Testimony of
David S. Bunton, President
The Appraisal Foundation

Modernizing Appraisals: A Regulatory Review and the Future of the Industry

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

November 16, 2016

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

The Appraisal Foundation
1155 15th Street NW
Suite 1111
Washington, DC 20005
202-347-7722
www.appraisalfoundation.org

INTRODUCTION

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

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

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

Rather, the Foundation:

- is a non-profit 501(c)(3) educational organization;
- was founded by eight national appraisal organizations 29 years ago;
- serves as an umbrella organization comprised of approximately 100 organizations and government agencies with an interest in valuation;
- was created to foster professionalism in appraising.

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

- individuals seeking to become a trainee appraiser, supervisory appraiser, state licensed appraiser or state certified appraiser must meet the minimum qualification requirements established by the Foundation's Appraiser Qualifications Board (AQB);
- all states and territories must use licensing and certification examinations either issued or endorsed by the Foundation's AQB; and
- all state licensed and certified real estate appraisers must adhere to the *Uniform Standards of Professional Appraisal Practice* (standards of conduct) written by the Foundation's Appraisal Standards Board (ASB).

On behalf of The Foundation, as a fair, impartial, and objective resource on valuation-related issues, thank you for the opportunity to address the specific topics on which you are seeking our perspective.

SPECIFIC TOPICS OF DISCUSSION REQUESTED BY THE SUBCOMMITTEE

Appraiser Regulatory Structure

Background

In the 1980s, the United States (U.S.) financial sector experienced a period of distress that was focused on the nation's savings and loan (S&L) industry. By 1984, Congress was already hearing complaints about faulty and fraudulent appraisals that were deepening the severity of the S&L crisis. To address the thrift industry's problems, Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which ushered in a number of industry reforms. The main S&L regulator (the Federal Home Loan Bank Board) was abolished, as was the bankrupt Federal Savings and Loan Insurance Corporation (FSLIC). In their place, Congress created the Office of Thrift Supervision (OTS) and placed thrift's insurance under the Federal Deposit Insurance Corporation (FDIC). In addition, the Resolution Trust Corporation (RTC) was established to resolve the remaining troubled S&Ls. The RTC closed over 700 S&Ls with assets of over $400 billion. Taxpayers were left with over $120 billion in losses and a shaken confidence in the U.S. financial system.

Title XI of FIRREA (Title XI) created the unique appraiser regulatory system we have in place today. The purpose of Title XI is:

> "*to provide that Federal financial and public policy interests in real estate related 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*."

To serve this purpose, Title XI authorized the uniform appraisal standards and minimum appraiser qualification criteria established by The Appraisal Foundation (Foundation), and authorized states to establish appraiser regulatory programs to ensure effective supervision of licensed and certified appraisers who are eligible to perform appraisals for federally related transactions (FRTs). The Appraisal Subcommittee (ASC), an independent executive branch federal government agency, was created by Title XI within the Federal Financial Institutions Examination Council (FFIEC) to provide oversight to the appraiser regulatory system. The Association of Appraiser Regulatory Officials (AARO), a non-profit organization, was formed in 1991 to facilitate communication between regulators and others involved with the appraisal profession.

The emerging system brought about stability and consistency where previously there was none. Prior to the creation of the Foundation and subsequent adoption of Title XI, anyone could declare him/herself a real property appraiser, the associations for appraisers each had their own individual set of rules about appraiser qualifications and standards of appraisal practice, and only a handful of states had chosen to regulate the occupation. The inconsistencies and uncertainties made a negative impact on the market and contributed to the financial crisis.

In the 25 years since the implementation of Title XI, the system has evolved and significant improvements have been made. Policy makers, lenders, consumers, and others relying on the services of a real property appraiser have greater assurance in the profession because:

- Appraisers now meet increased education requirements in specific valuation topics, gain experience under careful supervision, and successfully pass a robust, national examination;
- Appraisers now practice under a single set of uniform, ethical standards (i.e., the *Uniform Standards of Professional Appraisal Practice*, or USPAP), which have been tested in the courts and are looked upon globally as a gold standard;
- State regulatory bodies are established as envisioned with 76 percent deemed "good" or "excellent" in their compliance reviews;
- State boards embrace knowledge-based enforcement by having sent 783 state regulatory staff members to investigator training since 2009;
- State boards, comprised primarily of appraisers, are effectively policing the profession with more than 19,000 disciplinary actions reported to the National Registry in the ten-year period from January 1, 2006 through December 31, 2015; and
- The system operates in an open and transparent manner with the entities working together and engaging stakeholders and the public when emerging issues arise.

These strides illustrate the benefits of uniting the private sector with state and federal regulatory entities for a more streamlined and accessible regulatory system.

Since the enactment of Title XI of FIRREA in 1989, Congress has addressed other crises by creating similar regulatory structures to ensure a national threshold of competency:

- With the advent of the Arthur Andersen and Enron scandals in 2001, Congress created the private sector Public Company Accounting Oversight Board (PCAOB) to ensure that the auditors of public companies adhere to independent and transparent national standards.
- Following the 2008 housing crisis, Congress passed the SAFE Act, which mandates that mortgage originators are subject to background checks, a uniform

set of educational courses, and a comprehensive examination. This system is administered by the Conference of State Bank Supervisors' wholly owned subsidiary, the Nationwide Mortgage Licensing System and Registry (NMLS).

