



2600 Virginia Ave. N.W.
Suite 123
Washington, DC 20037

T 202-298-6449
F 202-298-5547
www.appraisalinstitute.org

March 17, 2003

Rules Docket Clerk
Office of General Counsel
Room 10276
Department of Housing and Urban Development
451 Seventh St., SW
Washington, DC 20410-0500

Re: **Docket No. FR-4722-P-01**
FHA Single Family Mortgage Insurance; Lender Accountability for Appraisals

The more than 25,000 members of the Appraisal Institute and American Society of Appraisers thank you for the opportunity to provide comments on the Department of Housing and Urban Development's (HUD) Proposed Rule Lender Accountability for Appraisals. The Appraisal Institute and American Society of Appraisers and HUD are working together to address appraisal issues impacting our nation's housing industry. As the preeminent groups for real estate appraisers in the United States, we appreciate this opportunity to comment on this very important issue.

We are pleased to see HUD has reiterated the importance of real estate appraisals to HUD's mortgage insurance program and that HUD is actively engaged to address current deficiencies within its appraisal programs. We are also encouraged to see HUD follow through on its commitment to hold lenders equally accountable for appraisals. We encourage HUD to implement the proposed rule to ensure the independence of real estate appraisers and maintain their important objective role free from inappropriate client pressure.

Detailed below, we offer several recommendations to strengthen your program and ensure that quality appraisals are performed for Direct Endorsement lenders, providing critical protection for the FHA Insurance Fund.

Lender Select and Lender Accountability

This proposed rule clarifies and strengthens HUD's regulations concerning the responsibilities of lenders approved by the Federal Housing Administration (FHA) in the selection of appraisers to perform appraisals on properties that will be the security for FHA insured mortgages. First, the proposed rule provides that lenders are to be held strictly accountable for the quality of appraisals on properties securing FHA insured mortgages. Further, the proposed rule specifically provides that lenders who submit appraisals to HUD that do not meet FHA requirements are subject to the imposition of sanctions by the HUD Mortgagee Review Board. The proposed rule would apply to both sponsor lenders, who underwrite loans, and loan correspondent lenders, who originate loans on behalf of their sponsors.

HUD's Lender Accountability Rule is a positive pronouncement. In 1994, Mortgagee Letter 94-54 set forth the procedures for lenders to select their own appraisers (Lender Select). Under this policy, Direct Endorsement lenders are allowed to select appraisers from the Lender Selection Roster. However, while the Direct Endorsement lenders were given the right to select their own appraisers, they were also required to accept equal responsibility with the appraiser, for the integrity, accuracy and thoroughness of the appraisal. In addition, Direct Endorsement lenders were to be held accountable by HUD for the quality of appraisals.

In April 1999, the GAO recommended HUD determine its own authority to hold FHA-approved lenders accountable for poor-quality appraisals performed by the appraisers they select. The GAO also recommended HUD issue guidance on the circumstances under which HUD may exercise its authority to hold lenders accountable. HUD informed the GAO it was working on a letter to mortgagees that it believed would meet the GAO's recommendations. Such a letter was never circulated, until release of the Lender Accountability rule.

We encourage HUD to enact the rule on Lender Accountability for Appraisals and hold lenders strictly accountable for the quality and accuracy of appraisals. Should HUD not be able to provide sufficient oversight over lenders, we suggest HUD consider eliminating the "Lender Select" program, replacing it with an alternative appraisal ordering system that provides essential independence for the appraiser.

Inappropriate Client Pressure

There is no doubt that, in too many instances, lenders directly require appraisers to deliver only an appraisal that meets the terms of a loan. Failure to deliver, results in a loss of future business. Recent episodes of predatory lending activity in several areas of the country include lenders, realty agents, investors, and others in so-called property "flipping" schemes to inflate home prices and perpetuate sales that generate fees. There are additional examples of fraudulent activity that could have been prevented if the underwriters had properly reviewed the appraisal reports.

Since Lender Select was adopted by HUD, our organizations report that instances of client pressure have increased greatly. This, our members say, comes as a direct result of granting the appraisal ordering authority to lenders.

Under the previous "Fee Panel" system, when an appraisal was ordered, FHA would randomly select appraisers from an approved panel of appraisers. The appraiser would perform the appraisal and send it to FHA and the originating lender. Under this system, the appraiser was more insulated from most forms of pressure to deliver a predetermined value or directed report.

By contrast, under Lender Select, the appraisal is ordered by the lender who keeps a roster of approved appraisers. Unfortunately, the power to select is also the power to influence. Through Lender Select, lenders have great influence over an appraiser to meet a predetermined value, ignore expensive and potentially deal-breaking property deficiencies, or deliver a report worded to facilitate the approval of the transaction. Fee appraisers make a livelihood on fees generated through

appraisal assignments. However, our members report that many lenders make future assignments contingent upon the appraiser meeting a predetermined appraised value. Should the appraiser fail to meet the predetermined value, the appraiser simply stops receiving future appraisal assignments.

