



October 14, 2009

The Honorable Nydia Velazquez
Chairwoman
House Small Business Committee
United States House of Representatives
2466 Rayburn House Office Building
Washington, DC 20515

The Honorable Sam Graves
Ranking Member
House Small Business Committee
United States House of Representatives
1415 Longworth House Office Building
Washington, DC 20515

Dear Chairwoman Velazquez and Ranking Member Graves:

On behalf of the 35,000 members of our respective professional organizations, we would like to comment on and clarify several issues relating to the valuation of distressed residential properties highlighted during your Committee's hearing on Wednesday, October 7th, titled "*The State of the Nation's Housing Sector: An Examination of the First Time Buyer's Credit and Future Policies to Sustain a Recovery.*" We respectfully request that this letter be considered as part of the hearing record.

Testimony was presented to the Committee critical of residential real estate appraisers alleging the improper use of foreclosed properties and properties from distressed sales as "comparables" for determining the value of single family homes where no adjustment had been made to reflect the relative condition of the properties. Further, it was suggested that a high number of new home sales have fallen through because the appraisal reflects a value below the contract sales price for the property.¹ Additionally, your Committee regarding the Home Valuation Code of Conduct that requires clarification.²

It is important for the Committee to understand that appraisers do not create value in the housing market; they report on what is occurring in the market. Real estate appraisers utilize recognized techniques and methodologies to develop an opinion of the market value. Appraisals are not performed to confirm the sales price, but instead are performed to establish whether the market value of property collateralizing a mortgage is commensurate with the amount of the loan and to protect the lender against loss in the case of a default. Moreover, the appraisal serves

¹ Testimony of Joe Robson, President of the National Association of Home Builders, before the House Committee on Small Business, October 7, 2009. Available at <http://www.house.gov/smbiz/hearings/hearing-10-7-09-homebuyers-credit/Robson.pdf>

² Testimony of Joseph Canfora, Regional Vice President of the National Association of REALTORS®, before the House Committee on Small Business, October 7, 2009. Available at <http://www.house.gov/smbiz/hearings/hearing-10-7-09-homebuyers-credit/Canfora.pdf>.

as an important consumer protection by providing home buyers with an independent opinion of value. The fact that some home sales have failed to close is largely the result of the housing market we are in today. All properties, including new construction, have to compete against high inventory levels and flat or declining home values in many parts of the country. Accordingly, we urge caution in connection with those who would prefer to “shoot the messenger” rather than face the realities of today’s distressed market.

Professional appraisers fully understand and agree that if foreclosure and/or distressed property sales are used as comparables, they must be treated carefully. Appropriate adjustments must be made by a qualified appraiser to reflect the physical condition of such properties as compared to the subject property. This is common practice. Further, consideration must be given to adjusting for the “conditions of sale,” taking into consideration any undue stimulus involved in the transaction. It is the professional real estate appraiser’s responsibility to be aware of these conditions and analyze the market, considering all relevant data and applying proven techniques and methods. Simply put, ignoring pertinent data can actually jeopardize the appraiser’s license.

The Uniform Standards of Professional Appraisal Practice (USPAP), which appraisers must adhere to in accordance with federal and state law, generally requires the consideration of all relevant transactions that have occurred in the market area and a determination as to which of those transactions should be used in the analysis to arrive at a *credible value opinion* for the subject property. An appraiser cannot ignore foreclosure sales and short sales if consideration of such sales is necessary to develop a credible value opinion. As is always the case in selecting sales to use as comparables, the appraiser must investigate the circumstances of each transaction, including whether atypical motivations or sales concessions were involved, or whether the property condition was compromised. For example, a short sale or a sale of a property that occurred prior to a foreclosure might have involved atypical seller motivations (e.g., a highly motivated seller) and so might not be an ideal comparable. On the other hand, a sale of a bank-owned property might have involved typical motivations, so the fact that it was a foreclosed property would not render it necessarily ineligible as a comparable. Further, some foreclosed properties are in inferior condition, so an adjustment for condition may be needed.

Given the complexity of this issue in today’s market, the competency and qualifications of the real estate appraiser is of critical importance in our system of real estate financing. Making proper adjustments to comparables involves essential methodologies that are part of the foundation of appraisal education offered by professional organizations such as ours. Appraisals of real property that involve “atypical market conditions” are often “complex” appraisal assignments, and require analysis by highly qualified real estate appraisers. Lenders or their agents – including appraisal management companies – would be well served by retaining the services of highly qualified appraisers where such conditions exist. Further, lenders and appraisal management companies must have robust review procedures in place to ensure that proper analysis and adjustments are made.

