HVCC Guidelines – Another Big Win For Big Banks

I am an appraiser and owner of an appraisal firm in Southeast Florida as well as a licensed real estate sales agent and member of the National Association of Realtors. I'm writing this letter to media outlets and government representatives as a plea for action. This letter reflects an appraiser's opinion of the new Home Valuation Code of Conduct (HVCC) rules which have been previously announced and have been recently revised with implementation set for May 1st of this year.

Our appraisal company has strived in earnest to provide accurate and professional appraisal services to the lending industry. During my years as an appraiser people have tried to bribe, threaten, harass, and punish me for providing impartial and accurate work. I consider this to be a necessary part of the job as we are typically one of the only parties to a real estate finance transaction who's pay is not dependant on the outcome of a loan. If you are buying a home or refinancing your home we are the people that are expected to give you and your lender an informed, honest, and independent opinion as to your home's worth.

My colleagues and I take the job very seriously as we understand that the majority of the time we are working with people that are making the largest investment of their lives. I wish that the new Home Valuation Code of Conduct rules reflected the same sense of responsibility to consumer interests exhibited by my staff and colleagues. Unfortunately this legislation will allow corporate banker control of one of the few remaining independent steps in the loan process. The recent changes are yet another example of special interests tipping the scales towards the benefit of a few and in direct contrast to the interests of the many. I believe the American people are tired of government officials that support special interests over public interests. I have been looking for a change in the business as usual model of Washington. I do not see that change reflected in this new legislation.

My primary concern with the Home Valuation Code of Conduct is that title companies and banks will be allowed to own their own Appraisal Management Companies (AMCs) which is a reversal of the earlier legislation position on this issue. The original proposal from Mr. Cuomo's office (he has been the main sponsor of these rules) had wisely indicated that Appraisal Management Companies could not be owned by lending institutions or title companies because **the banks they represent have a vested interest in the outcome of the appraisal portion of the loan process.** This industry does not need to break free from the relatively light bonds of independent scrutiny remaining in the loan process. What the industry needs is stricter regulation with oversight by independent sources. The Home Valuation Code of Conduct requires the vast majority of appraisals to be ordered through Appraisal Management Companies, while at the same time it allows ownership of those companies by the banks underwriting loans utilizing those appraisals.

The HVCC encourages a virtual monopoly due to control of the vast majority of appraisal assignments which are placed in the hands of a few management companies. These AMCs are **guaranteed** to receive all business from their parent company. Providing services to these organizations will be (and for the most part already is) a necessity for any appraisal firm to survive due to the volume of work that they control. Banks will demand use of their subsidiary Appraisal Management Company for **all loans** underwritten by their corporation, which is already beginning to happen (at lightening speed) as the implementation date of these rules draws near. At this time these bank owned AMCs control a large percentage of the total appraisal assignments, and with the HVCC rules being proposed they will control the vast majority of all assignments in the country.

Historically appraisers received orders directly from lenders or loan originators at a local office such as the appraisal firm which I own and operate. Firms were able to establish a reputation as fair and competent professionals and could reasonably expect to receive increased work volume as a result. Because the appraisal process demands in depth knowledge of local market conditions, appraisal firms have typically been small offices with territories consisting of a few Counties in their established local market. Some of the larger national appraisal firms are actually networks of these small appraisal offices. These smaller appraisal firms fall into the category of the “small businesses” we heard so much about during the election, and which I’m told form the backbone of the US economy.

In recent years the appraisal assignment process has shifted to a new industry system which primarily utilizes a handful of Appraisal Management Companies to distribute orders for appraisals throughout the country. In the new model, these companies operate on a national scale to distribute orders through a primary processing hub or hubs which can be located up to thousands of miles away from the property being appraised. In some cases they are even staffed through India, further reducing the number of American service jobs performed by Americans. There are benefits to centralized organization and processing, and all innovative suppliers in our changing industry should expect to evolve if they want to succeed. Unfortunately, bank owned Appraisal Management Companies are taking advantage of their virtual monopoly by skimming an unreasonable majority of the borrower’s fee making it almost impossible to survive as a professional appraisal firm.

