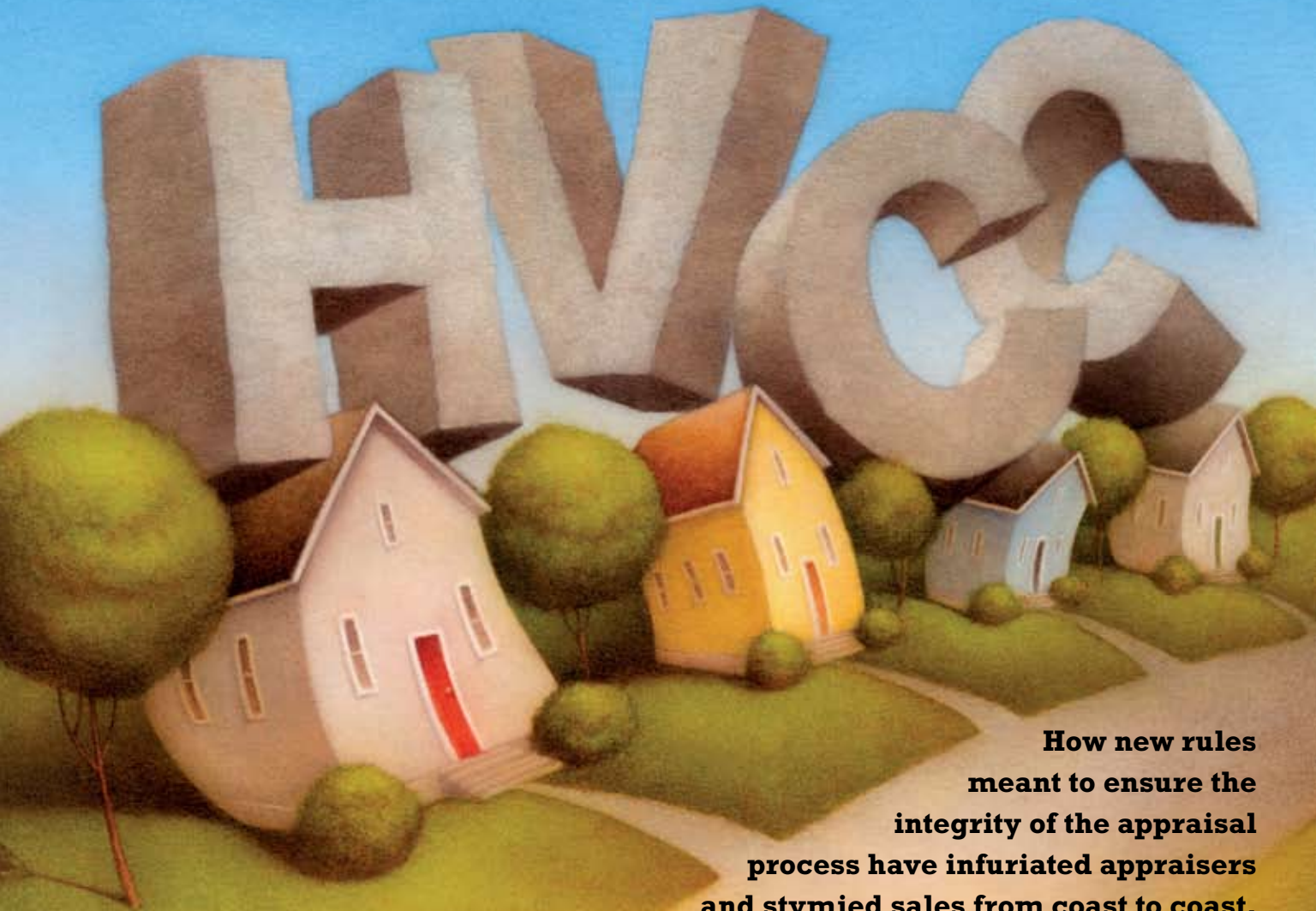


THE TROUBLE WITH THE



How new rules meant to ensure the integrity of the appraisal process have infuriated appraisers and stymied sales from coast to coast.

By Blanche Evans and Stacey Moncrieff

“You can’t make this up,” New York appraiser Jonathan Miller ruffed in his entertaining blog, *Matrix*, back in June.

Miller was recounting the frustration of a real estate salesperson who was trying to refinance her own New York apartment with her current lender. According to Miller’s telling, the out-of-town appraiser walked into the apartment, threw his hands in the air, and asked “How am I supposed to appraise this thing?”

That story sums up the feeling of many in the real estate industry toward the new Home Valuation Code of Conduct, a set of rules created to prevent those who stand to profit from a real estate transaction from putting undue pressure on the appraiser.

