instead providing regulatory cover to AMCs' practice of under compensating appraisers. This is a fatal flaw in the IFR's rules on appraiser compensation and must be corrected.

Accordingly, pursuant to 5 U.S.C. § 553(e), the American Guild of Appraisers requests that the Federal Reserve Board and/or the Consumer Financial Protection Bureau review, consider and respond to comments received after promulgation of the IFR and, if necessary, open the IFR to further public comments to reflect the experience in the marketplace since implementation of the IFR, and either:

1. Amend the IFR to make it clear that fees paid to appraisers used to provide support for fee awards as customary and reasonable may not consider or include fees paid to appraisers by AMCs, or;

2. Clarify that the Board did not intend the IFR to permit the consideration of fees paid by AMCs to appraisers as support for fee awards as customary and reasonable.

Respectfully Submitted,

American Guild of Appraisers

By:
Matthew R. Schneider
Benjamin J. Lambiotte
Garvey Schubert Barer

DFW AMB
CHARTERED 1988
Dallas Fort Worth Association of Mortgage Brokers

The Brokers' Choice
Affiliated with: National Federation of Mortgage Professionals, Washington, D.C.

REGULATORY IMPACT ON CONSUMERS and BUSINESSES REGARDING ORDERING and OBTAINING FAIR VALUE of RESIDENTIAL APPRAISALS

As President of Dallas/Ft.Worth Association of Mortgage Brokers I represent in excess of one thousand mortgage professionals ordering residential appraisals for consumers purchasing or refinancing homes. This equate in excess of forty thousand (40,000) appraisals ordered for consumers each year in a six county area including Dallas, Texas. Currently refinances are sixty (60%) percent of the transactions, the remaining forty (40%) are home purchases.

Because of the restrictions placed on the ordering of appraisals and the random selection process of appraisers, fair market values have been challenging to obtain. The decline of market value due to the economic downturn has added to these challenging conditions. The restriction placed on the ordering of appraisals can be cured with Congress acting. The downturn is improving with historic low rates.

There is one major and significant glaring inequity that is fixable in the ordering of residential appraisals to determine fair market value. Since the implementation of HVCC (Home Value Code of Conduct) in May 2010, ordering an appraisal for a purchase requires a copy of the sales contract which includes the property sales price. This influences the appraiser in determining the value. If the value is lower than the sales price, either the borrower will have to pay more or the seller will have to reduce his price. This then creates a challenge for all parties concerned because they have agreed upon a price. Why put the pressure on the appraiser to make the fair market value equal to or greater than the sales price? Let the appraiser determine fair market and the buyer and seller can work out any differences?

This is exactly what is done when the consumer does a refinance of his existing home loan. There is no seller and no realtor involved. Usually only a mortgage broker or bank loan officer orders the appraisal for the consumer. The loan originator is not allowed to influence the appraiser with any information regarding value of the house. He must strictly give the address of the house and request the date he wishes the appraisal to be finished. No desired values, no comparables, no improvements or any other information may be furnished. The appraisal associations have lobbied Congress to eliminate this influence.

RESULTS: many refinances do not make value and the borrower has paid for a useless appraisal. A dialogue needs to exist between the loan originator, the prospective appraiser and the home owner BEFORE an appraisal is ordered.

There are three fixes:

1. Allow the loan originator to order the appraisal and have a dialogue with all parties.
2. Prohibit furnishing the sales purchase price and the sales listing price on all purchases.
3. The HVCC created a middle man between the ordering of the appraisal by the loan originator and the selecting of the appraiser by the AMC (Appraisal Mortgage Co). Previously appraisals cost approximately $375. Currently appraisals cost approximately $450 with the AMC keeping $250 and the appraisers receiving approximately $200, approximately one half of their former income. Just like mortgage brokers, appraisers are samll businessmen who are suffering because of the inequalities of Dodd-Frank legislation and agreements such as HVCC.

This is a blatant inequity which penalizes many consumers from taking advantage of these historic low rates and stimulating the economy with the surplus savings on their mortgages. Small businesses are suffering. The information outlined above would go a long way in restoring confidence and equality in lending.

Dallas/Fort Worth Association of Mortgage Brokers is a non-profit professional organization dedicated to advancing the mortgage broker profession through the promotion of education, ethical practices, consumer fairness and political activism. Member mortgage brokers and loan officers are not only licensed by the State of Texas and registered with the National Mortgage Licensing System but are required to take continuing education courses and subscribe to a strict code of ethics.

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LEADING BUILDERS of AMERICA

June 27, 2012

The Honorable Judy Biggert
The Honorable Luis V. Gutierrez, IL, Ranking Member
Subcommittee on Insurance, Housing and Community Opportunity
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Congresswoman Biggert, Ranking Member Gutierrez and Members of the Committee:

I am writing on behalf of Leading Builders of America, a trade association representing twenty of the nation's largest homebuilders which collectively build over 30% of all new homes built in the United States. We thank you for convening a hearing to explore the issues surrounding real estate appraisals.