Suggestion for State-Based Alternative to Federal Regulatory Structure

Some have suggested that the federal arm of the appraiser regulatory system currently in place be replaced with a state-based structure. They point to regulation of other professionals involved in federally related mortgage transactions: real estate agents, bankers, and attorneys, among others, and pose the possibility for creating a similar oversight structure for appraisers. Examining this concept further, one finds:

1. <u>The Appraiser Membership Organization Structure is Fractured</u>
   Unlike professionals whose support structure includes a comprehensive national association to which most members belong, namely: the National Association of REALTORS, American Bankers Association, Mortgage Bankers Association and the American Bar Association, appraisers do *not* have a primary membership organization to create consistency across the profession. There are numerous appraiser associations, most of which specialize in niche markets. Among others of various sizes and interests, examples include:

   - **Commercial appraisal** – Appraisal Institute (AI), American Society of Appraisers (ASA), and Royal Institute of Chartered Surveyors (RICS)
   - **Residential appraisal** – National Association of REALTORS (NAR), National Association of Independent Fee Appraisers (NAIFA)
   - **Rural appraisals** – American Society of Farm Managers and Rural Appraisers (ASFMRA)
   - **Mass Appraisal/Assessment** – International Association of Assessing Officers (IAAO)
   - **Easement/Government Right of Way** – International Right of Way Association (IRWA)

   Adding to this complexity, it is a widely held belief that approximately 70 percent of state licensed and certified appraisers do not belong to a professional membership organization or adhere to ethical guidelines that professional association membership dictates.

   One strong national association, like those that exist for the other professions, would help to ensure consistency state by state. Without similar organization for appraiser professionals, a state-based appraiser regulatory structure would be hampered by competing interests of numerous membership bodies.

2. <u>The Number of Appraisers is Comparatively Small</u>
   There are approximately 80,000 licensed and certified appraisers in the United States. This compares to two million real estate agents, two million bank employees, and 400,000 American Bar Association members. The other professionals involved in mortgage lending transactions dwarf the number of appraisers and their membership organizations have significantly more political sway. It may be difficult for a state-based regulatory structure to ensure appraisal independence and consistent adoption of a common set of qualifications and standards given the imbalance.

Keeping a small yet effective federal footprint in the appraiser regulatory system is critical to overcoming these issues. Appraisers are the only independent voice in a real estate transaction. Payment for their service is not connected to the purchase price or successful closing. There are important public policy reasons to ensure appraisal independence and prevent undue influence in providing an opinion of real property value. The authority of the federal government levels the playing field for these appraiser "Davids" versus their "Goliaths." A federal presence helps to ensure appraiser quality and independence so that appraisals performed in conjunction with federally related transactions can be regarded as credible and worthy of public trust. This small federal footprint—currently the ASC—is important to ensure consistency across the country for consumers and the mortgage finance system.

Leveraging the Federal Footprint to Streamline Regulatory Compliance
Technology has drastically changed since the enactment of Title XI, allowing for the electronic transfer of critical data and information. Likewise, the geographic market area of many appraisers now reaches beyond individual state borders and certification in multiple jurisdictions is common.

With minimum appraiser qualification requirements set by the Foundation and adopted by all jurisdictions, appraiser state application materials are mostly duplicative state by state. This creates an unnecessary administrative burden for both state regulators and individual appraisers.

To ease regulatory burdens, the Foundation has started conversations with its advisory organizations, state regulators, and others to explore the development of a national portal for submission of appraiser licensing and certification application information. The portal would be accessible by each state jurisdiction and function similar to the NMLS for mortgage licensing. Congress recently expanded the authority of NMLS to allow it to service other professionals involved in mortgage lending. Expansion of that system for appraiser licensing and certification is worth exploring, and funding for the connection to state regulatory bodies could be provided by the ASC as part of its authority to offer grants to states. Leveraging the federal footprint in this manner would streamline the regulatory process, relieve administrative burdens, and help the states as well as the appraiser professionals relying on state services.

Effectiveness of the Appraisal Subcommittee

The federal entity in the appraiser regulatory system is the ASC. It is an oversight body primarily designed to:

- Monitor the states, the Foundation, and the federal banking regulators regarding Title XI related activities;
- Ensure appraisers who perform appraisals for federally related transactions meet the qualifications set by the AQB of the Foundation, complete appraisals in accordance with uniform standards, and are subject to effective supervision; and
- Provide grants to the Foundation and the states for Title XI activities.

The ASC has worked to carry out its Congressional charge in these areas, but as we envision the future of the appraiser regulatory system, minor adjustments would increase its effectiveness.

Monitoring

Since the enactment of Title XI, the focus of ASC monitoring has been administrative—ensuring proper regulations are in place and processes are completed timely. The 2015 ASC Annual Report indicated that it monitored the work of the Foundation by attending meetings and reviewing documents, that it monitored the ASC member agencies by noting they had adopted appraisal-related rules and policies, and that it monitored state regulatory programs by on-site visits to review documents and attend regulator meetings. These primarily administrative reviews found no issues of concern with the Foundation and ASC member agencies, and 42 of the 55 state jurisdiction regulatory programs are currently deemed as "Good" or "Excellent" following compliance reviews.

To increase the effectiveness of the ASC, the function of monitoring should evolve to more substantive issues in the following areas:

1. <u>Consistency in Enforcement Among the States</u>: The organizations that provide input and counsel to the Foundation report wide differences among states in the application of disciplinary measures for appraisers who violate USPAP. The ASC should use the information gained during compliance reviews to analyze states' enforcement decisions and provide an annual report about the outcomes.

2. <u>Proper Application of USPAP to Violations Charged:</u> The ASC review process is limited to verifying that states are resolving complaints within a one-year time frame set by ASC policy. To increase effectiveness, the ASC should review the states' complaint resolution decisions to ensure that they are properly and consistently determining an appraiser's adherence to USPAP when completing appraisals. The findings of these reviews should be shared with the states and other interested parties, and could become the basis for educational and informational programs to be developed if inconsistencies are revealed.