Although this kind of pressure exists in all facets of the appraisal business, under the Lender Select program, the problem appears to be magnified. This kind of pressure has very specific market consequences, as lenders seek out appraisers willing to conform to lender requests. Alarming, as a result, some appraisers have been blacklisted from performing appraisal assignments. Much of FHA's appraisal work appears to be gravitating toward the least qualified and least experienced appraisers in the profession.

The existence of client pressure through the Lender Select program has also dissuaded the most qualified and experienced appraisers with the highest education and experience requirements from performing FHA appraisals. A recent survey of our members indicates that fewer members are performing FHA appraisals. Of members who reported performing fewer appraisals for FHA, 44 percent claim that client pressure is the culprit, which was far and away the greatest complaint. HUD must address this issue if it wants to attract experienced and highly educated appraisers to be involved in its programs.

Recommendation: Establish policies on client pressure and provide this information to FHA appraisers

Mortgagee Letter 94-54 contains a section on "Pressure on Appraiser and Conflicts of Interest." This section states:

"The Department requires that appraisers chosen under this new procedure not be supervised or directed by any loan officers or loan production personnel. Chosen appraisers should be supervised by the lender's underwriting or management personnel. Instances of undue pressure or influence on an appraiser reported to HUD will result in appropriate disciplinary actions against the lender involved."

Although we are pleased HUD has accepted that undue pressure of appraisers exists, we feel the Department could do much more by providing more information to appraisers on the existence of HUD's requirements. Most appraisers are simply unaware that HUD will accept complaints against lenders applying undue pressure. Typically, they do not know whom to contact within the HUD bureaucracy, and no procedure has been established by HUD on how the appraiser is to submit his/her complaint.

We encourage HUD to establish a system that informs appraisers of HUD's requirements relating to inappropriate client pressure on appraisers and establishes common procedures for conducting investigations of complaints issued by appraisers. Such procedures would tell the appraiser what information must be provided in the complaint and whether the appraiser's identity will be held in confidence by HUD during the investigation. HUD could even establish a "hotline," or clearly specify a staff member who could handle such investigations and make this known to appraisers on the FHA

Appraiser Roster. HUD, when receiving these complaints, should provide sufficient resources to conduct thorough investigations and conduct effective enforcement activities.

In addition, we are aware of instances where some realty agents attempt to influence lenders to direct FHA Appraisal Assignments to certain appraisers over others. Inappropriate pressure is sometimes applied to not use specific appraisers they believe will jeopardize their transaction either with repairs required or values below the contract price. Just as the loan officer may attempt to influence the appraiser with a threat of no future business, these real estate agents may attempt to similarly influence the lender or the appraiser.

Such influence has caused our members to raise concerns over the credibility of HUD's appraiser selection process. In fact, the 1999 Third Quarter Report of the HUD Office of Inspector General's Report stated concern over this issue:

"While HUD regulations require lenders to select and be responsible for the work of single family property appraisers, the regulations do not prohibit lenders from selecting appraisers recommended by real estate agents. However, in our opinion, lenders acquiescing to influence from real estate agents in the selection of appraisers calls into question the appraiser selection process. HUD requires lenders to exercise due diligence in choosing only the best-qualified and knowledgeable appraisers. However, HUD has little assurance that lenders are exercising due diligence in the selection of appraisers if lenders are being pressured to select certain appraisers."

The HUD OIG audit recommended that HUD remind Direct Endorsement lenders that they are responsible and accountable for selecting appraisers and ordering the appraisal report on single family properties. This responsibility must be taken seriously and must not be given to anyone else. Also, if a lender can demonstrate that undue pressure from any individual or entity involved in the FHA insurance program caused the lender's business to suffer by following FHA rules, HUD should consider appropriate disciplinary action against the responsible individuals or entities. We concur with this position.

Adequate Review System

According to HUD, the purpose of this proposed rule is not to mandate that lenders follow a specific course of action to ensure compliance with FHA appraisal requirements. Rather, the purpose of the proposed rule is to require that a lender act to ensure appraisal quality and to emphasize that the lender will bear responsibility if an appraisal does not satisfy FHA requirements. Each lender, under the proposed rule, will have the discretion to choose the means by which it will ensure such compliance. The Lender Accountability proposed rule states there are numerous tools that lenders may use to determine whether an appraisal satisfies FHA requirements.

Recommendation: HUD should not accept the use of AVMs alone as an adequate review system.