As the housing market struggles to emerge from the biggest downturn since the Great Depression, we are experiencing a number of frustrations with the current appraisal process. These issues are holding back the pace of recovery.

Appraisals are the basis on which homes are financed so when appraisals are artificially too high or too low, it creates market disruption and frustration for buyers and sellers alike. The appraisal process needs to be free from undue influence, however when appraisals are inaccurate there should be mechanisms in place to have them reviewed and if necessary, adjusted.

Due to the downturn when real estate values plummeted, appraisals in declining markets have artificially lowered home values. There are a number of factors contributing to this affect including distressed sales being used as "comparable sales" for non-distressed properties, energy efficient features not being properly valued and inconsistency among appraisers -- particularly Veteran Affairs (VA) appraisers.

The following is a series of very practical suggestions that could address some of the issues we experience in the marketplace every day.

1. **Federal agencies should require appraisers to use only "ordinary course" sales as comps and prohibit the use of distressed sales in appraisals for federally backed loans.**
   With so many foreclosures on the market, appraisers are using foreclosed and distressed sales to determine the value of re-sales and new homes. This is an apples-to-oranges comparison because distressed sales are involuntary sales and as a result are artificially low and not suitable to determine values in a voluntary sale. This creates a downward spiral as every appraisal that artificially lowers a home price will be used as a new lower comp for the next home sale. What

makes the situation worse is when foreclosures are used and the "declining market" designation is applied causing a double hit to the home's value. Use of distressed sales should be eliminated (or limited) as comps for non-distressed sales.

2. **Require Visual Inspection.**
   If a distressed sale is used as a comparable sale, the appraiser should be required to perform a visual inspection of both homes. Today, many appraisals are done from a computer with square footage being the primary measure of likeness. A visual inspection will allow the appraiser to more accurately determine condition, added features and maintenance issues. Distressed homes often are in a state of disrepair, have missing appliances and systems, drywall damage, overgrown landscaping, etc. All of which impact the value of the property far more than a simple square footage comparison.

3. **Suspend use of automatic "declining market" reductions.**
   Today, appraisers can check a box on the appraisal if they are in a "declining market," this simple check mark causes an automatic 5% reduction in value. This has a spiral effect because each artificially low appraisal today will be a lower comp for the next sale tomorrow. With prices across the nation having already fallen dramatically over the past 6 years, the declining market has already been factored into to home values. Prices alone should be enough of an indicator of a declining market without applying an additional penalty.

4. **Energy Efficient features should be properly valued during appraisals.**
   A framework needs to be put in place that will allow buyers, lenders and borrowers to maximize the energy efficiency of homes. Today, while energy efficient features substantially reduce the operating costs of owning a home, they generally are assigned little or no value by appraisers.

   Federal housing agencies could adopt a process which instructs lenders to account for expected energy costs (as measured by a HERS energy rating) in the debt-to-income qualifying ratios. These ratios typically value Principal, Interest, Taxes and Insurance (PITI), to measure the borrower's ability to afford regular monthly mortgage payments. Recognition of a reduction in monthly utility bills would allow the purchaser of a more efficient home to qualify to finance the costs of energy saving improvements. Lenders could then add the net present value (NPV) of expected energy savings when calculating the loan-to-value ratio. This will help ensure that the underwriting process consistently and accurately captures the added value of energy saving features, allowing homeowners to finance the cost of efficiency improvements as part of their mortgage.

5. **Enhance the appraisal review process to utilize third party oversight.**
   Today's appraisal review process, which is the mechanism used to facilitate reconsideration of lower-than-expected appraisals, requires the seller to convince the original appraiser to change his appraisal. This doesn't allow for an objective review. A third party, which could be another appraiser, should be charged with making an objective determination of the proper market value of the home.

6. **Appraisals rules for VA loans should conform to appraisal rules for other federal loan programs.** Many appraisal problems are created by VA loan appraisal rules which are inconsistent with those of the rest of the industry creating delay, confusion, last minute appraisals and surprising results for buyers, sellers and lenders. VA appraisers should be selected from a pool of approved appraisers, appraisals should be performed within a 7 days (instead of 19 days), appraisals on new construction should be allowed to be performed prior to house being 95% complete, and VA appraisers should be required to share the comps they rely on so if an appraisal is disputed, the seller must not have to guess which properties were used as comps.

7. **The time frame that FHA and VA appraisals are "attached" to a property address should be shortened from six months to one month.**
   Currently, an appraisal for an FHA or VA loan performed within the prior 6 months must be used by any future lenders. This is typically an issue when an appraisal comes in below the desired selling price and the deal falls through. In many cases the seller will then make enhancements or modifications to the property to increase its value but the 6-month rule prevents them realizing any appraised value from those investments. (i.e. added fencing, landscaping, hardwood flooring, enclosed loft to make 4th bedroom, etc.). This forces the seller to delay the sale for 6 months.