3. <u>Analysis of Complaints Referred to Banking and Appraiser Regulators Via the Appraisal Complaint National Hotline</u>: The enactment of the Dodd-Frank Act gave the ASC the authority to create a hotline to receive and refer complaints of non-compliance with appraiser independence and USPAP. It also gave the ASC the authority to follow-up on complaint referrals to the states, financial institution regulators, and others to determine the status of the resolution. While an information and referral portal was established, the ASC should complete its charge by following up on referrals and publishing information about the resolutions.

To increase effectiveness while keeping the federal footprint small, the ASC should move to reviewing reports and information, instead of the labor-intensive and costly site and meeting visits, for those entities found to be compliant or without major concern in previous years.

A structural change would further help the ASC meet its monitoring requirements. The ASC is comprised of representatives of the Federal Reserve, Office of the Comptroller of the Currency (OCC), Federal Housing Finance Agency (FHFA), Federal Deposit Insurance Corporation (FDIC), Consumer Financial Protection Bureau (CFPB), National Credit Union Administration (NCUA), and the U.S. Department of Housing and Urban Development (HUD). The ASC staff is put in a difficult position by the mandate that they must monitor the agencies' appraisal-related activities from which their board members are appointed. This became evident with some of the agencies' rulemaking decisions to reduce the impact of Title XI by creating a myriad of exemptions to the definition of "federally related transactions" and increasing the threshold amount under which an appraisal is not required. This structure also impacted decisions made by the ASC about the Appraisal Complaint National Hotline. A more independent reporting structure would enable the ASC to more effectively carry out its Congressional mandates to monitor the actions of these agencies.

Ensuring Appraisers are Qualified

To ensure that qualified appraisers are qualified to develop appraisals used in conjunction with federally related transactions, the ASC maintains a National

Registry of state licensed and certified appraisers. The National Registry contains the names and credential information of individuals that the states have deemed to have met qualification criteria established by the AQB and whose practice has not been found in violation of USPAP. We are encouraged that the ASC is working to improve the National Registry by creating a unique identification numbering system that will identify appraisers individually rather than by credentials held as many appraisers hold credentials in multiple jurisdictions. To make the National Registry more robust, the ASC should capture additional information about the appraiser including primary area of appraisal practice (e.g., commercial, residential, litigation, assessment, etc.), primary location of practice territory (e.g., urban, rural), any professional designations held, and contact information (including email address). This information would help individuals select an appraisal professional who meets their needs and to communicate to all appraisers about items of importance.

Grants in Support of Title XI Activities

While no federal tax money is used to support the appraiser regulatory system, states are required to annually collect and submit to the ASC $40 per state licensed and certified appraiser. These funds support the work of the ASC, provide it with funding to issue grants to the Foundation to support Title XI-related activities undertaken by the Appraisal Standards and Appraiser Qualifications boards, and enable the ASC to provide grants to states to support Title XI activities in the areas of complaint resolution and data submission. In the last five years, these grants combined have ranged from 25 percent of the ASC's annual budget ($1.1M of its $4.27M budget in 2011) to less than 15 percent of its annual budget ($569,000 of its $3.8M budget in 2015). Without consistency in funding, the Foundation must seek alternative revenue sources and the states must increase licensing and certification fees for appraisers to fund state regulatory programs. Greater stability and equity in funding amounts would be helpful for planning and execution of Title XI by the Foundation and the states.

Establishing a funding distribution model would bring greater consistency and stability to support Title XI activities. As examples, the model could:

- Set a minimum percentage of ASC funds collected to be used for grants to the Foundation to fund Title XI-related activities (e.g., 25 percent);
- Set a minimum percentage of ASC funds collected to be used for grants to states to fund Title XI-related activities (e.g., 25 percent); and/or
- Set a maximum percentage of ASC funds collected that it may keep for its federal oversight responsibilities (e.g., 50 percent).

The Impact of the Dodd-Frank Act on the Current Regulatory System, Stakeholders, and Consumers

While the Dodd-Frank Act ushered in some beneficial regulatory reform, it also created its share of unintended consequences. Promoting appraisal independence is an admirable goal, but building upon the Appraisal Management Company (AMC) model first made prevalent in the *Home Valuation Code of Conduct* (HVCC) had its drawbacks as well.

The Good

Codifying specific appraisal independence violations in federal statute was a big victory for appraisers. With the passage of Dodd-Frank, loan originators, processors, underwriters, mortgage brokers, and real estate salespeople were put on notice that appraisers could not be "bullied" into making deals work. Dodd-Frank provided a laundry list of acts that would constitute violations of appraisal independence. While many involved in the residential real estate marketplace needed no such compelling legislation, appraisers stood up and took notice that provisions to safeguard their independence were now part of federal legislation. Dodd-Frank also included provisions that permitted appropriate communication with appraisers for legitimate business needs.

Dodd-Frank also included some consumer protection provisions aimed at predatory lending practices. Such practices significantly contributed to the real estate "bubble," which ultimately resulted in the loss of significant wealth to a great number of Americans.

The introduction of federal legislation that enabled the ASC to regulate AMCs was another positive aspect of Dodd-Frank. Many states implemented AMC regulation prior to the enactment of the federal law, but Dodd-Frank gave formal authority to the state appraiser regulatory agencies to do so. The federal regulations for AMCs promulgated by the ASC take effect in August 2018.

Dodd-Frank also authorized the Foundation's AQB to establish minimum requirements for trainee, supervisory appraisers, and licensed residential appraisers. Although prior to Dodd-Frank many states had voluntarily implemented the minimum qualifications for these classifications that were set by the AQB, the federal law assisted in greater consistency.

The prohibition against using Broker Price Opinions (BPOs) as the primary basis for evaluating collateral was also seen as a positive aspect of Dodd-Frank. While BPOs provide a valuable service in buying and selling real estate, they do not offer the independent, impartial, and objective analysis that an appraisal offers. Nor do they provide the depth and breadth of the analyses found in appraisals.

