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Testimony of
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On Behalf of the
Appraisal Institute and
American Society of Appraisers

Before Subcommittee on Housing and Community Opportunity
Of the
House Committee on Financial Services
On

"Simplifying the Home Buying Process: HUD's Proposal to Reform RESPA"

Presented by
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Mr. Chair and members of the Subcommittee, I am Alan Eugene Hummel, President of Iowa Residential Appraisal Company in Des Moines, Iowa and 2003 President of the Appraisal Institute. I am pleased to be here today on behalf of the Appraisal Institute and American Society of Appraisers, which together represent more than 25,000 real estate appraisers in the United States.

I want to thank you for holding this hearing. The Department of Housing and Urban Development Proposed Rule on the Real Estate Settlement Procedures Act (RESPA) is of great importance to consumers and the financial community. This issue is also important to members of our organizations, who together constitute the leading professional organizations of appraisers in the United States.

The proposed rule on RESPA impacts real estate appraisers in two areas: 1) HUD wants lenders to provide consumers a simple, clear and firm Good Faith Estimate (GFE), at no or nominal cost, so they can better understand the charges, including appraisal costs, and use it to shop for a home loan and service providers before they become so invested in the process that they cannot back out; and 2) HUD wants to allow certain entities to assemble and offer consumers "guaranteed mortgage packages" (GMP) - a guaranteed mortgage interest rate and a guaranteed price for a complete package of settlement services, including appraisal services.

We agree with the primary goal of the proposed rule, which is to simplify and improve the process of obtaining a mortgage. There is little doubt that the volume of paperwork required to obtain a mortgage is burdensome to the homebuyer, and we commend HUD for undertaking this difficult task.

However, the proposed "packaging" of services raises the issue of proper and full disclosure of appraisal costs and appraisal services to consumers. In light of recent mortgage fraud and predatory lending cases throughout the country, we believe it is important to honor safeguards which protect homebuyers from unscrupulous actors in the residential real estate market.

Specifically, we are concerned that the proposal to package services may actually limit existing consumer protections. Secondly, the proposed rule has the potential to increase incidents of inappropriate client pressure or influence, a phenomenon that is detrimental to the lending process. This kind of influence has negative market consequences, as consumers face the financial danger of entering into a mortgage for more than the value of their new home. Finally, offering a guaranteed price for an assemblage of settlement services, or package, may lead to a shortage of qualified appraisers to perform appraisal assignments. Such a shortage would result in delays and ultimately higher costs for the consumer.

Therefore, we cannot support the rule as proposed. The following details our concerns with the proposed rule and offers specific suggestions on how to address them.

Appraisal-Related Problems with Guaranteed Mortgage Packages and Good Faith Estimate
The proposed rule would remove regulatory barriers to allow a package of settlement services to be made available to borrowers. According to HUD, these transactions, arguably, would be simpler and more transparent for borrowers, and would allow market forces, borrower shopping, and competition to further reduce the costs of settlement services. To accomplish this objective, first HUD would establish a carefully circumscribed safe harbor under RESPA for GMP transactions. Any entity (a lender, broker, other settlement service provider, or other entity), hereinafter a "packager," may qualify for the safe harbor as long as it offers a GMP. The packager must offer the GMP to a borrower following his or her submission of application information, but before the borrower's payment of any fee to the packager.

The proposed rule offered an example of how these arrangements might work with real estate appraisers in a GMP:

> "For example, a packager could contract to have XYZ Appraisal Company complete all its appraisals for a given period for $300 each rather than the $350 the company normally charges for a standard appraisal. The packager could rely on that discounted contract price in pricing the package of guaranteed costs to the borrower. With their own costs negotiated in advance, packagers could disclose the cost for the entire package early in the borrower's mortgage shopping process with certainty, and the borrower then could compare different vendors' packages."

Concern 1: **Packaging is not consistent with disclosure**. A fundamental goal of HUD's proposal is to protect consumers. It is our view that the packaging of services is inconsistent with the goal of seeking greater disclosures of costs to consumers.

Today, an appraisal is a vital part of home buying or refinancing. The appraiser is an independent third party delivering an unbiased opinion of value. Although the appraiser is typically hired by the lender, it is the appraiser's objectivity that helps <u>both</u> the lender and the consumer when entering into a financial relationship.