8. **Allow direct comparables to be used for up to one-year**
   Builders of new home communities typically build several different home plans within each community. If a buyer purchases a new to-be-built home with a design plan that hasn't been built within the prior six months, the appraiser may not use as comps any of the homes in the community with the same design plan. In today's market conditions, it is not uncommon that a design may not have been sold within six months and it's unreasonable to eliminate a comparable sale in the same community with the same plan just because it's more than 6 months old. This 6-month rule should be changed to one-year.

9. **In new home communities, allow appraisers to use homes under contract as comps.**
   Homes in backlog are those where the selling price and features have been agreed to by the builder and the buyer, a contract has been signed and a deposit has been received, but construction is not completed. These home contracts reflect the most up-to-date market conditions and accurately reflect current market value for a given community. Allowing appraisers to use contracts as comps will allow a more accurate comparison to very similar homes often with similar features. New communities may have an eight-month build cycle, this rule artificially suppresses the market during the entire eight-month construction cycle until the first home closes.

10. **Provide predetermined values for certain upgrades to new homes**
    Appraisers provide no guidelines of value for the hundreds of options/upgrades a buyer can select. For instance, a typical case is where a buyer selects an upgraded energy efficient refrigerator for which the builder charges the market price of $3,300 (same price as a big box store) and at closing the appraiser only values it at $2,300 even though she couldn't buy the

refrigerator anywhere for $2,300. If the seller and builder knew what the value of the upgrade would be upfront they could make better decisions about whether or not to add it.

11. **Allow lenders to communicate with appraisers on non-value issues.**
While recent rules prohibit lenders from communicating with appraisers, strict adherence to the rules has made the process for settling "non-value" issues unnecessarily difficult and has delayed closings for many buyers. Non-value issues include simple errors or omissions such as the misspelling of a name; address incorrect; appraisal incomplete because a box was not checked. Once the value has been determined, communication on these types of issues should be allowed for a smoother process.

Again, we thank you for exploring these issues and we urge the committee to take steps to address these issues to make appraisals more consistent and more accurate which will unlock a stronger housing recovery.

Sincerely,

Kenneth Gear
Executive Director

MORTGAGE BANKERS ASSOCIATION
Investing in communities

Statement for the Hearing Record

Mortgage Bankers Association

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Insurance, Housing and Community Opportunity

"Appraisal Oversight: The Regulatory Impact on Consumers and Businesses"

June 28, 2012

The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to submit this statement for the hearing of the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity entitled "Appraisal Oversight: The Regulatory Impact on Consumers and Businesses."

Property values are in a period of dramatic fluctuation, with some areas of the country experiencing significant declines, while others are showing signs of recovery. Now, more than ever, it is critical for property appraisals to be undertaken in an unbiased manner for both consumer protection and safety and soundness reasons.

The appraisal industry has undergone tremendous change since 2008 and the establishment of the Home Valuation Code of Conduct (HVCC) for government sponsored enterprise (GSE) mortgages. HVCC required appraisal independence and accuracy by limiting outside influences on appraisers and it prohibited the GSEs from purchasing mortgages from any lender that did not adhere to the HVCC's requirements. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which repealed the HVCC and required that it be replaced with similar, federal regulations, further solidified these changes, as did the Federal Reserve's Interim Final Appraisal Rule (the Interim Rule), which became mandatory on April 1, 2011. Final rules from the Bureau of Consumer Financial Protection (CFPB) are anticipated later this year.

The changes that have already occurred have, in MBA's view, been extremely beneficial to consumers and the mortgage industry that serves them. Homebuyers can be more confident that the value of their homes have been objectively assessed before closing and lenders can also be more confident that the appraisal was arrived without undue pressure through an independent appraiser, an appraisal management company (AMC), or through a separate in-house appraiser panel.

Currently, the full range of legislative, regulatory and industry-based measures work in concert with each other to provide a comprehensive framework for ensuring appraisers are protected from undue influence. These measures include:

- Provisions of the Dodd-Frank Wall Street Reform and Consumer Protections Act, Home Ownership and Equity Protection Act, and Truth in Lending Act;
- Supervisory guidance issued by the federal banking agencies;
- Appraisal requirements issued by the Federal Housing Administration;
- The Uniform Standards of Professional Appraisal Practices; and

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

- The aforementioned Interim Rule.

MBA has long supported efforts to require residential property valuation practices that minimize opportunities for fraud, coercion or undue influence in the loan approval process. Appraisals that overstate or understate the market value of properties are harmful to unsuspecting consumers and ultimately increase consumer borrowing costs. Lenders have a vested interest in obtaining an accurate appraisal because appraisals serve as the primary valuation tool for lenders' collateral. When a home is over-appraised, lenders are left with a security interest that is unlikely to satisfy the debt in the event of foreclosure. Fannie Mae and Freddie Mac customarily use inaccurate appraisals to require lenders to repurchase mortgages sold to them upon default – regardless of how minor the inaccuracy is, and even if the inaccuracy is immaterial to the default. Additionally, the high rate of GSE loan repurchases is preventing many qualified borrowers from obtaining a mortgage.

