

From: Morse & Company, Ed Morse
Subject: Appraisal and Evaluation Guidelines

Comments:

Comments On: Interagency Appraisal and Evaluation Guidelines

Dear Federal Reserve:

Your proposed guidelines are a small step in the right direction. They are still very inadequate. FIRREA requires agencies to prescribe appropriate standards for the performance of real estate appraisals. [See pages 8-9 of your proposed rules]. On page 10 of your proposed rules, it states they are guidelines, and "provide guidance on safe and sound appraisal and evaluation program"... Are the proposed rules advisory, or mandatory? They are even titled as "Guidelines", which are advisory, not mandatory. Writing regulations that are not binding is shameful. It part of the failure of bank and thrift regulators, and the proposed rules must be re-written to be mandatory, not merely advisory in nature.

From the small changes in the prior rules one would conclude the banking and financial markets are liquid, sound, profitable, and the appraisal guidelines are clear, and effective. You should know that is not the case. Is this really a sincere attempt at workable appraisal regulations? Don't you read the volumes of published articles about appraisal fraud, appraiser coercion, lack of independence and conflicts between loan origination and appraisal engagement, and black-listing appraisers that actually exercise independence? Your proposed rules do nothing to correct these problems, and do not even acknowledge the problem exists. Hey, that's the way to bring about changes in lending institution management, ignore the problems! Given this economic background, largely created by ineffective regulators, and weak regulations, you are proposing GIRLIE REGULATIONS, not meaningful rules.

Ambiguity is rampant in the proposed guidelines. As a consulting appraiser I have previously advised lenders of the content and meaning of your prior rules, largely the same as the proposed rules, and have been told they didn't have to follow what were only "guidelines", not mandatory rules. In addition, they point out the language is usually "should", rather than using mandatory language like must, or shall. Are these rules advisory "guidelines", or mandatory regulations? Which is it?

A standard and a guideline are different. Much of the language in the guideline is drafted as being advisory, and a guide, not a mandatory regulation. The proposed rules use verbs like "should", not a clear

requirement that mandates action by the institution. Consequently, the new rules are not clear on what, if anything is actually required. See Black's Law Dictionary, 4th Ed. on the meaning of should, which ordinarily implies a duty or obligation, but is not a requirement like the word must. The law dictionary defines the word must, to be like the word shall, which is of mandatory effect. Also, see the legal treatise Word and Phrases, permanent edition, on the meaning of should. Numerous recent federal and state court decisions cite the meaning of 'should' as suggesting a course of action, or being permissive, but is not mandatory like the use of the word must, or shall. See 39 W&P 369 et seq. Look at the bottom of page 9, which states 'the agencies are issuing the proposed Guidelines to provide further clarification of supervisory expectations for regulated institutions...' This is bureaucratic double-speak of the worst kind. Are the proposed guidelines expected to be adhered to, or is it simply paper shuffling as the financial system crashes and you can claim you proposed a new rule to shift blame from your over-sight role? Are you drafting expectations, or regulations? Get a spine. This ambiguity permeates your proposed guidelines. If you high-paid bureaucrats don't have the courage to draft a binding regulation, then hire a private consulting appraiser that can.

On page 12 of the proposed rule, it discusses current appraisal development standards and the Scope of Work Rule. This is good. However, as an appraiser with 35 years of experience, I find only those institutions with staff appraisers, or those with review appraisal programs that employ appraisers to actually have the knowledge to discuss with the appraiser the "needs and expectations for the appraisal", and to conduct a meaningful dialogue on the scope of work, and assumptions, if any, to be used in the appraisal. The smaller institutions simply delegate this job to the loan officers, and this creates a conflict of interest, and places un-trained layman, commission loan officers, and marketing agents in control of the appraisal procurement process. This compromises the process. This can be cured by requiring institutions to separate loan production from appraisal engagement, regardless of the size of the institution, or to engage consulting appraisers, or have outside appraisers advise on the process, the independence, and perform reviews. Expecting laymen or even loan officers to review appraisals and discern or discover improper analysis is simply not realistic or effective. Despite billions in loan losses, don't you learn this? Also, the only way to enforce these rules is to require financial and regulatory audits to report on the compliance of such independence. It is simple if you really want to eliminate much of the coercion that exists in the system.

On page 11, the heading states Minimum Appraisal Standards, but the language states it is a guideline to provide further clarification. More ambiguity.