The rules, which went into effect May 1 for all conventional, single-family loans destined for sale to

Fannie Mae or Freddie Mac, prohibit mortgage brokers and real estate brokers from ordering appraisals and require that lenders erect a firewall between loan production staff and the appraiser. Sounds reasonable. After all, the appraiser is there to assure that the lender’s funding decision is sound, right?

Since the rules took effect, however, they’ve set off a firestorm of protest around the country.

Appraisers say the HVCC threatens their livelihood, leads to low-quality appraisals, and increases the cost to consumers. Their ire is focused mainly on large appraisal management companies (AMCs), which they say are unjustly benefiting from the rules. Real estate brokers and salespeople say the rules are delaying closings and killing deals.

“Although the intent of the HVCC was good, in practice, it’s not reasonable,” says Joe Sabella, of

Imperial Appraisals LLC in Fairfield, Conn. “The very people who were intended to be protected by the rules are the ones getting hurt.”

Charlie Elliott, MAI, SRA, owns Century 21 franchises in Greensboro and Boone, N.C., and operates an independent appraisal management company. The idea of the firewall, he says, is critical to avoiding the kind of mortgage fraud that took place during the boom years.

“Wink-and-nod collusion has gone on between loan originators and appraisers in a wholesale way,” Elliott says. “The loan officer cashes in on commissions at closings, and the appraiser solidifies his position to receive orders for that lender’s future business. We as taxpayers have paid outrageous sums to bail out banks in support of this cozy arrangement.”

The trouble, Elliott says, is that the new code is vague and confusing. “It’s somewhat reminiscent of the story of the horse being put together by a committee and the result being a camel.”

Indeed, the six-page HVCC is so difficult to interpret that Fannie Mae has produced an eight-page document of frequently asked questions. Freddie Mac has published guidance, too—and still many questions remain unanswered. Miller says he and his friends refer to the HVCC as “havoc.”

How did things get so messy?

THE GREAT AMC DEBATE

When the real estate boom went bust, people naturally asked: How did this happen—and how can we prevent it from happening again?

One of those people was New York State Attorney General Andrew Cuomo. In 2007, Cuomo launched an investigation into the practices of one AMC. In October of that year, he filed suit claiming that executives at Washington Mutual (now part of JP Morgan Chase) had successfully pressured the AMC, eAppraiseIt, to use the lender’s proven appraiser list in order to ensure that appraisals were “hitting their mark.”

Such pressure, it’s widely acknowledged, helped lead to the rise and precipitous fall of the housing market. The suit is still pending.

Figuring the eAppraiseIt case was just the tip of the iceberg, Cuomo threatened Fannie Mae and Freddie Mac with subpoenas and an investigation of alleged widespread appraisal inaccuracies in the companies’ portfolios. Fannie and Freddie then began discussions with Cuomo on what policies could eliminate lender pressure on appraisers. Their joint solution: the Home Valuation Code of Conduct, which was finalized just four months before the May 1 effective date.

Independent appraisers immediately cried foul.

“The easiest way for lenders to comply with the HVCC firewall rules is to work with an AMC,” says appraiser Francois (Frank) K. Gregoire, IFA, RAA, with Gregoire & Gregoire Inc., of St. Petersburg, Fla. “The HVCC sets up AMCs as the guardians of appraiser independence, and isn’t it ironic that the investigation that prompted the rules centered on an AMC allegedly manipulating the system to please its customer?”

For appraisers whose assignments came mostly through mortgage banks and brokers, the code has amounted to a reversal of fortune. Business relationships they’d nurtured for years suddenly dried up. “It literally killed the independent appraiser industry,” says Sabella, who has been in the business since 1985.

That’s not to say appraisers can’t work with AMCs. Many do. The appraisal management function has been around for 40 years, and Elliott says AMCs provide important follow-up, review, and record-keeping services to their clients.

For the largest lenders, AMCs are simply the way business is done today. “When you’re ordering thousands of appraisals every single day, the risk to you is extraordinary,” says Jeff Schurman, executive director of the Title/Appraisal Vendor Management Association in Pittsburgh, which represents a variety of settlement service vendors, including large AMCs. “Would it make sense to hand those off to thousands of [independent] appraisers?”

AMCs help lenders control their costs, Elliott says. “In the past, banks spent money they couldn’t recoup. AMCs enable them to outsource those costs and report one fixed cost to the consumer.”

In addition to helping banks’ bottom line, the decision to outsource appraisal management is part of a growing corporate trend toward decentralized control through various types of cooperative arrangements, Schurman says. “It’s a classic make or buy model for conducting commerce.”

Not surprisingly, as banks have grown, AMCs’ market share has increased. In the mid-1990s, AMCs accounted for only about 5 percent of all appraisals, according to a 1996 article in *Appraisal Update*. But Elliott estimates that half of appraisals today are ordered through AMCs, and almost everyone agrees that the percentage is increasing as a result of the HVCC.