For these reasons, we strongly endorse the following principles underlying existing appraisal-related requirements:

- Clear, distinct firewalls should exist between the appraiser and those who will be compensated based on the outcome of the transaction for which the appraisal was prepared, including mortgage brokers, real estate sales personnel, and loan officers directly involved in the transaction.

- As long as sufficient firewalls are established, lenders should be permitted the option of utilizing in-house appraisers, independent appraisers and/or appraisal management companies.

These principles are embodied in MBA's positions on key appraisal issues:

MBA strongly supports efforts to promote residential property valuation practices that minimize opportunities for fraud, coercion or undue influence.

Current compliance requirements comport with many of MBA's principles for ensuring the validity of property valuations and the integrity of those who conduct such valuations. MBA strongly endorses policies to ensure that appraisers conduct property valuations in a manner that is free from the influence of any party to a real estate transaction that has a financial interest in its outcome, including real estate agents, title agents, mortgage brokers, loan officers, sellers and buyers. Allowing a party with a material interest in the completion of the loan transaction to influence an appraiser undermines what must be an arms-length collateral valuation process. Appraiser independence is critical to protecting the lender and the borrower from valuations that misrepresent the true market worth of a property.

Lenders have adjusted their business models to support these new compliance requirements and have utilized a variety of methods to ensure compliance, including using Appraisal Management Companies (AMCs), independent appraisers, in-house appraisal staff, and automated valuation models. MBA strongly believes lenders should have all of these options to properly assess the risk that lenders ultimately hold.

MBA supports the "reasonable and customary fee" provision as long as it is sensibly applied.

Key provisions in Dodd-Frank and the Interim Rule require appraisers to be paid "customary and reasonable fees." With respect to this provision, MBA supports the Federal Reserve's determination that the marketplace should be the primary determiner of the value of appraisal services. This test adopted by the Board in the Interim Rule is logical, fair, and objective. It best protects consumers from excessive fees and allows the marketplace to create efficiencies which ultimately result in lower consumer borrowing costs.

MBA supports regulation of appraisal valuation standards by a strong, single, federal entity, rather than a patchwork of state laws where separate and conflicting state requirements create confusion and costly compliance burdens for lenders.

The proliferation of legislative activity in the states regarding the regulation of the appraisal industry and AMCs is an area of particular concern. Many states have considered a range of legislative proposals aimed at dictating how appraisal/vendor management companies should operate their businesses. This activity has resulted in myriad laws that have unnecessarily increased the regulatory burden on lenders requiring them to comply with often conflicting state regulations. Some proposals for appraisal/vendor management company governance have presented conflicts of interest and inconsistencies and would bring unintended consequences. Generally, these proposals would neither improve the industry nor safeguard the consumer.

In an effort to provide reasonable and effective oversight and consistent policies, MBA recommends that instead the regulation of appraisal valuation standards be carried out by a strong, single, federal entity, rather than through a patchwork of state laws where separate and conflicting state requirements create confusion and costly compliance burdens.

MBA believes that strong, uniform national supervision of the appraisal industry is critical to achieving consistently high standards to serve consumers. One possible approach that deserves consideration would be for the Appraisal Subcommittee of the Federal Financial Institutions Examinations Council (FFIEC) to serve in that capacity. Effective national regulation would assist in rebuilding trust and confidence in the appraisal and mortgage industries and provide protection against unscrupulous actors who taint the home buying process and place both lenders and consumers at financial risk.

Importantly, AMCs owned by insured depository institutions, independent national institutions and agents acting on behalf of the depository institution, including joint ventures, should be exempt from state regulation and instead be subject only to federal oversight. Small AMCs, not working on behalf of lenders, who are typically local or regional companies, would still be under state regulation. This federal oversight would ensure the standardization and consistency of high quality appraisals and consistent expectations and experiences for consumers.

MBA appreciates the opportunity to present the above points for your consideration and we stand ready to serve as a resource as you study this issue further.

NAHB

STATEMENT OF THE
NATIONAL ASSOCIATION OF HOME BUILDERS

Hearing Entitled:
"Appraisal Oversight: The Regulatory Impact on Consumers and Businesses"

Subcommittee on Insurance, Housing and Community Opportunity
United States House of Representatives
Committee on Financial Services

June 28, 2012

The National Association of Home Builders (NAHB) appreciates the opportunity to submit this statement to the Subcommittee on Insurance, Housing and Community Opportunity on *"Appraisal Oversight: The Regulatory Impact on Consumers and Businesses."* NAHB is a Washington-based trade association representing over 140,00 member firms involved in home building, remodeling, multifamily construction, property management, housing finance, building product manufacturing and other aspects of residential and light commercial construction.

The ongoing stress in the housing and mortgage credit markets has brought greater focus to the importance of accurate appraisals. In response to criticism that lax appraisals contributed to the financial crisis, more restrictive appraisal policies have been implemented by lenders, federal banking regulators, the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), the United States Department of Agriculture (USDA), and Fannie Mae and Freddie Mac (the Enterprises). However, the pendulum has swung too far, producing a downward bias in the home valuation process. The problem has been exacerbated by improper appraisal practices, a shortage of experienced appraisers and inadequate oversight of the appraisal system.