On page 12, under Appraisal Development and Appraisal Reports, more weasel language, like "The proposed Guidelines remind institutions the institution is responsible and should discuss it's needs and expectations for the appraisal with the appraiser." All insured institutions are loaning taxpayer funds or taxpayer guaranteed and insured funds, and should be required , not just be reminded to engage in specific, detailed, and documented and independent appraisal programs, and engage in discussions with the appraiser on collateral value issues in order to protect the institution and taxpayer

funds. Your guidelines establish no meaningful regulations. They should.

Too much of your proposed guideline is advisory. On the bottom of page 13 and top of page 14, reviewing appraisals is discussed. Again, advisory or permissive language is used

.... "The agencies expect institutions to maintain a robust review process..." Well, why don't you REQUIRE they do so? Write your expectation so it is a regulation, then audit for it's compliance, and jerk the charter or take over banks that fail to comply. Your guidelines are full of wishes and expectations, no requirements or regulations. Your rules should require changes in bank management practices. Changes in the efficiency and profitability of these institutions must be top-down, as well as bottom-up, starting with better risk analysis, better credit analysis, better credit underwriting, better collateral value programs, better revised appraisal requirements, and most importantly, better bank management. If you really want to make the appraisal and collateral valuation programs important, [and it underlies the risk and security for all the loans by these institutions], make the institution, and their auditors report directly to the Board of Directors and require reports and compliance studies to be considered in all financial and regulatory audits. That would eliminate most of the appraisal coercion and conflicts of interest. A simple way to achieve this is to require, as an audit requirement, the auditor anonymously poll all the appraisers on the banks roster, and inquire whether any loan or bank officers have used coercive or retaliatory tactics against the institutions' appraisers. Reporting the results of the audit poll to management and to disclose it in all regulatory and financial audits would end the practice in 1 year. Do you want to assure appraiser independence? Then require audits to include the issue. Requiring all institutions to only buy loans from originators that similarly poll and audit their firms to be free of coercion, and report acts of coercion would soon eliminate some of the fraud currently in the residential lending process. So how many losses do you want to avoid, and how much taxpayer money do you want to save, if any? I suggest OCC carefully research the failure of WAMU, which recently failed at the cost of billions of dollars of taxpayer and shareholder funds. They engaged in wholesale coercion against appraisers, and largely farmed out appraisal management functions to try to insulate themselves from the inevitable liability. Based upon lawsuits and publications, they instructed their appraisal management company to hire only those appraisers they coerced and that would 'make their numbers'. Do your rules protect against such practices? No. Did you stop widespread coercive tactics by WAMU and others? Why not? You need to require institutions monitor, manage, and report all acts of coercion, and mandate separation between loan production and appraisal engagement and management functions. Your "Guidelines" sadly fail to do so.

On page 19, the Appraisal and Evaluation Program is outlined. The rule states what the program should include: The rule should be revised to state what the program must include: and make the 8 items mandatory, and require regulatory and financial audits to examine those 8 items. Again on the bottom of page 19, under the evaluation program, the proposed rule appears to be advisory by stating an institution should do those items. Is it required or not?

On page 21 the proposed rule specifies the selection of persons who may perform appraisals and evaluations. Again, this entire rule appears to be advisory, not mandatory. That has been a huge problem in enforcement and lack of compliance, i.e. lender pressure and discrimination in appraiser selection, based upon retaliatory motives by loan originators. The changes are simple. Change the wording of the rule in several places from should, to shall. Do you expect all the elements of appraiser independence to be advisory, or mandatory? Will you require audits on these issues?

Starting on page 23, the minimum appraisal standards are included. I note the word must is used (for the first time) to direct appraisal requirements. This highlights the weakness of using "should" in the previous parts of the regulation.

On page 24, your proposed rule requires the appraisal to be written and "contain sufficient information and analysis to support the institution's decision to engage in the transaction." The rule then states the institution should obtain an appraisal that is appropriate, considering risk and complexity. The level of detail should be sufficient to understand the analysis; and the rule continues the scope of work should be consistent with similar property types, market conditions, and transaction. Do you mean lending transactions, or some other type of transaction? The rule continues on to say the appraisal report "should" contain sufficient disclosure of the nature and extent of research and inspection to verify the property condition and support the value conclusion. The word "should" needs to be replaced by must, [or shall] to clearly require language that is mandatory, and compliance by the institution.