We do not believe the use of an Automated Valuation Models (AVM) constitutes an effective appraisal review program. AVM's are a form of computerized statistical modeling. They offer the least in human verification of real-time property condition and characteristics, as they rely primarily on public records and proprietary databases for information. In areas of homogenous properties, and properties that are not suffering from deferred maintenance or customized features, AVMs have shown relative reliability. There are a wide variety of models in use across the U.S., and they have a wide ranging "confidence level" as a final value indicator.

At their basic level, AVM's are not operated by technicians with no valuation expertise or particular knowledge of the property they are appraising, nor of the sales that are being used within the analyses. Typically the reports are transmitted in proprietary formats that vary from vendor to vendor, have limited detailing of the analysis and typically are not signed by an individual who could be held accountable for the conclusion.

If a lender chooses to use an AVM to perform appraisal reviews, we recommend that it be used by qualified appraiser employed by the lender. Should the AVM compute a different conclusion than the appraisal performed by an appraiser, a series of events should determine whether the appraisal was inaccurate or whether other circumstances, were involved, included whether the AVM was inaccurate. We recommend lenders order an appraisal review by a qualified appraiser.

Additional Recommendations

Our respective organizations urge HUD to address the systemic problems in its appraisal programs and abandon the Appraiser Watch Initiative. For HUD to attract highly experienced and educated appraisers to be involved with FHA appraisal program, it must address the issues stated above. In addition to the problems pointed out above, we hope HUD will consider the following suggestions if it proceeds to finalize the Appraiser Watch Initiative. These suggestions are outside the scope of the Appraiser Watch Initiative, yet we hear from our members that these issues should be addressed.

Recommendation: HUD should revise its proposed FHA Appraiser Watch Initiative to review appraiser performance through reviews of appraisals.

The FHA Appraiser Watch Initiative, modeled after the current FHA Credit Watch Termination Initiative, is intended to provide an electronic, fully computerized monitoring system, which would permit an appraiser to be removed from the Roster if the rate of defaults and claims on closed mortgages linked to the appraiser exceeds a rate established by HUD.

The initiative fails to recognize that the appraisal is not likely to be the cause of default. The vast majority of defaults are caused by "life situations" such as illness, divorce or job loss. Appraisers do not underwrite loans. They do not approve borrowers or collect monthly mortgage payments. Appraisers see no mortgage applications and they do not check the credit records or tax returns of borrowers. In fact, the only information an appraiser typically sees is the name and address of the home being appraised.

In addition, the value of a home can – and very often does – change between the time of the appraisal and the time of default. Most foreclosures occur beyond the date of the appraisal or the creation of the loan. Meanwhile, the physical condition of the home is likely to have deteriorated, particularly if the house has been abandoned or vacated at the time of foreclosure. HUD should not expect an appraisal done at one point in time to have validity at the foreclosure at a much later point in time.

Instead, we recommend HUD adopt policies to flag potentially inaccurate appraisals and review the performance of the appraiser through an appraisal review performed by a qualified appraiser. This is an area in which recent technology developments may present cost-effective solutions. Some automated systems used by market participants today can flag discrepancies in appraisals and call for a review by a qualified appraiser in seconds.

Recommendation: Revise policies relating to financing and seller concessions

We suggest HUD revise its policy in relation to financing and seller concessions such as discount points, down payment assistance, settlement assistance and buy downs. Many of our members have expressed concern over appraisers not taking these concessions into account when performing FHA appraisal assignments.

We recommend HUD issue a letter to all approved appraisers on the FHA Appraiser Roster to emphasize the importance of appraisers reporting, analyzing and adjusting for financing and seller concessions. Such a letter could state:

1. The appraiser must disclose when selling concessions exist on the subject as well as comparable sales;
2. Comparable sales used by the appraiser must be adjusted for selling concessions, discount points, settlement assistance and seller contributions;
3. Failure to make adjustments will result in removal from the HUD Appraiser Roster and all reports with such violations will be sent to the state licensing board.

Recommendation: Remove unqualified appraisers from the FHA Appraiser Roster

On January 29, 2002, our organizations submitted comments to HUD regarding the Proposed Rule on Appraiser Qualifications for Placement on the FHA Single Family Appraiser Roster. This Rule was designed to strengthen the licensing and certification requirements for placement on the FHA Appraiser Roster. Among other things, the Proposed Rule requires that appraisers on the Appraiser Roster have professional credentials that are based on the minimum licensing/certification standards issued by the Appraiser Qualifications Board (AQB) of The Appraisal Foundation. We reviewed the Proposed Rule and agreed that the proposed actions represent a sound first step in addressing problems related to the Appraiser Roster. However, even though HUD instituted similar requirements more than two years before the Proposed Rule was released, hundreds of unqualified appraisers were accepted on the FHA Appraiser Roster because of administrative loopholes. We have strongly

recommended that HUD take steps to remove them to maintain the integrity of the FHA Appraiser Roster.