It is difficult to come to a conclusion other than appraisal standards are not clear, best practices have not been well communicated, and enforcement is not occurring in a consistent manner. For all sectors that interact with appraisers – consumers, home builders, realtors, lenders, the government-sponsored enterprises, mortgage insurers – appraisal quality and appraiser competence remain tremendous challenges. The problem is an urgent one, yet throughout the extended housing recession little attention has been focused on the fundamental problems. Until today. NAHB thanks the Subcommittee for this hearing, hopefully the first of many, which will explore the impact of inaccurate appraisals on the flow of mortgage credit and the housing recovery.

Background

Appraisals remain a major problem for the housing industry. The process has gone seriously wrong due to a breakdown in appraiser education and qualifications as well as dysfunctional federal and state regulatory oversight and enforcement. Other challenges facing the appraisal industry include shortcomings in appraiser training and experience in dealing with new construction and green building. Additionally there is insufficient new construction, energy efficient and green building data available to appraisers and current valuation practices do not provide a process for expedited appeals of inaccurate or faulty appraisals.

Too often, due to faulty appraisal practices, the builder's house winds up with an appraised value less than the cost of construction. In an NAHB survey of builders, nearly two-thirds of the respondents (64 percent) said that they had an appraisal that was below the agreed-upon contract sales price for a house, and one-third of the respondents indicated they had lost a sale because of a low appraisal. NAHB is not advocating that appraisals should be higher than the real market. Rather, our goal is to establish an appraisal system that produces accurate values through all phases of the housing cycle.

A key concern is that is some appraisers are using distressed sales – many of which have been neglected and are in poor physical condition – as comparables in assessing the value of brand new homes, without accounting for major differences in condition and quality. Without such adjustments, the two are not comparable. Appraisers don't typically enter and inspect these fixer-upper homes; if they did, they would likely recognize the substantial differences between a foreclosure and a state-of-the-art new home. The inappropriate manner in which distressed sales are utilized is distorting home valuations. Use of the cost and income approaches in conjunction with the comparable sales approach would mitigate such distortions.

The dramatic increase in the use of Appraisal Management Companies (AMCs) is another factor contributing to inaccurate appraisals. Some AMCs have reduced appraiser compensation, which has led to more activity by appraisers with less training and experience, and shortened turnaround times for valuations to as little as 48 hours. These changes have had a significant adverse effect on appraisal quality.

Regulatory Structure

Regulatory oversight of the appraisal industry is a dysfunctional patchwork of federal and state regulations. At the federal level, the Appraisal Subcommittee (ASC) of the Federal Financial Institutions Examination Council (FFIEC) sets appraisal practices and procedures through The Appraisal Foundation (TAF). TAF is a private, non-profit entity which through its Appraisal Standards Board (ASB) establishes appraisal practices through the Uniform Standards of Professional Appraisal Practice (USPAP). Oversight of appraiser qualifications and appraisal practices falls to the individual states, and many jurisdictions have inadequate resources to adequately perform this function. In some states, fees collected for appraiser licensing and certification are swept into a general fund and are not utilized in appraisal/appraiser oversight and enforcement.

In January, The Government Accountability Office (GAO) released a report, *Real Estate Appraisals – Appraisal Subcommittee Needs to Improve Monitoring Procedures*, which identified several weaknesses that have limited the ASCs effectiveness, including weak enforcement tools and reporting procedures; inadequate policies and procedures for monitoring appraisal requirements; no written policies to determine if TAF's activities are consistent with the statutory mandates; and not fully addressing the requirement of the Dodd-Frank Act for the ASC to establish and operate a national hotline to receive complaints of noncompliance with appraisal independence standards and USPAP.

In conjunction with the report, the GAO conducted a survey that supports the conclusion that appraisal quality and appraiser competence remain a tremendous challenge. The survey asked state appraisal regulators to evaluate the effectiveness of the current real property appraiser regulatory system, the effectiveness of TAF, state agency structure and resources and the appraisal complaint process. The complete survey can be found at http://www.gao.gov/special.pubs/gao-12-198sp/.

In NAHB's opinion the results of the GAO survey indicate there is much work to be done. For example, the GAO's findings show that:

- Less than 40 percent of state regulatory officials rated TAF, ASB and the Appraisal Qualifications Board (AQB) as very effective in:
    - Setting standards for the way appraisals should be conducted;
    - Establishing the qualifications needed to become an appraiser;
    - Setting requirements for appraisers' continuing education; and,
    - Approving courses for appraisers' education or training.
- Less than 25 percent of respondents rated TAF, ASB and AQB as very effective in determining the qualifications needed by instructors who teach courses to appraisers and providing guidance on disciplining appraisers.
- Less than six percent rated the newly formed Appraisal Practices Board (APB) as very effective in improving the quality of appraisals.
- Less than 50 percent found the AQB's qualifications for appraiser education and experience mostly adequate.