Although the appraisal services necessary to close a loan may be primarily for the benefit of the lender, we believe consumers benefit from an appraisal ordered by the lender as well. The proposed rule recognizes this dual function in its proposed rule, stating:

> "HUD believes however, that there are certain settlement services that are of specific interest and value to the borrower such as pest inspection, appraisal and the purchase of lender's title insurance (which may affect the cost of owner's title insurance)."

Under the GMP, the consumer will not know what kind of appraisal or valuation was performed, what was charged for those services, including whether any of these services were "marked up", and ultimately how much they are paying for these services at closing. Packaging may help simplify the process from the lender's perspective; however, the type of valuation performed and borrower's fees will be obscured. We believe the borrower deserves more protection.

There are many different types of appraisal or valuation services that can be provided during a mortgage application. Officially, an "appraisal" is the act or process of determining an opinion of value. Appraisals conform to industry-wide standards known as the Uniform Standards of Professional Appraisal Practice (USPAP) and are performed by licensed or certified professionals. Anything short of this is known as a "valuation," which can be computer assisted and performed by the lender or broker. Oftentimes valuations are performed by those that have an interest in the transaction.

Various levels of property analysis may be utilized in estimating the market value of a property. Automated Valuation Models (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. AVMs are typically most reliable in areas of homogenous properties, and those that are not suffering from deferred maintenance or customized features. There are a wide variety of models in use across the U.S., with a wide range in the "confidence level" in the final value indicator. At their basic level, AVM's are operated by technicians with no valuation expertise or particular knowledge of the property they are appraising, nor the sales that are being used within the analyses. Typically the reports are transmitted in proprietary formats that vary from vendor to vendor, are limited detailing the analysis and typically not signed by an individual who could be held accountable for the conclusion.

At the other end of the spectrum is a "complete appraisal" from an individual who has been trained in appraisal analysis and methodologies and holds, at minimum, credentials from a state appraisal licensing agency with requirements for education, experience and record keeping. This professional performs a much more detailed analysis of not only the macro-economic conditions that effect property values, but the individual characteristics of the property being appraised as well as those properties that have sold. Most times, an actual viewing of the property takes place by the professional to discern if the property contains any characteristics, good (updated features such as flooring and kitchens, amenities such as pools or finished space in the lower or upper levels of the home) or bad (leaking roofs, signs of structural instabilities, location next door to detrimental conditions). Many times these factors are not available through any other source than a visual viewing of the property, and the existence of the various items may have a substantial impact on the value of the property. These appraisals are often reported on a standardized industry-recognized form, which allows for the consistent review and audit of appraisals.

We believe the type of appraisal or valuation performed and the costs associated with these services should be transparent to the consumer since the consumer is paying for the service. As HUD has recognized, the appraisal has a specific interest to the borrower, and we feel those services, and that interest, should be fully disclosed.

There is also good reason for identifying the appraiser in the documentation for the consumer, as it helps create a system of ensuring the credibility for the work product and the accountability for the appraisal fees. Withholding or obscuring this information has the potential only to harm the borrower.

Concern 2: Limiting the upfront fee a borrower pays to the lender for the cost of preparing a GFE, and encouraging packaging arrangements will **increase appraiser exposure to inappropriate client pressure**. Real estate appraisers too often face inappropriate pressure from lenders, brokers, realty agents and management companies (often owned by lenders) to produce unsupportable values that facilitate mortgage transactions.

To capitulate to such pressure, an appraiser would violate the Ethics Rule of the USPAP[1]. However, failing to deliver a predetermined value under these circumstances often results in an appraiser being labeled "difficult to work with" or ostracized by clients in the marketplace. Unfortunately, according to our members, many lenders seek out appraisers willing to conform to such unscrupulous demands.

This kind of pressure has negative market consequences, as **consumers face a greater threat of entering into a mortgage that is greater than the value of their new home**. HUD and the lending community in general also face a threat as well, as these inaccurate appraisals do not accurately reflect the value of their mortgage portfolios and thus, increase the exposure to risk. Furthermore, transactions that are consummated at sales prices above their true market value can then be used to further exacerbate the overvaluation of other homes - leading to over lending on homes that are being refinanced - not just those being transferred in ownership.