Yet many appraisers are frank in saying they’d rather quit the business than work with an AMC. They say AMCs add costs for consumers while forcing appraisers to work with impossibly fast turnaround times at cut-rate prices. Consumers pay for the appraisal but are usually left in the dark about how much the appraiser was paid to complete the appraisal report. >>>

TAKE THE QUIZ

Test your knowledge of the new HVCC guidelines. Search for “HVCC Quiz” at REALTOR.org/realtormag.

FACTS YOU NEED TO KNOW ABOUT



There's a lot of misinformation about what the Home Valuation Code of Conduct requires. Here are the facts:

FACT:

Real estate sales professionals and lenders can talk to appraisers, including making requests to consider additional data or to correct errors.

FACT:

The code applies only to 1- to 4-unit single family loans sold to Fannie Mae or Freddie Mac.

FACT:

A mortgage broker may transfer an appraisal if the lender who ordered the original appraisal grants permission. However, in practice, portability isn't happening.

FACT:

Lenders may directly retain the services of an independent appraiser, as long as the contact is not made by loan production staff. Use of an appraisal management company is not required.

>>> “It’s very clear, under the current manner of doing business, that a fee paid to the appraiser through the AMC is not disclosed on the HUD-1 form,” Gregoire says. “Instead, the HUD-1 shows the appraisal fee charged to the borrower. I’d say in most cases that fee is between \$375 and \$550 and the appraiser is being paid 40 percent to 50 percent of that fee.”

Gregoire says he gave up AMC work 15 years ago after he discovered that he was just breaking even on assignments.

Compounding the problem for appraisers: Since April 1, they’ve been required to complete a detailed new Fannie Mae market conditions form. Most appraisers say the form’s a good thing—but it’s added work they aren’t being paid for, they say.

MARKET DISRUPTIONS ABOUND

When a property is under contract but there’s no appraiser in the area willing to take the assignment, the AMC has to cast a wider net. That’s happening a lot today, according to real estate practitioners. Although the Uniform Standards

for Professional Appraisal Practice (USPAP) specifically address knowledge of a geographic area, for a variety of reasons, appraisers may feel compelled to take out-of-area assignments. The result, practitioners say, are appraisal reports that often fall well below the contract price and don’t accurately reflect local market conditions.

“I can pull a depressing list of transactions that have gone away entirely or closed at a significantly lower figure than the buyer and seller agreed to—and now are a poor neighborhood comp—as a result of the HVCC,” says Fritzi Barbour, CRB, CRS®, of Coldwell Banker Caine Co. in Greenville,

S.C., and president of the Greater Greenville Association of REALTORS®.

Salespeople, armed with good information, can challenge a low appraisal. During a REALTOR® magazine webinar June 25, Judy Zeigler, CRB, CRS®, of Windermere Real Estate in Palm Desert, Calif., said that for one of her sales she was able to show that the comps the appraiser used were in considerably worse condition than the subject property. Zeigler was able to produce better comps and close the sale, albeit with a new lender and another appraisal.

To be fair, not all of today’s low appraisals are coming from AMCs or out-of-area appraisers. “Fear of the unknown is what I think is making everyone so conservative. Appraisers don’t know the ramifications to them or their career if future appraisals come in lower on a random audit basis,” Barbour says.

In a June survey of NATIONAL ASSOCIATION OF REALTORS® members, 37 percent of sales practitioners said they’d experienced at least one lost sale as a result of the new code, and 70 percent reported an increased use of out-of-area appraisers. In the same survey, 70 percent of NAR appraiser members said consumers were paying higher fees, while 85 percent reported a perceived reduction in appraisal quality.

“The quality of the appraisals has sunk to a horrendous level,” charges Sabella, who says he’s now limiting his practice to private assignments. He relates a typical story:

“One of my now-former clients, a mortgage broker, called me on a home in Fairfield, Conn. The listing agent got a call from the appraiser asking where the town was; the appraiser was from New Jersey! It took him three weeks to come out and do the inspection because he didn’t want to schlep to Connecticut for one \$150 assignment. He had to wait to book a few assignments in the state. It took another two weeks to get the appraisal back, and it had to be redone. The consumer lost the deal. For that, the buyer had the privilege of paying \$450.” (Note: The HVCC does require that an appraiser be licensed or certified in the state in which the property is located.)

THE HOME VALUATION CODE OF CONDUCT

KEY DATES:

May 1, 2009

The HVCC goes into effect.

May 16

Washington Post columnist Ken Harney reports that the HVCC seems to be driving up appraisal costs.

NAR’s board of directors adopts a policy that AMCs should be regulated.

June 22

NAR sends a letter to New York Deputy Attorney General Andrew Cuomo and Federal Housing Finance Agency Director James Lockhart calling for an 18-month moratorium.