The survey supports NAHB's concerns with diminished appraisal quality, the need for a fair and timely process to appeal appraisals and to ensure the competency and qualifications of the appraiser community.

The failures in the process noted by GAO perpetuate the cycle of declining home values, drive more home owners under water, negatively affect housing demand and are obstacles to the recovery of the housing market. Major reforms in appraisal practices and oversight are needed to ensure that appraisals accurately reflect true market values and do not contribute to price volatility.

Solutions

NAHB has been a leading advocate for correcting the valuation process and has undertaken a number of actions to raise awareness and address the adverse impacts inaccurate appraisals are having on the housing sector. NAHB has conducted four Appraisal Summits (two in 2009, one in 2010, and one in 2011) to provide opportunities for the agencies and organizations that establish appraisal standards and guidelines to join housing stakeholders in a constructive dialogue on major appraisal topics of concern. The goal of the Appraisal Summits is to identify recommendations and solutions that participants can jointly pursue to improve the appraisal process.

Through the Appraisal Summits and feedback from builders and others in the field, NAHB has identified the following key areas of focus to improve current appraisal requirements and practices:

Strengthen Education, Training and Experience Requirements for Appraisers of New Home Construction, including:

- The establishment of greater education, training and experience requirements for those who are assigned appraisals of new construction to ensure that lot values and building costs, including those for energy efficient, green building and other evolving new construction techniques and mortgage products, are fully considered in valuation of new home construction.
- The incorporation of the qualifications for appraisers of new construction into appraisal regulations and guidelines of the bank regulatory agencies, Fannie Mae, Freddie Mac, FHA, VA and USDA.
- The prompt implementation of federal legislation directing the federal financial regulators to establish minimum state requirements for the regulation and licensing of appraisal management companies.

Improve the Quantity and Quality of Data for New Construction through:

- Establishment of an appraisal data base system for new construction.
- Standardization of loan level valuation data by Fannie Mae, Freddie Mac, FHA, VA and USDA in their Uniform Appraisal Dataset (UAD).
- Expansion of the UAD to include new construction, energy efficient and green building data standards.

Develop New Appraisal Standards and Best Practices for Conducting Appraisals in Distressed Markets by:

- Modifying current appraisal practices and procedures to consider all three approaches to value -- cost, income and sales comparison -- in appraisals of residential properties to mitigate distortions and volatility.
- Giving greater weight in distressed markets to alternative means of valuation, such as the cost-based approach to value.
- Revising banking agency guidelines to require the appraisal entities used by financial institutions to avoid the use of distressed sales as comparables for new construction sales and, if distressed sales are the only comparables available appropriate, to make adjustments to accurately reflect possible condition and stigma issues associated with distressed properties.

Develop Processes for Expedited Appeals of Inaccurate or Faulty Appraisals through:

- Federal agency adoption of an appeals structure similar in design to that of the Department of Veterans Affairs Loan Guaranty Service Home Loan Program.
- The establishment of more efficient, timely and effective processes for state and local appraisal oversight.
- The establishment of a timely value dispute resolution process that is fair, balanced and appropriate to allow interested parties to appeal appraisal values when appraisal assumptions are incorrect.

Strengthen Oversight of Appraisal Activities through:

- Full implementation of appraisal mandates in recent federal legislation addressing:
    - Appraisal independence
    - Customary and reasonable fees
    - Mandatory reporting of appraisal standards violations
    - Strengthening of state appraisal oversight and enforcement of regulations.
    - Dispute resolution
    - Valuations other than appraisals
- Establishment of best practices for effective and consistent appraisal practices, policies and procedures.
- Creation of an effective state and federal regulatory system for appraisal oversight.

NAHB stands ready to work with appraisal, housing and financial stakeholders to address the real challenges we face in restoring the public trust in how we build, transfer, value and finance the American consumer's most valuable asset. We must work together to reform appraisal practices that support accurate and sustainable values. Solving these issues, in the short and long term, is a critical step toward restarting the housing industry and America's economy.

HOUSTON ASSOCIATION OF REALTORS®

June 28, 2012

The Honorable Judy Biggert
Chairwoman, Subcommittee on Insurance,
Housing and Community Development
United States House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Luis Gutierrez
Ranking Member, Subcommittee on Insurance,
Housing and Community Development
United States House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairwoman Biggert and Ranking Member Gutierrez:

On behalf of the 24,000 members of the Houston Association of REALTORS® (HAR), we are writing to thank you for scheduling today's hearing on appraisal oversight. We believe that restoring confidence in the U.S. housing market is critical to our nation's overall economic recovery. This hearing on appraisal oversight is an important step in restoring such confidence.

HAR would also like to thank Representative Al Green of Houston, a member of the U.S. House Committee on Financial Services, for working with you to schedule this important hearing. Congressman Green has listened to the concerns of his REALTOR® constituents and HAR greatly appreciates the positive relationship we have with the Congressman and his dedicated staff.