Under the proposed reforms, lenders will likely face a dilemma on when to order a credit report and appraisal. Without advance payment, lenders who order a credit report and appraisal for a given loan will be liable for these costs and face exposure to loss should the borrower not go through with the loan, which is likely to happen with greater frequency when more shopping takes place. In order to limit their exposure, lenders are likely to defer ordering the credit report and appraisal until the borrower commits to the loan, which is likely to slow down the loan process. This is contrary to the mortgage industry's desire to expedite the loan process.

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[1] "An appraiser must perform assignments ethically and competently, in accordance with USPAP and any supplemental standards agreed to by the appraiser in accepting the assignment. An appraiser must not engage in criminal conduct. An appraiser must perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests." Uniform Standards of Professional Appraisal Practice, lines 258-261, p.7, 2003 Edition. Source: The Appraisal Foundation.

Lenders that are exposed to unpaid fees are more likely to exert greater pressure on appraisers to "bring in the numbers" so those loans can be made with reduced “kick out” risk. Historically, the borrower pays the appraisal and credit report fee at the time of application. Under this arrangement, the appraiser was somewhat, although not entirely, insulated from collection and lender pressure issues since the money was held in escrow by the lender.

Another possibility is that, in an effort to limit their exposure to loans that do not close, lenders and third party settlement service providers who order credit reports and appraisals early in the application process may attempt to negotiate contingent fee arrangements with vendors. Such arrangements are not allowed by USPAP and are barred in many states[2].

So that HUD can properly rely on quality appraisals to help protect the interests of lenders and borrowers, it should not encourage a system that rewards companies that use volume contracts with outside vendors to be competitive. Many of our members are concerned that these volume contracts will generate moral hazards which will result in lower quality appraisals, greater client pressure, lower financial stability for the nation's mortgage financing system and create a higher risk for consumers who may inadvertently commit to mortgages that are higher than the equity of their collateral. HUD should avoid creating a system whereby a single client provides so much business that an appraiser's economic viability would be decimated upon losing that client.

Concern 3: Many of our members are concerned that offering a guaranteed price for an assemblage of settlement services could impact many small appraisal businesses throughout the country (particularly in non-metropolitan areas), leading to a **shortage of qualified appraisers to perform appraisal assignments**. Contrary to one of the premises of the proposed rule, research shows that the appraisal component of settlement service costs has not seen a pricing increase in over a decade. In fact, appraisal fees for many services have decreased due to technology and efficiencies in the market.

Even with these efficiencies, it is not feasible for appraisers to continue to provide consistent, quality appraisals for less, especially if they are unable to charge market prices for complex assignments. Routinely, appraisers are confronted by properties that demand more of their time to complete the assignment. For example, if a property to be appraised is fronted by water or other unique amenities, it will likely require the appraiser to compile comparable sales from multiple locations and towns. Because the house and the comparable sales are not ordinary, the appraiser must talk to someone familiar with the property to find out particularly distinguishing data. This type of complex residential appraisal assignment

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[2] “It is unethical for an appraiser to accept compensation for performing an assignment when it is contingent upon: 1) the reporting of a predetermined result (e.g., opinion of value); 2) a direction in assignment results that favors the cause of the client; 3) the amount of a value opinion; 4) the attainment of a stipulated result; or 5) the occurrence of a subsequent event directly related to the appraiser's opinions and specific to the assignment's purpose.” Uniform Standards of Professional Appraisal Practice, lines 287-294, p.8, 2003 Edition. Source: The Appraisal Foundation.

would require greater staff hours to complete, thus warranting a fee that can be significantly higher than the standard appraisal fee.

The proposed rule outlines a one-size-fits-all concept of a 10 percent tolerance, or upper limit, on charges provided by third-party service providers. This tolerance is too restrictive. When extra costs result from an atypical appraisal assignment, the appraiser should be able to recoup the expense.

While market forces are currently lowering appraisal costs, the proposed rule appears to create a disincentive to perform mortgage appraisal assignments. Our members are concerned that the proposed rule may ultimately encourage existing appraisers to decrease mortgage appraisal work and would discourage new appraisers from entering the profession. In an effort to keep appraisal costs down and maintain the availability of appraisers throughout the country, HUD should enact policies that encourage a larger pool or participants, not a smaller one.

RESPA Suggestions

To address these concerns, we offer the following suggestions:

Suggestion 1: Since packaging hides the type of valuation performed and obscures fees paid for valuation services from the consumer, **we encourage HUD to keep the contract appraisal fee under the GFE and out of the GMP**. Instead, we recommend that only the lender's charge for reviewing or administering the appraisal function be included in the GMP, not the amount paid to a contracted appraiser.