June 25

Reps. Travis Childers (D-Miss.) and Gary Miller (R-Calif.), members of the House Financial Services Committee, introduce HR 3044 calling for an 18-month moratorium.

Schurman calls such stories mostly urban legend. But they're credible enough that Freddie Mac, in a July 10 bulletin, reminded lenders that appraisers must be familiar with the local market. On July 22, the Federal Housing Finance Agency, the new regulator of Fannie Mae and Freddie Mac, issued guidance that lenders should use appraisers who have clear experience in the geographic area.

NAR applauded the FHFA statement but said in a July 23 news conference that serious problems with the HVCC remain.

WHO'S GUARDING THE HENHOUSE?

Most prickly are the issues of AMC ownership and regulation. Many of the largest AMCs are owned, at least in part, by the largest banks, including JP Morgan Chase (Quantrix), Citigroup (Finiti), and Wells Fargo (Rels), among others.

"There's a very functional reason that banks would own AMCs," argues Schurman. "Partial or full ownership of an AMC assures lenders that their pipeline of appraisal orders will remain intact. This provides lenders a strategic advantage over competitors that don't have such control over their own external appraisal management vendors. Moreover, it reduces the risk of a disruption to their loan production pipeline, improves productivity, and reduces overall operating costs. These cost savings can then be conveyed to consumers in the form of lower interest rates, points, and fees."

To critics, including NAR, bank ownership subverts the ability of AMCs to remain independent. "Banks owning AMCs is contrary to the intent of the HVCC," Elliott says.

Sabella is more blunt: "Banks make money by lending money. The fact that they have an interest in AMCs is unbelievable. It should be illegal."

The first draft of the HVCC, released in March 2008, limited bank ownership of AMCs to 20 percent. During a comment period, NAR sent a letter to Fannie Mae and Freddie Mac urging them to prohibit *any* bank ownership. "Allowing lenders to obtain appraisal reports from appraisal management companies where the lender has a stake in owner-

ship does not meet the spirit of this agreement and does not uphold the independence of the appraisal process," 2008 NAR President Richard F. Gaylord said in a letter to Daniel Mudd, then president and CEO of Fannie Mae.

But when the final rules came out in December 2008, not only did they not prohibit bank ownership but the 20 percent limit was gone. The change was made in a way that appears almost capricious. One section of the final rules seems to prohibit bank ownership, stating:

"In underwriting a loan, the lender shall not utilize any appraisal report . . . prepared by an appraiser employed, engaged as an independent contractor, or otherwise retained by any appraisal company or any appraisal management company affiliated with, or that owns or is owned, in whole or in part, by the lender or an affiliate of the lender."

Turn the page, and the very next section eliminates the prohibition with a list of conditions that only a bank compliance officer could love.

In a letter to Cuomo and FHFA Director James Lockhart in June, NAR called for an 18-month moratorium on the HVCC, explaining the difficulties it's causing in the market and pointing out, once again, the inherent conflict of interest in bank-owned AMCs. NAR noted that the Independent Valuation Protection Institute, which was written into the rules as the mechanism for enforcement, wasn't even established yet. "A moratorium would give you and the GSEs [Fannie Mae and Freddie Mac] more time to implement this critical element of the HVCC," the letter said.

NAR is now seeking a legislative solution, advocating for HR 3044, a bill that would impose an 18-month moratorium on the HVCC. In late July, there were 46 cosponsors of the bill. At the same time, NAR is calling for state regulation of AMCs, primarily through amendments to the Financial Institutions Reform Recovery and Enforcement Act, the 1989 legislation that put USPAP in place.

Until the issues with the HVCC are resolved, the outcome for consumers is added uncertainty in the homebuying process at a time of fragile recovery. ■

HVCC IS HURTING ME!

Are you experiencing the negative consequences of the new Home Valuation Code of Conduct? If so, write to your members of Congress and ask them to co-sponsor HR 3044, a bill that would impose an 18-month moratorium on the code. For a list of sponsors, visit www.govtrack.us.

June 29–30

NAR president Charles McMillan visits the New York attorney general's office and the Federal Housing Finance Agency to discuss problems surfacing as a result of the HVCC.

July 10

Freddie Mac reminds mortgage sellers and servicers that appraisers "must be familiar with the local market in which the property is located and must be competent to appraise the subject property" and "must be provided with a copy of the sales contract." Freddie also clarifies that it doesn't require appraisers to use REOs or short sales as comparables.

July 22

The FHFA releases a statement saying lenders should use appraisers who have clear experience in the geographic area of the subject property and clarifying that appraisers aren't prohibited from talking with real estate practitioners. In the statement, the FHFA denies charges that the HVCC results in low appraisals or favors AMCs.