The Bad

Despite the specific exceptions noted in Dodd-Frank, many in the residential mortgage lending arena mistakenly equated the appraisal independence provisions with an appraiser being "radioactive." Such misunderstanding was relatively commonplace, but has been tempered more recently due in part to efforts of the Foundation, including the development of promotional material identifying these issues as "Common Myths" (Attachment 1) and elaborating on them at conferences and speaking engagements.

Dodd-Frank also reinforced the AMC appraisal procurement and management model to the point that many lenders mistakenly believed Dodd-Frank *required* them to use an AMC. Nevertheless, many lenders welcomed codification of the AMC model because it allowed them to outsource engaging appraisers, manage their progress for the duration of an assignment, and rely on them to perform at least a cursory review of the appraisal report. In addition, some lenders found the AMC model to be a newly discovered source of revenue. These lenders determined they could charge borrowers the "going rate" for appraisals, yet they weren't required to pay the AMCs since the AMCs receive the bulk of their funding from the appraiser. This resulted in many appraisers feeling like they were servants to a new master, and to add insult to injury, lost 40 to 60 percent of their appraisal fees.

Dodd-Frank benefited consumers by requiring lenders to provide a copy of the appraisal that was utilized in underwriting a loan. The CFPB went a step further and required lenders to provide borrowers with copies of *all* valuation products that were considered in conjunction with the loan application. Unfortunately, many borrowers were simply confused when receiving this information prior to closing. Some wondered why certain products reflected one opinion of value, while a different product showed another. And how was the appraisal fee the borrower paid actually applied to these various products? In an effort to aid in understanding, the Foundation created material that could be provided to borrowers upon receiving these valuation products (Attachment 2); unfortunately, the CFPB opted not to require lenders to provide it.

Dodd-Frank included a provision whereby the appraisal fee paid listed on the Closing Disclosure statement *may* delineate between the fee the appraiser received and the fee retained by the AMC. Unfortunately, the CFPB opted <u>not</u> to require the Closing Disclosure statement to separately identify these fees. This lack of transparency is a disservice to all parties, leading borrowers to believe the appraiser received the full fee paid when in fact it is generally about half of what is paid.

Dodd-Frank included provisions for appraisers to be paid customary and reasonable fees. Unfortunately, to date such provisions have not been consistently enforced. Further, many appraisers perceived such a provision to be incredibly ironic since the legislation further entrenched the AMC model where appraisers now received a fraction of the fees they had in the past.

The *De Minimis* Threshold and Federally Related Transactions

Background

In the summer of 1990, the federal financial regulatory agencies developed their appraisal regulations, which included a $50,000 *de minimis* threshold, with the exception of the Federal Reserve Board (FRB), which set its threshold at $100,000. Real estate transactions below this threshold would not have to be appraised by a state licensed or certified appraiser.

In the spring of 1992, the FDIC, the OCC, and the OTS revised the regulations and changed their thresholds for requiring a state licensed or certified appraiser to $100,000. In June of 1994, the federal financial regulatory agencies then increased the *de minimis* to $250,000, where it remains today. As a result of outreach meetings over the past year associated with The Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), there have been several recommendations that the current threshold of $250,000 be doubled to $500,000.

We strongly oppose such an increase because it would significantly dilute the intent of Title XI of FIRREA. Title XI was put in place to ensure the safety and soundness of our deposit insurance fund. The value of the underlying collateral in a lending transaction needs to be determined by a professionally trained appraiser who adheres to performance standards and is credentialed by a state. With the current median existing home sales price of $234,200, a $500,000 *de minimis* would exempt most residential mortgage transactions. An individual's primary residence is often their single largest investment and neither lenders nor borrowers would be afforded the protection of having a trained professional determine whether an appropriate price is being paid for a property.

Federally Related Transactions

Related to the *de minimis* is the issue of what constitutes a federally related transaction. When Congress passed FIRREA, the intent was that most residential mortgage transactions would be considered federally related transactions.

In the early 1990s, the federal financial regulatory agencies adopted a series of regulations that resulted in 12 instances where a transaction is no longer considered a federally related transaction (Attachment 3). These exemptions greatly reduced the number of federally related transactions. It is estimated that fewer than 20 percent of residential mortgage transactions are federally related transactions.

There continues to be a great deal of confusion in the marketplace about what constitutes a federally related transaction. Most individuals involved in the appraiser regulatory system are under the false impression that the majority of residential mortgage transactions are federally related.

For example, in August 2015 the AARO wrote a letter to the ASC requesting a definition of what constitutes a federally related transaction. To date, AARO has not received a response to their letter.

By raising the *de minimis* and very narrowly defining what constitutes a federally related transaction, the intent of Title XI of FIRREA has been significantly undercut.

A Shortage of Appraisers

In recent months there have been numerous reports of appraiser shortages, long waits to obtain an appraisal, and higher appraisal fees. The chart included with this testimony (Attachment 4)—developed by the ASC staff—illustrates the rise and fall of appraiser credentials as well as the correlation between appraiser credentials and mortgage originations. While this chart suggests that the shortage is not a national problem, there is no question that there are shortages being reported in certain markets.

Ironically, the number of state certified real estate appraiser credentials is almost ten percent higher today than it was ten years ago. However, there are several factors that may be causing localized appraiser shortages. In large part, these factors apply almost exclusively to the residential mortgage lending sector of the profession for the following reasons:

The Demise of the State Licensed Residential Real Estate Appraiser

As a result of the real estate crisis, Congress passed the *Housing and Economic Recovery Act of 2008 (HERA),* which required that appraisers for Federal Housing Administration (FHA)-insured mortgages must be "certified" by the state in which the property to be appraised is located or by a nationally recognized professional appraisal organization. Effective October 1, 2009, FHA no longer accepted new applications from state licensed residential appraisers per the HERA requirement. All roster appraisers must now be state certified and appear on the ASC's National Registry in order to conduct appraisals for FHA-insured mortgages.

