NATIONAL
COMMUNITY
REINVESTMENT
COALITION
NCRC

Testimony

Testimony of

David Berenbaum

Chief Program Officer
National Community Reinvestment Coalition

On the subject of
Appraisal Oversight: The Regulatory Impact on Consumers and Businesses

Submitted to the
United States House of Representatives
Committee on Financial Services
Subcommittee on Insurance, Housing & Community Opportunity

Thursday, June 28th, 2012

National Community Reinvestment Coalition

727 15th Street, N.W.
Suite 900
Washington, D.C. 20005
www.ncrc.org

Voice: 202-628-8866
Fax: 202-628-9800

Testimony

Of

David Berenbaum
Chief Program Officer
National Community Reinvestment Coalition

On the topic
of
Appraisal Oversight: The Regulatory Impact on Consumers and Businesses

Submitted to the
United States House of Representatives
Committee On Financial Services
Subcommittee on Insurance, Housing & Community Opportunity

Room 2128
Rayburn House Office Building

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

[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]

---

[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.*

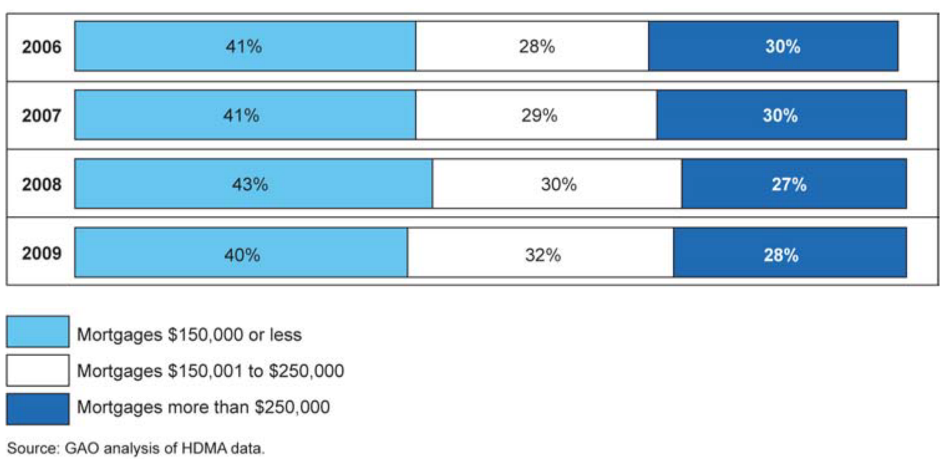
8. *Responsible Appraisal Practices Ensure and Expand Housing Opportunities in an Open Society.*

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.*

Requiring Professional Appraisals Regardless of What Institution Originated the Loan:

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]



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

The report notes that in recent years, however, the threshold has had limited impact on the proportion of mortgages with appraisals because mortgage investors and insurers such as Fannie Mae, Freddie Mac, and the Federal Housing Administration have voluntarily required appraisals for mortgages both above and below the threshold. However, since these appraisals are mandated on the forms they defined, they are still limited and self-serving. A more robust standard for defining the appraisal requirement suitable for specific lending situations could be achieved by broad industry and consumer cooperation.

While these entities currently dominate the mortgage market, many of the proposed Federal and private sector plans to scale them back could lead to a more privatized market, and whether this market would impose similar requirements is unknown. Therefore, it is NCRC's recommendation to the House Financial Services Committee that valuations conducted by licensed appraisal professionals should be required for <u>all</u> real estate guaranteed loans – public or private – for transactions above $50,000. This will ensure meaningful consumer protection while reducing risk to all of the parties involved with originating, servicing, insuring or guaranteeing the mortgage transaction.

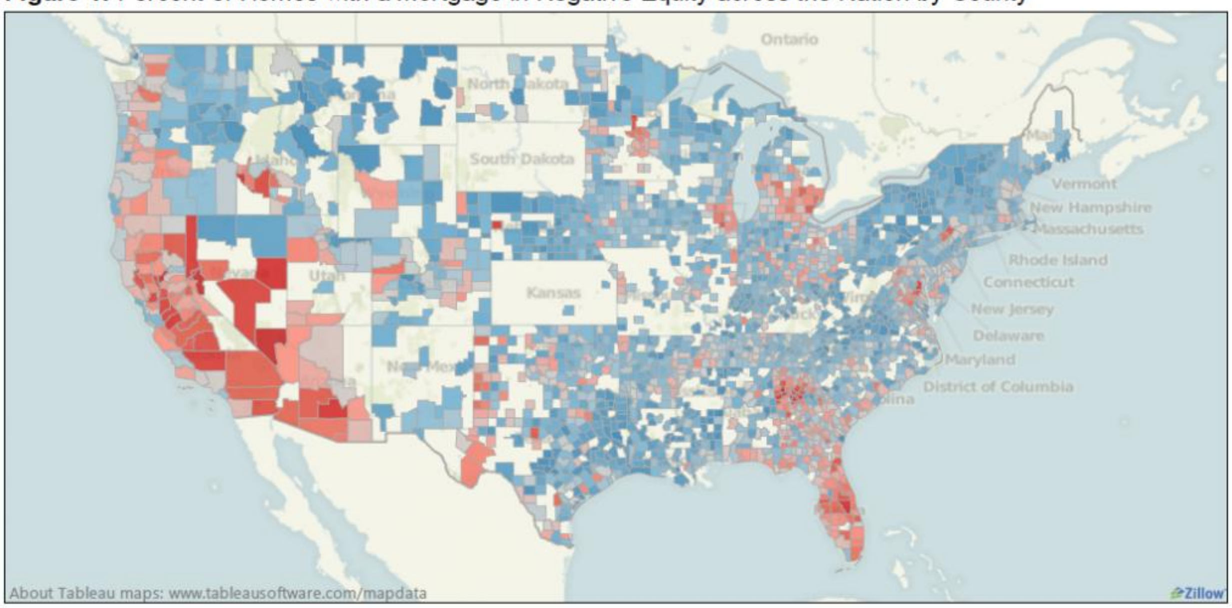
Further, the National Community Reinvestment Coalition agrees with the position of the American Guild of Appraisers, which notes in its recent petition to the Federal Reserve Board and the CFPB that the real estate appraiser is the only participant in a loan transaction who is a disinterested expert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

---

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

---

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