The result of this new model is the degradation of accurate quality work as experienced appraisers find it harder and harder to remain in business. In the new appraisal model, the large management companies are operating as profit centers for the bank or title company as they often take as much as 70% of the fee paid by the borrower. Since they control such a vast quantity of appraisal orders, and since their parent companies can specify the management company as a sole supplier of appraisal services for their loans, these large AMC’s are able to essentially (and some times quite literally) auction off appraisal assignments. This system virtually guarantees a minimum amount of time will be spent by the lowest bidding appraiser performing each assignment if he/she wishes to make enough money to survive.

Given that appraisers have historically been paid 90-100% of the end user’s appraisal fee, they have been able to provide relatively accurate values by spending the time necessary to property research and write their reports. Lately, since the AMC industry has begun to take over the industry, we have seen a profound drop in quality as appraisers rush to provide enough low dollar low quality reports to survive. Whether or not this has contributed to the poor equity positions of loans written by these lenders, it undoubtedly has not helped.

Although all management companies demand timely reports that do not have obvious errors, there are many considerations that are lost in the new contract appraiser selection model. Primarily due to lack of concern over experience and lack of risk involved, the assignment of appraisals by management companies is often based on the contractor’s ability to charge the lowest possible fee. As long as a supplier meets the minimum requirements and can provide assignments on time, they are placed on a level playing field with long term industry professionals with 10 times the level of experience. In fact, by spending a minimal amount of time working on the appraisal suppliers can reduce their turn time making them the most preferred suppliers. The primary concerns that are usually expressed include working for the lowest bid price, providing fast delivery, and providing a report which lacks technical errors. The actual “quality” of the appraised value is not usually discussed and is not easily measured. Since the bank ordering the appraisal is not going to keep the property as an asset (typically the loan is resold), there is little or no risk for the lender associated with the actual equity of the property long term. The goal for these lenders is to get an appraisal that meets minimum Fannie Mae guidelines so that someone else can take on the risk. This process is efficient, quick, easy, and cheap (representing all of the new industry ideals). Quality appraisals are cumbersome, take longer to produce, are more expensive, and result in the most accurate value which may “kill the loan”.

The current system rewards those lowest bidding contractors available without sufficient regard to the substantive quality of the appraisal or experience level of the supplier’s staff. As long as the management company can extract the maximum profit level, the actual quality of the final number produced is basically irrelevant. Does this sound familiar? Does anyone remember the definition of insanity? Have we learned anything in the past two years? I propose that we try a different approach and take some regulation control back from the corporations, not reward them with more.

In a free market society, the risky lending practices displayed over recent years would have been punished by falling stock prices of the most irresponsible banks and subsequent takeovers by the most responsible lending institutions that were able to show prudence in their lending practices. What is taking place looks like the opposite scenario from where I’m sitting! Many of my colleagues and I had assumed that quality appraisers would be sought out following the recent mortgage melt down, but we have learned that quality is not among the concerns typically discussed by potential clients. I have bail out fatigue as an insider watching money flow to a number of these corporations without sufficient regulation planned or implemented. I do not see what risk is left for these banks related to quality of the appraised value since they continue to resell the vast majority of loans and most recently have seen their cash positions “infused” by the tax payers.

Apparently the lending industry agrees, and we now can see that the quality professional appraiser is no longer in demand. The best example of the professional appraiser’s future that I can provide is the story of the World Savings appraisal staff. This was a lender that did not resell their loans, and therefore had a strict selection & training process to ensure quality appraisers and accurate results. Their team of employee and sub contract appraisers had a reputation as being among the best in the industry. Their relatively strong loan portfolio certainly contributed to their worth as the company itself was valuated before being sold off. World Savings was purchased by Wachovia in 2008 and Wachovia was then purchased by Wells Fargo (with assistance of a now famous tax break), and now the World Savings stock of highly qualified appraisers around the country have been told to go home and find new careers or work for the AMCs at a greatly reduced rate of pay.

The lowest bidders are not the professionals of the industry; they are the most minimally qualified suppliers available. Quality appraising requires perspective of events over time and years of experience or access to other professionals with experience for guidance. There are skills and knowledge that can only be obtained over time or through collaboration of a group to handle due to the unique attributes of a given home, community, sub market, etc. Running an office of professional appraisers has associated overhead costs and they cannot remain competitive with appraisers working alone from their homes.