The rule needs to better identify what is expected, and whose responsibility it is to describe and delineate report content that is "sufficient information and analysis to support the institution's decision to engage in the transaction". If this just a value conclusion, or a physical description of the property, or description of the financial and legal attributes of the collateral? This language is too general and not specific. In addition, it is not within the appraiser's knowledge to know what information is sufficient in content and analysis to support the institution's decision unless the institution communicates a need for certain information that will vary by transaction. For example, one abuse I see in residential lending is that lenders rarely provide title reports to their appraisers, so the appraiser cannot consider title restrictions, easements, and other detrimental issues which are 'assumed away', although they are evident in the title report. The lender desires to make the loan and generate the fees, and then transfer risk to the secondary market, GSE, MBS or other markets for the risk of loss. Based upon the current credit crisis, this system has largely failed, mostly because of poor credit underwriting, but collateral value is also declining, and it is imperative that rules include mandates, and more detail if institutions are actually going to comply. At a minimum, another sentence should be inserted to require: "All appraisals must value the actual title of the collateral as it is secured by the institution, as it exists on the date of the transaction." This would require 'as is valuations of the actual collateral', while it is not clear the

proposed rule would require that.

The requirements on pages 25-29, as well as the entire document, must be re-drafted with mandatory language, not advisory language, which uses, 'should'.

On page 35, Validity of Appraisals and Evaluations, the language is again the permissive 'institution should' rather than mandatory criteria on the validity of appraisals.

On page 36-39 Reviewing Appraisal and Evaluation is discussed. Again, the language is permissive. The proposed guideline is very inadequate. Appraisers are required to take hundreds of hours of education to be licensed or certified, and have years of experience. There are minimum state licensing standards, licensing exams, and peer reviews for designated appraisers. To expect meaningful appraisal review, one must be similarly qualified as the appraiser. It is not adequate to advise the institution "Persons who review appraisals and evaluation should be independent of the transaction and possess the requisite education, expertise, and competence to perform the review commensurate with the complexity of the transaction." Require the reviewer to be a competent, and an appropriately credentialed appraiser, and write a mandatory rule. There should be no exception for "small or rural institutions" because they can hire review appraisers, and to do so will ensure compliance and independence. You should describe and define risk-focused factors in reviews, and require elements like loan size, credit, risk, and collateral value be specifically considered. The general language in this guideline is meaningless. If banks, FNMA, FHLMC, and wall street did not understand the risk of Alt-A, sub-prime, and stated income loans, how can institutions now be expected to use 'risk-focused' appraisal review procedures? Too many banks simply lack effective management, with no history of managing through economic downturns [recessions], and they lack any knowledge of appraisal, or collateral risk. They lack the knowledge to comply with these general pronouncements. Re-draft this as a mandatory regulation, with itemized details. An appraisal review is a term of art in the appraisal profession, and it is a critical analysis of the assignment results of an appraisal, appraisal review, or appraisal consulting report. Appraisal reviews are part of appraisal practice. See USPAP. If you expect these review functions to be carried out by laymen, you should not use the term "review", which implies a specific degree of analysis and appraisal competency. Laymen cannot and do not conduct appraisal reviews, but they can perform basic screening and fill out checklists. Your guideline is not clear on what you expect, and what is actually required in this process. It should be clear whether you require a layman to follow a procedure, or a competent professional to comply with a USPAP process.

Pages 39-40 discuss expectations for Portfolio Monitoring and Updating Collateral Valuation. The guideline is permissive, and should be mandatory. It should be re-drafted as a mandatory rule. Declines in collateral value are

more often obscured by institutions, not recognized, researched, managed, and written-down. Where have you been? Bad loans are sold. Privatize the income and origination fees, then sell the loans to FNMA, FHLMC, or in MBS's to socialize the loss, at taxpayers expense. Wake-up. If you want to end this cycle, draft specific detailed rules on portfolio management requirements. Require institutions to re-value collateral upon measurable changes in value, i.e. market declines of 10% or more, and you should require a re-appraisal upon default or other triggering events of non-performance of the loan, and a commensurate write-down to the actual collateral value, less allowances for loss severity if the loan goes into default. This will provide a much clearer picture of the institutions actual financial condition.

Thank you for the opportunity to comment on these rules.

Sincerely Yours

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