This has had a very significant impact on the number of state licensed real estate appraisers. While some obtained the state certified real estate appraiser credential, many left the profession. A ten-year comparison of appraiser credentials (below) shows a decrease in the number of state licensed residential real estate appraisers by over 70 percent.

Active Appraiser Credentials

	2006	2016
Certified General	**34,812**	**39,011**
Certified Residential	**46,701**	**49,550**
Licensed Residential	**29,921**	**7,950**

The Education of Users of Appraisal Services

Another significant change that has occurred in recent years is the fact that many lenders today do not want licensed residential or trainee appraisers involved in the performance of residential appraisals. This decision occurred in large part because of the abundance of caution that lenders exercised following the economic crisis of 2008. The Foundation was surprised to learn that many lenders believe that Dodd-Frank prohibits them from using these individuals, which is simply not the case. Using state licensed residential appraisers and trainees would greatly reduce any backlog of appraisal assignments. Licensed residential appraisers are legally able to perform appraisals on the vast majority of residential real estate in this country (non-complex residential property with a loan amount below $1,000,000, and complex residential property with a loan amount below $250,000). In addition, trainee appraisers can perform appraisal assignments on any property a supervising certified appraiser is legally able to perform, provided the report is co-signed by that supervising certified appraiser. The Foundation is working with professional associations who represent lenders to raise awareness that the use of both licensed residential appraisers and trainee appraisers is permissible and should be encouraged.

The Economic Factor

Even with the "customary and reasonable fees" provision contained in Dodd-Frank (enacted in 2010), there is little debate that residential appraisal fees have stagnated in recent years. Whether it is due to the advent of AMCs or because some users of appraisal services view appraisals as a "commodity," there has been an impact on the number of appraisers who want to perform appraisals for residential mortgage lending. Many have opted out of residential appraising altogether or have diversified their practice to include such specialties as eminent domain, insurance, assessment appeal, and litigation support. While the number of residential appraisers remains strong, there may be a shortage of appraisers ***willing*** to accept assignments below a certain fee threshold.

A large number of residential appraisers believe the working conditions for many assignments in the residential mortgage lending sector are untenable. Many of the pricing and turnaround time models used by AMCs were developed for urban and suburban markets. In rural areas, many appraisers refuse to take on assignments due to: (1) the level of compensation; and (2) a short turnaround time requirement when the property is a considerable distance away. Some appraisers believe an AMC must "justify" the fee it is earning by placing greater scrutiny on appraisal reports, and create additional requirements for the appraiser.

Many clients and users of appraisal services have also asked for more in residential mortgage appraisal assignments. Performing an enhanced scope of work and providing more detail in a report should create an expectation of *higher* – not lower fees. Lower fees, quick turnaround time expectations, and increased client requirements result in an unsavory cocktail for many appraisers; from a strictly economic point of view, it is simply not worth their time.

The Dispersion Factor
While we can easily identify the number of appraisers in each state through the ASC's National Registry, how those appraisers are dispersed in their respective states is much more difficult to assess. There is little doubt that there are counties and towns around the United States that are underserved by appraisers; but that has historically been true to some degree. The Foundation believes that the significant reduction in the number of licensed appraisers has adversely impacted rural areas. Individuals who may have possessed multiple credentials in such fields as real estate sales, insurance, and real estate appraising may have let their licensed residential appraiser credentials lapse when the demand for their services dropped off significantly as a result of the FHA policy and refusal of lenders to engage them.

A Look Ahead
While the Mortgage Bankers of America projects a reduction of mortgage originations over the next two years, the Foundation has some concerns about the number of real estate appraisers 3-5 years from now and wants to ensure there are no unnecessary barriers to entry for qualified individuals seeking to enter the appraisal profession. It is for this reason the AQB is looking into alternative ways that individuals may meet certain qualification criteria requirements.

The Role of Appraisals in a 21st Century Marketplace

Appraisals performed by ethical and competent appraisers are a cornerstone of safety and soundness policies for financial institutions insured with federal funds. Without an independent, impartial, and objective opinion of value for collateral, lenders could make risky loans without the safeguard of knowing their investments are protected.

We have all witnessed financial crises that took their toll on financial and real estate markets and burdened U.S. taxpayers with a heavy debt. As discussed, the Savings & Loan Crisis of the 1980s brought about regulatory reform that included, for the first time, national requirements for the licensing and certification of real estate appraisers performing appraisals in federally related financial transactions.

Moving forward, what role will appraisals play? Although there are obviously fluctuations (e.g., "bubbles") from time to time, the long-term trend for real estate in this country is clearly one of appreciation. And the higher the property values, the larger the loans that homebuyers and homeowners will seek. Larger loans equate to potentially greater risk for financial institutions and the secondary market, thereby possibly creating increased exposure for the taxpayer. Therefore, it could be argued that in the years ahead, professional valuations will be even more important than they are today. However, appraisers will need to embrace new paradigms with respect to the roles they play.

With the advent of "big data" and evolving technology, there are those who believe a computer can provide a more "accurate" opinion of value than appraisers. As these technologies become more refined, it's likely that, in certain cases, that may be true. In areas with extremely homogenous housing and ample sources of market data, a well-written automated valuation model may be a perfectly appropriate way to analyze the collateral on a relatively low-risk loan.

Conversely, there are many markets consisting of properties with varying ages, qualities of construction, condition, levels of renovation, lot sizes, view amenities, etc.—not to mention special financing arrangements or seller concessions. It is in these markets where a professional appraiser is needed to apply the type of *judgment* that a computer cannot replicate. While a computer can do a great job of "crunching" numbers, its output is only as good as its input. If the information required to properly analyze market activity is not entered by a trained professional with a solid understanding of the marketplace, the ensuing results may be suspect.

