JOINT TESTIMONY OF THE
REAL ESTATE VALUATION ADVOCACY ASSOCIATION (REVAA)
AND
COALITION TO FACILITATE APPRAISAL INTEGRITY REFORM (FAIR)

BY

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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

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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:

[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 have 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]

<u>The Regulatory Structure Applicable to AMCs</u>

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

[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

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[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.