To the extent that some appraisers inappropriately may use foreclosure or distressed sales as comparables without making appropriate adjustments, we believe that these matters speak to the competency and qualifications of the appraiser and call for enforcement including referral to the appropriate state licensing board or professional appraisal organization. We firmly believe that existing appraiser licensing laws, which require demonstrated knowledge and understanding of the sales comparison approach, including proper adjustment procedures, are entirely sufficient, as long as qualified and competent appraisers are being engaged by lenders and there is effective enforcement in place. In this regard, we strongly encourage lenders, home builders, real estate agents, appraisers, and others to demand that the lending community utilize the services of highly qualified appraisers in today’s market and report instances of inappropriate adjustments to the state appraiser licensing authority or professional appraisal organization for review and proper disciplinary action.

Competent and qualified appraisers are skilled in applying the methodology required to make necessary adjustments on comparable properties. Accordingly, there is no need whatsoever for government or agency guidance on this issue. However, it may be beneficial for Fannie Mae, Freddie Mac, and the Federal Housing Administration to further publicize their expectations of lenders relative to obtaining reliable real estate appraisals in current markets. Such guidance could remind lenders and financial institutions to do the following:

- Seek out the services of highly qualified appraisers in complex appraisal assignments, including those who have earned professional appraisal designations from a nationally recognized professional appraisal organization
- Recognize that conditions of sale (sales concessions) are equally as important as the condition of a property to the credibility and reliability of the real estate appraisal. This requires that the appraiser be fully apprised of any non-real property items included in the contract sales price including cash, homeowners or golf community fees, automobiles, or other personal property
- Provide sufficient time for the real estate appraiser to conduct the proper analysis of the subject property and comparables used, and prohibit unreasonable turnaround times or turnaround times that compromise the quality of the appraisal
- Promote communication between appraisers, builders, and real estate agents. Appraisers are finding it increasingly difficult to confirm builder sales (which are not reported in Multiple Listing Services), and to confirm a sales transaction with real estate agents.

There are several items related to the Home Valuation Code of Conduct (HVCC) that we wish to clarify, as well. Your Committee received testimony indicating that the cost of appraisals has increased by approximately \$100 since the implementation of the HVCC. Further, it was stated that appraisers now must consider their obligations under the Uniform Standards of Professional Appraisal Practice (USPAP) and the additional burden of complying with the HVCC. Further, similar to the complaint above regarding the use of foreclosure or distressed sales as comparables, the HVCC has been blamed for scuttling new home sales.

Our research indicates that a vast majority of appraisers working for appraisal management companies are facing severe "cramdowns" in fees by as much as 60 percent. This is causing many appraisal firms, the vast majority of which are small businesses, to consider leaving the appraisal profession.

This is due to a combination of factors, including the loss of major clientele (mortgage brokers recently represented 60 percent of appraisal orders, but now represent less than 10 percent), but also the business model employed by many appraisal management companies. This model typically funds itself on the backs of appraisers, forcing reductions in market rate fees for acceptance on "approved appraiser panels."

Under traditional models, banks and mortgage lenders had an internal appraisal management and review function that administered appraisal management for the institution. The process has not changed except that it has been outsourced by some with savings to the lender. This was an overhead expense that was typically paid for through loan processing fees or interest rate charges. When appraisal management companies are used to broker appraisal services, institutions are passing through those costs through the appraisal line of the HUD-1 statement, rather than charging them separately from appraisal costs. This gives the appearance that appraisal fees may have increased, but what is really occurring is that the cost of an additional function (appraisal management) is being moved from loan processing to the appraisal.

Further, it is important to point out that the HVCC imposes no obligations on appraisers. Instead, the HVCC is a set of rules for **lenders** who wish to sell loans to Fannie Mae and Freddie Mac. While USPAP compliance has been required of appraisers for 20 years, the HVCC imposes no additional burden on appraisers.

Lastly, while we share many of the concerns expressed about the HVCC – most importantly, continuing concerns regarding appraisal quality and consumer disclosure of appraisal and administration fees -- we do not believe it is fair to blame the HVCC for scuttling new homes sales. As stated above, the appraisal is reflective of occurrences

within the market, and many markets are facing severe economic transitions today. While the appraisal is a critical safety and soundness component, there are several other factors that contribute to lost sales, not the least of which is stricter underwriting standards by lenders. Appraisals, like supervisory loan-to-value ratio and underwriting requirements exist to help lenders make safe and sound loans.

As the largest professional organizations of real estate appraisers in the United States, we would be pleased to meet with you or your staff to discuss these issues further. According to recent census data, 98 percent of real estate appraisal firms are small businesses, and they, like many others, face challenges in today's economy. To arrange a meeting or if you have any questions or concerns, please call Bill Garber, Director of Government Affairs, Appraisal Institute, at 202-298-5586, (bgarber@appraisalinstitute.org), or Peter Barash, Government Relations Consultant to the American Society of Appraisers at 202-466-2221 (peter@barashassociates.com).

Sincerely,

Appraisal Institute
American Society of Appraisers
American Society of Farm Managers and Rural Appraisers
National Association of Independent Fee Appraisers