Having said that, appraisers are poised to be part of the solution; not an obstacle or impediment to sound financial policies. While the type and extent of analyses appraisers will perform is likely to be different than what has been done in the past, seasoned appraisers are some of the best candidates to accurately analyze and interpret market data. While some appraisers fear the emerging technology as a threat to their livelihoods, others embrace it and position themselves to increase their relevancy in the future.

As evidenced by alternative valuation products that have surfaced in today's marketplace, appraisals cannot be "one size fits all." Rather, the extent of analyses and the communication of opinions and conclusions must be flexible. For transactions involving low risk and smaller financial commitments, abbreviated reports that can be performed quickly and at a low cost are needed. Alternatively, lenders considering higher risk investments involving significant capital will continue to rely on more detailed analyses that can be greatly augmented by incorporating new tools and technologies that continue to evolve.

While the marketplace may demand more streamlined products such as Broker Price Opinions, Automated Valuation Models, Desktop Valuations, Comparative Market Analyses, Reconciliation Reviews, etc., who better to perform such transactions than a competent, ethical, valuation professional?

Indeed, financial transactions in the 21st century will be different. And professional appraisers are up to the challenge of meeting the needs of the marketplace.

Conclusion

The Title XI real property appraiser regulatory system, while unique and not without its flaws, has made a positive very real difference over the past quarter century. It is the glue that holds the 55 jurisdictions together and every effort should be made to further refine and improve a system that has demonstrated effectiveness *without the use of appropriated funds.* The Foundation stands ready to assist with this effort in any manner you believe is appropriate.

Appraisers have historically made a significant contribution to the safety and soundness of our financial system and their important role will continue in the future. The catalyst for the creation of the current appraiser regulatory system was to protect the integrity of our deposit insurance system, a need that is as strong today as it ever was.

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

COMMON MYTHS ABOUT THE HOME BUYING PROCESS

ATTACHMENT 1

REAL ESTATE BROKERS

MYTH

REAL ESTATE BROKERS ARE PROHIBITED FROM COMMUNICATING WITH APPRAISERS.

FACT

Brokers are permitted to communicate with an appraiser and to provide them with additional information as long as the communication is not intended to unduly influence the outcome of the appraisal. The exchange of relevant information—including terms of the sale, relevant comps, and home improvements—can help an appraiser develop a more credible opinion of value.

MYTH

NOTHING CAN BE DONE IF A BROKER HAS CONCERNS OR QUESTIONS REGARDING A COMPLETED APPRAISAL.

FACT

If there are questions or concerns with an appraisal, there are concrete steps brokers can take through the lender, like submit additional comps for the appraiser to consider, request the appraiser correct errors in the appraisal report, and ask the appraiser to provide further detail to explain his/her conclusion.

MYTH

APPRAISERS REQUEST COPIES OF THE PURCHASE AGREEMENT FROM BROKERS SIMPLY SO THEY'LL KNOW HOW MUCH TO APPRAISE THE HOME FOR.

FACT

Appraisers are required to review the purchase agreement (if available during the ordinary course of business) to fully understand the terms of the transaction. Appraisers don't simply look at a pending sale price and try to "justify" the transaction. They perform research and analyses to provide their own opinion of value.

LENDERS

MYTH
A LENDER AND AN APPRAISER CANNOT COMMUNICATE BEFORE, DURING, OR AFTER AN APPRAISAL IS COMPLETE.

FACT
Not only are lenders permitted to talk to appraisers, they must. Communication is essential for the exchange of appropriate information, including the intended use of the appraisal, the scope of work necessary for credible assignment results, and more.

MYTH
NOTHING CAN BE DONE IF A LENDER HAS CONCERNS OR QUESTIONS REGARDING A COMPLETED APPRAISAL.

FACT
If there are questions or concerns with an appraisal, there are concrete steps lenders can take, like submit additional comps for the appraiser to consider, request the appraiser correct errors in the appraisal report, and ask the appraiser to provide further detail to explain his/her conclusion.

MYTH
LENDERS MUST USE AN APPRAISAL MANAGEMENT COMPANY (AMC) TO ORDER AN APPRAISAL.

FACT
Lenders are entitled to engage an appraiser directly. However, to avoid any potential undue influence on the appraiser, certain safeguards are required (e.g., in most cases the person at the lending institution selecting the appraiser cannot be the same person approving the loan).

MYTH
AMCs ARE NECESSARY TO ENSURE THAT APPRAISERS AREN'T INFLUENCED BY LENDERS.

FACT
Regardless of whether an AMC is used, lenders are not permitted to influence the value of a home, and licensed and certified appraisers are required by law to follow strict guidelines (i.e., the Uniform Standards of Professional Appraisal Practice) that guarantee an unbiased and meaningful analysis of value.

BORROWERS

MYTH

AN APPRAISER IS HIRED BY THE BORROWER.

FACT

Even though the borrower may be responsible for the cost of an appraisal, appraisers are hired by lenders. Appraisers provide an analysis of the collateral, so that lenders understand the value of a property when making the loan decision.

MYTH

THE MONEY PUT INTO A HOME TRANSLATES DOLLAR-FOR-DOLLAR INTO A HIGHER APPRAISAL.

FACT

The cost put into a home improvement project may very well add value to a home; however, the value of any improvements are based on what the market is willing to pay for them, and may not necessarily correlate to the cost. Not all renovations positively impact property values.

MYTH

APPRAISERS SET THE VALUE OF A HOME.

FACT

Appraisers don't set the value of a home, nor do they confirm a home's sale price. Their role is to produce a credible opinion of value which reflects the current market.

MYTH

APPRAISERS AND HOME INSPECTORS PERFORM THE SAME FUNCTION.

FACT

Though both provide crucial information, their roles are very different. An appraiser provides an objective, unbiased analysis so the lender can better understand the value of a property. An inspector is typically hired by the borrower and performs an objective visual examination of the physical structure and systems of a house to ensure the structural integrity of the property.