Since the appraisal process is subjective, it not difficult to provide inferior appraisal services without leaving significant clues for detection. A given report may be technically correct (having no obvious factual errors), utilize several comparable sales within close proximity and within other statistical guidelines, but still be grossly inaccurate. By spending only a few hours on research and the preparation of the report, an appraiser can turn over a larger number of orders but quality will undoubtedly suffer. An experienced quality appraiser may put 10 times as much effort (and associated time) into a report while the end product may appear relatively similar if you are not familiar with the market area being appraised. The HVCC solution to this concern is to require appraisal reviews, but is not reasonable to require a percentage of appraisals to be reviewed by a computer or from a desk in India and expect the accuracy of appraised values to improve. You might weed out the appraisers that flagrantly lie or send in technically inaccurate work, but you will not easily find the appraisers that provide technically accurate work that incorrectly values the home. Over the past few years my colleagues and I have seen an increasing number of appraisals which are poorly prepared and are grossly inaccurate due to the tendency to utilize the most *conveniently* available comparable sales as opposed to the most *relevant* sales which invariably take longer to discover and verify. A rushed appraisal using the most obvious sales is easy to write, quickly completed, hard to identify, and <u>rarely includes a realistic value</u>.

Using common sense anyone can see that the lowest bidders are not the people you want watching over your assets, let alone the largest asset backed system in the entire country. You wouldn't apply this theory to your retirement stock portfolio by hiring the financial advisor that will handle your assets for the lowest fee would you? I think you would be more likely to hire the professionals that know what they are doing and that charge reasonable fees for their services.

The small experienced appraisal firms that know what they are doing used to prosper within the industry, but now they are being pushed out of business nationwide. In the wake of the new industry model we find isolated inexperienced appraisers that rush out their files. I hear a lot of talk about job creation, but a job lost is just one more that has to be replaced. While the proposed model does generate the largest possible profit margin to the management companies and their parent corporations, it does not serve the interest of the consumer or the country. In fact the fee charged to the consumer for appraisals has actually increased over the past several years according to the borrowers I have spoken to while over the same time period the appraiser's pay has been typically cut in half. During one of my last appraisals performed in 2008 I was sternly questioned by a borrower who was upset that her appraisal was costing more than she paid just a few years ago, and she wanted to know why "we" were charging her more. On that particular assignment I was making nearly half the fee I would have been paid for the same job just 18 months ago.

If the HVCC is allowed to be implemented as written, we will be forcing the vast majority of appraisal business through AMCs while at the same time we will be driving non lender/title company owned AMCs out of business. I think the American people have had enough of the banking model that puts profits before all other considerations, and I know for a fact that I have had enough. However Mr. Quomo apparently has decided that the banks have sufficiently proven their ability to self regulate to the extent that now they deserve to take over control of the appraisal industry.

Is this really our plan to restore opportunity and prosperity to the country? Competition is the cornerstone of capitalism, and it is easily possible to operate an Appraisal Management Company by keeping a reasonable portion (30-40% or less) of the appraisal fee while paying experienced professional sub contractors enough to make a reasonable living. You don't even have to operate offshore to be profitable. If management companies were able to compete on a level playing field we would see a multitude of new management companies enter the market competing to provide the highest levels of service and quality. Why would we not allow these companies to thrive through innovation and competition instead of creating a monopoly of lender and title company owned management companies?

It is distressing to me that the current AMC model will allow this near monopoly to enrich their companies with 50-70% of the fees while degrading the accuracy of these appraisal reports. This should be the time to restore trust and confidence in the system, but instead we are allowing deconstruction of the most impartial gate keepers in the entire loan process. Why is it necessary to allow the banks and title companies to control the appraisal industry? What other possible interests are being served besides those of a very few mammoth corporations? What damage is being caused to the appraisal industry and how long will it take to rebuild the numbers of professional appraisers that are being lost?

I implore those of you in government to pay attention to this legislation which is already having a major impact on these small businesses before it is too late. I implore the news media to focus on the HVCC and similar RELEVANT issues that have such a large impact on lending industry regulation. This letter only briefly addresses a small part of the larger issues involved but if anyone would like more information or more in depth comments I would be more than happy to provide further details.

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