We are discouraged that HUD still has not addressed this problem. HUD admitted there were hundreds of unqualified appraisers on the FHA Appraiser Roster, yet it set forth no procedure for removing them. In fact, under that proposed rule, no action was taken against the unqualified appraisers. HUD should address this problem and ensure that qualified appraisers are performing assignments for FHA.

Recommendation: Crack down on FHA appraisers that perform extraordinary High-volumes of appraisal assignments; refer appraisers to state appraisal boards.

A development in Georgia has highlighted the problem of appraisers performing “extraordinarily high volumes” of FHA appraisals. Recently, a member of the Appraisal Institute alerted the HUD Inspector General to this problem. A common arrangement in these cases is for FHA-approved appraisers to have “trainees” (who are not approved for the FHA Appraiser Roster) perform interior inspections of homes and then for the FHA-approved appraiser to sign the reports as if they had inspected the homes themselves. According to recent information provided by HUD, many appraisers had performed in excess of 1,000 appraisals in a given year (almost 3 appraisals per day for 365 days), which appears to be a clear violation of HUD’s appraisal policies.

The HUD Atlanta Homeownership Center responded in March 2002, saying it was able to identify 10 appraisers who completed in excess of 500 appraisals in 2001. Of those 10 appraisers, two were removed from the FHA Appraiser Roster in 2001 for a period of one year. The Atlanta HOC also committed to monitor reviews of appraisals completed by the remaining eight active appraisers. However, under HUD’s Proposed Rule whereby appraisers would only be monitored according to a default rate, it is unlikely HUD would take any action against these appraisers. We recommend HUD institute policies immediately to ensure approved FHA appraisers research, inspect and complete FHA appraisal assignments appropriately.

In addition, according to HUD Valuation Handbook 4150.2, Section 7-3, HUD is required by law to refer appraisers to state appraiser boards if it feels a case warrants such a referral. There has been no indication that HUD has referred any of the individuals involved in these cases to the Georgia Real Estate Appraisers Board. In addition to addressing the problem of high-volume appraisers, we strongly encourage HUD to refer deserving cases to state appraiser boards for possible further action.

Suggestion: Increase FHA education and qualifications requirements for FHA appraisers and HUD staff.

HUD should strive to have the most qualified and experienced appraisers performing appraisals on its behalf. It should also ensure its headquarters and field staff are sufficiently trained in appraisal practices and methodologies to review the work of fee appraisers. We suggest the test for acceptance on the appraiser roster be modified to raise standards to ensure that highly qualified and experienced appraisers are accepted on the roster. We also suggest HUD periodically recertify

and/or reevaluate appraisers on the FHA Appraiser Roster. Just as an appraiser has to recertify with a state appraiser board periodically, appraisers approved on the FHA Appraiser Roster should recertify their qualifications. Recertification training would also give HUD the opportunity to interact with appraisers regarding various updates and possible concerns with the operation of the program.

In addition, members of our organizations have demonstrated a high level of experience and competency in issues of concern to HUD. We would like to see HUD make an effort to recruit members of professional societies, as they represent the best source for appraisal work due to stringent continuing education requirements and adherence to the highest professional ethics and standards. Members of professional societies, if actively involved, represent a great resource to HUD that is currently being ignored.

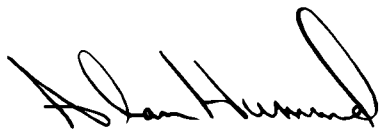
HUD has taken some positive steps in regards to training staff to ensure competency with appraisal issues. During July, August, and September of 2002, the Appraisal Institute presented real estate appraisal training courses at the Denver, Philadelphia, and Santa Ana Home Ownership Centers for the Office of Housing, Single Family Insured Housing Division of HUD. The courses presented met the education requirements of the Appraiser Qualifications Board of the Appraisal Foundation for appraisal licensing. The courses were taught by practicing appraisers with many years experience in the single-family market. The courses brought fresh perspectives to HUD employees and were well received. The interaction between market players and employees improved the understanding of those in charge of overseeing the risk management of single-family mortgages insured by the Office of Housing and should improve the operations of the Home Ownership Centers. We encourage HUD to embark these types of training projects on a more regular basis.

Concluding remarks

We appreciate the opportunity to comment on Lender Accountability for Appraisals. Our organizations stand committed to helping HUD address these important issues.

Should you have any questions, please contact Don Kelly, Vice President of Public Affairs, Appraisal Institute at 202-298-5583 or dkelly@appraisalinstitute.org, or Ted Baker, Executive Vice President, American Society of Appraisers at 703-733-2019 or tbaker@appraisers.org.

Sincerely,



Alan E. Hummel, SRA
President
Appraisal Institute



John Connolly, ASA
President
American Society of Appraisers