HOMEBUILDERS

MYTH

HOMEBUILDERS ARE PROHIBITED FROM COMMUNICATING WITH APPRAISERS.

FACT

Builders are permitted to communicate with an appraiser and to provide them with additional information as long as the communication is not intended to unduly influence the outcome of the appraisal. The exchange of relevant information—including construction features, details, and upgrades, as well as relevant comps—can help an appraiser develop a more credible opinion of value.

MYTH

NOTHING CAN BE DONE IF A BUILDER HAS CONCERNS OR QUESTIONS REGARDING A COMPLETED APPRAISAL.

FACT

If there are questions or concerns with an appraisal, there are concrete steps builders can take through the lender, like submit additional comps for the appraiser to consider, request the appraiser correct errors in the appraisal report, and ask the appraiser to provide further detail to explain his/her conclusion.

MYTH

APPRAISERS ONLY RELY ON COMPARABLE SALES AND DO NOT TAKE INTO ACCOUNT THE COST TO BUILD A HOME.

FACT

Appraisers do need to consider the cost to build a home and, at times, must perform a cost approach to deliver a credible appraisal. However, because cost does not always equal value. appraisers cannot simply look at what it costs to build a home to provide an opinion of value. They must perform research and analyses to determine what the marketplace is willing to pay.

THE APPRAISAL FOUNDATION

Authorized by Congress as the Source of Appraisal Standards & Appraiser Qualifications

Effective January 2014, rules adopted by the Consumer Financial Protection Bureau (CFPB) allow borrowers to receive copies of all valuation products ordered with their loan (even if the lender did not rely on them) three days prior to closing. Various valuation products (appraisals, AVMs, BPOs) may produce different values and cause confusion for borrowers.

Understanding Valuation Products

A Quick Guide for Borrowers

As a borrower, it is important to understand the differences between the valuation products you may receive before closing on your loan and the relative reliability and applicability of each product. When reviewing valuation products, keep in mind that:

- An **Appraisal** is an opinion of value performed by a professional state-licensed or -certified appraiser. It complies with the *Uniform Standards of Professional Appraisal Practice* (USPAP), which requires appraisers to be independent, objective, and impartial. An appraiser must remain unbiased and produce an opinion of value that is credible, or worthy of belief. An appraisal by a competent professional appraiser is the most reliable of all valuation products.

- An **Automated Valuation Model** (AVM) is a computer-generated estimate of a property's value that a lender might use in some circumstances to assist in evaluating the collateral for a mortgage. The output of an AVM is heavily dependent on the quantity and quality of the data input. With proper use, an AVM can help support the findings of an appraisal, but when used alone its output may not be credible.

- A **Broker Price Opinion** (BPO) is typically prepared by a real estate broker and is another tool a lender might use to evaluate the collateral for a loan. A BPO, as originally intended, does not comply with USPAP, and real estate brokers are not obligated to comply with USPAP and its corresponding appraiser independence requirements. BPOs were designed for brokers to assist home buyers and sellers in arriving at a list or purchase price.

- A **Comparative Market Analysis** (CMA) is similar to a BPO and is commonly prepared by a real estate agent to help decide on an asking or offering price. Like a BPO, a CMA does not comply with USPAP and real estate agents are not required to comply with USPAP.

The Appraisal Foundation, the nation's foremost authority on the valuation profession, has additional resources for consumers. For more information, including A Guide to Understanding a Residential Appraisal, please visit www.appraisalfoundation.org.

1155 15th Street, NW, Suite 1111, Washington, D.C. 20005
Phone: 202-347-7722; FAX: 202-347-7727; Web: www.appraisalfoundation.org

Attachment 3

FEDERALLY RELATED TRANSACTION EXEMPTIONS

§225.63 Appraisals required; transactions requiring a State certified or licensed appraiser.

(a) *Appraisals required.* An appraisal performed by a State certified or licensed appraiser is required for all real estate-related financial transactions except those in which:

(1) The transaction value is $250,000 or less;

(2) A lien on real estate has been taken as collateral in an abundance of caution;

(3) The transaction is not secured by real estate;

(4) A lien on real estate has been taken for purposes other than the real estate's value;

(5) The transaction is a business loan that:

(i) Has a transaction value of $1 million or less; and

(ii) Is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment;

(6) A lease of real estate is entered into, unless the lease is the economic equivalent of a purchase or sale of the leased real estate;

(7) The transaction involves an existing extension of credit at the lending institution, provided that:

(i) There has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the institution's real estate collateral protection after the transaction, even with the advancement of new monies; or

(ii) There is no advancement of new monies, other than funds necessary to cover reasonable closing costs;

(8) The transaction involves the purchase, sale, investment in, exchange of, or extension of credit secured by, a loan or interest in a loan, pooled loans, or interests in real property, including mortgaged-backed securities, and each loan or interest in a loan, pooled loan, or real property interest met Board regulatory requirements for appraisals at the time of origination;

(9) The transaction is wholly or partially insured or guaranteed by a United States government agency or United States government sponsored agency;

(10) The transaction either:

(i) Qualifies for sale to a United States government agency or United States government sponsored agency; or

(ii) Involves a residential real estate transaction in which the appraisal conforms to the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation appraisal standards applicable to that category of real estate;

(11) The regulated institution is acting in a fiduciary capacity and is not required to obtain an appraisal under other law;

(12) The transaction involves underwriting or dealing in mortgage-backed securities; or

(13) The Board determines that the services of an appraiser are not necessary in order to protect Federal financial and public policy interests in real estate-related financial transactions or to protect the safety and soundness of the institution.

(b) *Evaluations required.* For a transaction that does not require the services of a State certified or licensed appraiser under paragraph (a)(1), (a)(5) or (a)(7) of this section, the institution shall obtain an appropriate evaluation of real property collateral that is consistent with safe and sound banking practices.