HAR is the largest individual membership trade association in Houston, and the largest local Association/Board of REALTORS® in the United States. HAR represents a wide variety of housing industry professionals, including over 200 licensed and certified appraisers. In conjunction with the National Association of REALTORS® (NAR), our association is committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers.

We would like to voice our support and concurrence with the comments and recommendations from Frank K. Gregoire, the 2011 Chair of NAR's Appraisal Advisory Committee and President of Gregoire & Gregoire, Inc. As Congress works to resolve issues regarding appraiser competency, appraisal management companies, credible valuations of real property, and state regulation of the appraisal profession, HAR thanks you for your efforts and stands ready to work with you in any way we can.

Sincerely,

Wayne Stroman
Wayne Stroman
2012 Chairman of the Board
Houston Association of REALTORS®

Shad Bogany
Shad Bogany
Federal Political Coordinator for Rep. Al Green
2012 Chair-Elect, Texas Association of REALTORS®

cc: Representative Al Green

Written Statement of William F. Kidwell, Jr.
President – IMPACT Mortgage Management Advocacy and Advisory Group (IMMAAG)

"Appraisal Oversight: The Regulatory Impact on Consumers and Businesses"

Hearing before the House Financial Services Committee
Subcommittee on Housing and Community Opportunity
Thursday, June 28, 2012

Chairwoman Biggert, Ranking Member Gutierrez and Members of the Subcommittee, the following statement is offered for the record and I thank you for the opportunity to submit the statement. The thousands of state licensed mortgage loan originators not directly represented at today's important hearing depend on **IMMAAG**[1] to provide them information and occasionally to speak for them. Those professionals are central to the Congress's stated desired solutions to make the mortgage delivery processes more efficient, simpler, clearer and understandable to consumers. Today's hearing is particularly relevant to those goals in as much as the subject stands as an icon for how not to oversee market activities.

Somewhere over time it seems that the idea of why appraisals are needed has been lost. The fact is that the value of any asset is determined by the price a willing buyer pays a willing seller in an arm's length sales transaction. The idea of appraisals was borne to assist buyers and sellers with an estimate of what a fair value might be. As it relates to real property, primarily due to the financial size of the transaction and the fact that most buyers could not pay cash for the home they wanted to purchase, lenders began asking for appraisals to determine the likelihood that the amount loaned could be recovered by the sale of the underlying collateral if the even to occurred that the borrower no longer paid. Then as it became apparent that homes were investments with appreciating value which created paper equity but not liquidity, the appraisal became a method to value the asset so an owner could exchange paper equity for cash or access to a credit facility to increase liquidity.

So, there are actually two different reasons for an appraisal to be desired and each of those reasons drives a different set of expectations and motivations and needs. In the first, the purchase

[1] IMMAAG is a Colorado for profit information company founded in 2008 to provide the tens of thousands of small and independent mortgage brokers and originators a clearing house and information source regarding legislative and regulatory activity affecting their business and customers and with 2,900% growth in registered users since January 2010 has evolved into a center for advocating their common causes.

of a home, the seller is interested in an appraised value that supports the asking price. It would be naïve to believe the seller wants a lower value when trying to sell. On the other hand the buyer, even though few act this way, really wants a value that is as low as possible, but buyers generally operate as though they simply want a value that supports their emotional desire to buy a home. In the sales transactions, everything else being equal the buyer stands mostly on the sidelines with respect to the appraisal process and valuation. The lender simply wants accuracy so they are confident that the loan to value they believe they have will be adequate to reeover the loan balance and costs associated with recovery.

On the other hand, the majority of appraisal transactions today do not support a purchase / sale. In fact, based on the Mortgage Banker Association's most recent report, refinances comprise almost 80% of the weekly applications for mortgages. In a refinance there are only two participants and their objectives are not congruent. The borrower wants the highest appraised value possible and the lender continues to want accuracy. This is a pure financial transaction, not a real estate transaction. I point this out because on today's panel the subcommittee will hear from a trade association representing the real estate community, but will take no testimony from state licensed mortgage brokers who represent a material portion of the delivery process affecting this huge segment of the transactions requiring appraisal.

The committee is seeking answers to the regulatory impact of appraisal oversight on consumers and business and will not have the advantage of hearing from the professionals who live and work in the local market and must process the transactions which have been negatively affected by reactions based on misinformation and misunderstanding.

Possibly more than any single change, the unilateral action taken by then New York State Attorney General Andrew Cuomo to threaten a law suit against Fannie Mae and Freddie Mac which resulted in a negotiated settlement leading to the Home Valuation Code of Conduct has harmed the housing market, cost consumers the loss of paper equity and net worth to the tune of trillions of dollars and has resulted in a process that has become imbedded so deeply that even when the Dodd Frank Act terminated the policy, the FHFA and FHA refused to change their HVCC inspired policies.

It is one thing for oversight when there is proof of harm, inefficiency or ineffectiveness. It is another thing entirely for powerful people to use their position to unilaterally influence industry based on anecdotal information and unsupported allegations. For all intents and purposes it is this cause that has led to existing appraisal processes which not only harm consumers through artificial value suppression, but harms the appraisers it ostensibly was designed to protect.

The Home Valuation Code of Conduct was a draconian flexing of the muscles of a single state's attorney general. It was so effective in changing the landscape that even after the Congress terminated it through the passage of the Dodd Frank Act, FHFA and FHA refuse to change the policies implemented specifically to support HVCC.

To address the committee's questions I will simply bullet point some of the impact of the regulatory oversight of the appraisal process. Unfortunately, with the exception of elevating the public awareness one power oriented official's stature the recent misdirected actions with respect to appraisals has produced only negative results:

Fraud: A driving reason for HVCC and resulting regulation is to reduce valuation fraud. According to MARI reports since HVCC's inception valuation fraud, to the extent it can be truly measured or estimated has not improved.

Transportability: One of the elements of the Dodd Frank Act in Section 1472(h) directed the regulators to insure appraisal transportability between lenders. This aspect of the law continues to be ignored and has not been addressed to date by regulation and the result is to make mortgage delivery inefficient, delay closings and increase consumer costs because generally while lenders pay lip service, transportability is not a widely supported practice.

Appraiser Competence: One of the most dramatic consequences of regulatory oversight, and I include the HVCC in that category in spite of the fact that it was a forced policy, not regulation per se, is the fact that thousands of competent, experienced appraisers have been driven out of the industry due to the onerous requirements supported by HVCC and the Dodd

Frank Act. You will hear about this from today's witnesses. Not only has the competence of the appraiser community generally declined, with respect to geographic competence, since many of the AMC's are out of the state in which the property is, often the appraiser selected because they are willing to work for less and be subject to the rules of the AMC, is without the local expertise necessary to truly provide the value insights of a particular community.

Appraiser Compensation and Consumer Cost: Because of the practically mandatory use of a new middle man, the AMC, two things have happened in tandem, both negative. Appraisers whose fees have always been driven to competitive levels by the market have been reduced by requiring revenue for the AMC. At least a portion of this change has been borne by the consumer in the form of higher prices. In addition, when combined with the ineffective application of transportability, which was less frequently needed when local experts, the loan originators, ordered appraisals from local experts, the appraiser; many more redundant appraisals are necessary today leading to increased consumer cost and delayed closing or failed transactions.

Inefficiency and Complexity: The result of the myth-based reaction to a perceived, but unproven market issue, instead of achieving the stated goals of simplicity, clarity and accuracy the current regulated processes have led to market inefficiency and a level of complexity that frustrates sellers, buyers, lenders and leads to increased costs and failed transactions.

Housing Recovery: Possibly the most significant bottom line impact of the overzealous, misdirected and draconian intrusion in the market is the suppression on housing prices and recovery.

The committee will hear a variety of other insights from the witnesses, but **IMMAAG** believes that while there is value in regulatory guidanee and it is difficult to escape an overreaction due to the depth of this century's financial crisis, this committee needs to send a message to the regulators that HVCC has been terminated and it is time to allow industry and the distribution system to return to the local, on the ground delivery mechanisms which were effective for decades and only failed when artificially overheated housing appreciation combined with a glut of unproductive, pent up capital led to excesses driven to convert locked up brick and mortar, paper net worth to spendable net worth.

There is no easy answer, but the chosen path has proven it is an obstacle to, not a solution for the problem the regulators feel they need to solve. Appraisal regulation has become the poster child for the wrong approach. Hopefully, our regulators and Congress can learn from that and reset the course by engaging industry in designing an effective solution.

In closing, I would like to make one final observation for the committee. Mortgages are delivered locally. Mortgage brokers (now called originators) were excluded from participating in the appraisal order process due to HVCC. Even in the face of congressional attempts to reverse that inappropriate reaction and even with the October 2010 termination of HVCC, the FHFA and the FHA have continued in their Appraiser Independence Requirements (A.I.R.) to refuse to change the processes. They continue to refuse to allow the most expert, most professional control source to be a participant in what is arguably the most empirically based tool a lender has to assess its understands its exposure in a purchase or refinance. In October 2010 I personally spoke with the attorney at the Federal Reserve Board who managed the Board's drafting and implementation of the Dodd Frank Act's required appraisal independence rule and was told by Ms. Kathleen Ryan that the Board did not intend the interim final rule to exclude mortgage brokers from the appraisal ordering or delivery process. I then spoke with management at both FHFA and FHA and was told that they did not care and intended to simply continue in the spirit of HVCC. A bad, questionably motivated local threat of litigation has become the foundation of the process that is central to managing housing finance risk and the regulators have done nothing to address. **IMMAAG** asks the Congress and this committee to take on that task and offers our expertise and the expertise of the thousands of state licensed mortgage loan originators who have not had a voice in this process to help.

Thank you for accepting **IMMAAG**'s comments. I look forward to the opportunity to assist.

William F. Kidwell, Jr. NMLS#174542