(c) *Appraisals to address safety and soundness concerns.* The Board reserves the right to require an appraisal under this subpart whenever the agency believes it is necessary to address safety and soundness concerns.

(d) *Transactions requiring a State certified appraiser*—(1) *All transactions of $1,000,000 or more.* All federally related transactions having a transaction value of $1,000,000 or more shall require an appraisal prepared by a State certified appraiser.

(2) *Nonresidential transactions of $250,000 or more.* All federally related transactions having a transaction value of $250,000 or more, other than those involving appraisals of 1-to-4 family residential properties, shall require an appraisal prepared by a State certified appraiser.

(3) *Complex residential transactions of $250,000 or more.* All complex 1-to-4 family residential property appraisals rendered in connection with federally related transactions shall require a State certified appraiser if the transaction value is $250,000 or more. A regulated institution may presume that appraisals of 1-to-4 family residential properties are not complex, unless the institution has readily available information that a given appraisal will be complex. The regulated institution shall be responsible for making the final determination of whether the appraisal is complex. If during the course of the appraisal a licensed appraiser identifies factors that would result in the property, form of ownership, or market conditions being considered atypical, then either:

(i) The regulated institution may ask the licensed appraiser to complete the appraisal and have a certified appraiser approve and co-sign the appraisal; or

(ii) The institution may engage a certified appraiser to complete the appraisal.

(e) *Transactions requiring either a State certified or licensed appraiser.* All appraisals for federally related transactions not requiring the services of a State certified appraiser shall be prepared by either a State certified appraiser or a State licensed appraiser.

[Reg. Y, 55 FR 27771, July 5, 1990, as amended at 58 FR 15077, Mar. 19, 1993; 59 FR 29500, June 7, 1994; 63 FR 65532, Nov. 27, 1998]

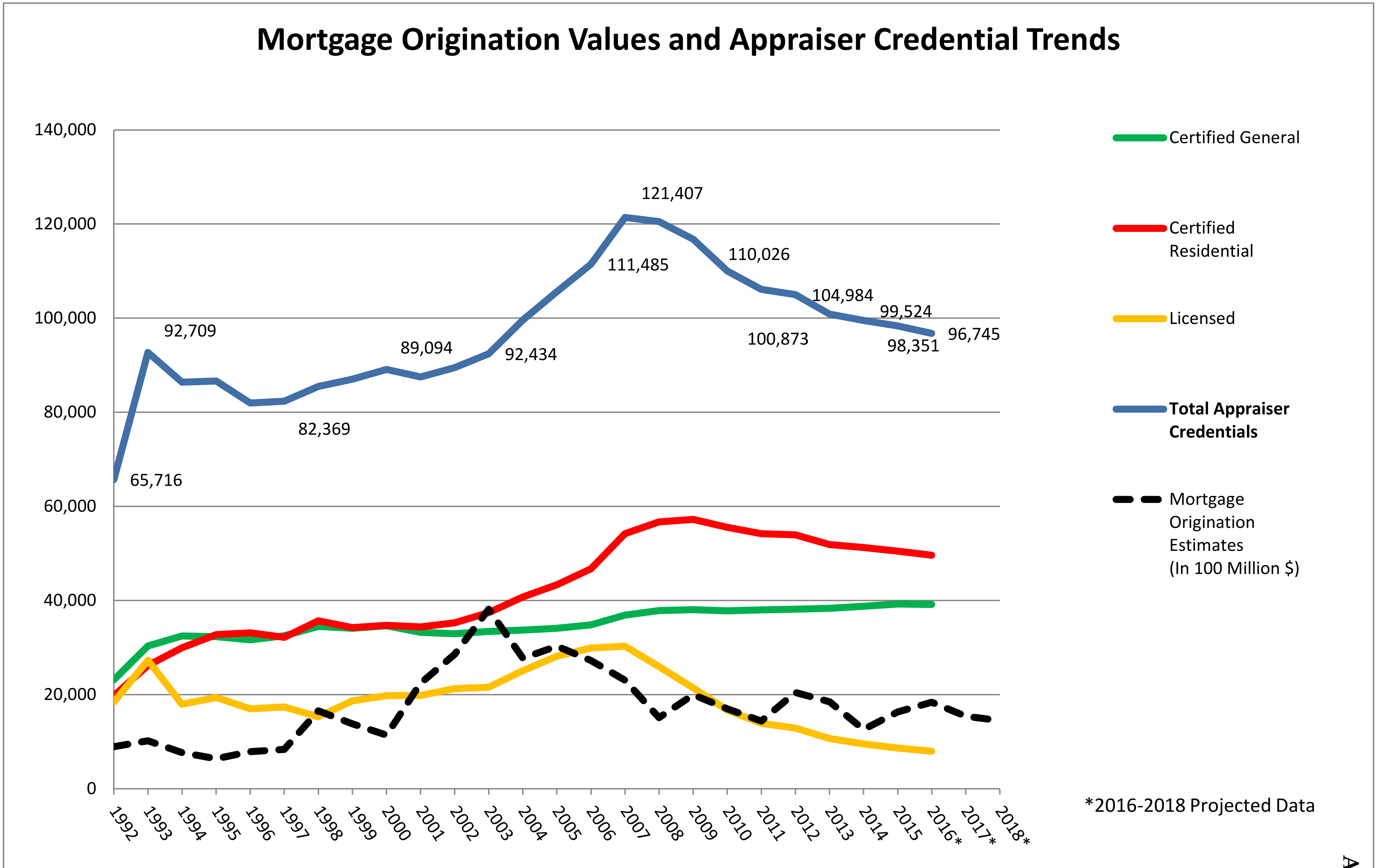

*Chart provided by the Appraisal Subcommittee

Attachment 4