Under our recommendation, the fee that is paid to the contracted real estate appraiser would not be included with application, origination and underwriting services and any other lender required services or other fixed fees. This suggestion would allow the contract appraiser to be considered an entity outside of the GMP package. It is our view that a GFE disclosure is adequate for consumers, in particular if the costs are itemized. Under these circumstances, the consumer could be given a copy of the contract appraiser's invoice at closing to document the actual cost of service. Lender fees for appraisal administration would then be transparent, and could subsequently be compared to the quotes in the GMP package. At the same time, it is likely that the “price point” of the appraisal services will continue to decline if it is not in the GMP because of market forces and technology. HUD should allow these natural market forces to work.

We do not recommend doing away with the GMP proposal altogether. We simply call for the rule to be modified to allow for full disclosure of the appraisal fees, which HUD has admitted is of interest and value to the consumer.

Suggestion 2: **HUD should include language in the final rule that prohibits client pressure, make such policies accessible to appraisers, and require lenders to pay for all third-party services regardless of loan status**. The proposed packaging of services will concentrate significant purchasing power among the largest national financial institutions and management companies. Coupled with the proposed requirement that definitive, upfront fee schedules be provided to prospective borrowers, these national purchasers of appraisal services will be able to exert unbridled pressure on independent fee appraisers. Therefore, it is critical that safeguards be included in the proposed RESPA final rule that squarely address the most critical and vulnerable areas for the appraisal community - client pressure and contingent fees. Both of these practices should be prohibited in the final rule through the inclusion of clear and unambiguous language.

HUD 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 it 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 HUD, and HUD has established no procedure 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 HUD will hold the appraiser’s identity in confidence 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 licensed and certified appraisers. HUD, when receiving these complaints, should provide sufficient resources to conduct thorough investigations and conduct effective enforcement activities.

HUD should also prohibit any and all contingent fee arrangements in connection with appraisals. We recommend language be included in the final rule mirroring comments in the Management section of the Ethics Rule of USPAP wherein it is recognized that it is unethical for an appraiser to accept compensation for performing an assignment when the assignment is contingent upon (1) the reporting of a predetermined result; (2) a direction in assignment results that favors the cause of the client; (3) the amount of the value opinion; (4) the attainment of a stipulated result; and or (5) the occurrence of a subsequent event directly related to the appraiser's opinions and specific to the assignment's purpose. Including the above language in the proposed RESPA final rule would parallel what is now part of most state law.

Suggestion 3: **HUD should create an exemption for loans secured by historic and high-value or otherwise atypical properties with the requirement for accurate GFEs**. A "one-size-fits-all" approach to packaging is likely to lead to greater standardization of fees for appraisal services. Such standardized fees will not allow for the premiums that are warranted for complex appraisal assignments.

Since the appraisal fee must be communicated to the borrower by the financial institution very early in the relationship, time will not allow for fees to be reflective of such premiums that are typically charged for complex residential appraisal assignments - e.g., historic properties, high-value residences, etc. So as to not stifle the public's ability to use these types of properties for collateral, the proposed RESPA final rule should contain a "carve out" provision that allows more flexibility with fees that need to be charged for these types of unique appraisal services.

About the Appraisal Institute and American Society of Appraisers

The Appraisal Institute is the acknowledged worldwide leader in residential and commercial real estate appraisal education, research, publishing and professional membership designation programs. Its extensive curriculum of courses and specialty seminars provides a well-rounded education in valuation methodology for both the novice and seasoned practitioner. Members of the Appraisal Institute form a network of highly qualified professionals throughout the United States and abroad. They are identified by their experience in and knowledge of real estate valuation and by their adherence to a strictly enforced *Code of Professional Ethics and Standards of Professional Appraisal Practice*.

The American Society of Appraisers is an organization of appraisal professionals and others interested in the appraisal profession. International in structure, it is self-supporting and independent. The American Society of Appraisers is the oldest and only major appraisal organization representing all of the disciplines of appraisal specialists, including real property. ASA is diligent in its efforts to strengthen and uphold the *Principles of Appraisal Practice and Code of Ethics* in order to protect the client.

We appreciate this opportunity to provide our official comments for the record. Should you have any questions, please contact Don Kelly, Vice President of Public Affairs, Appraisal Institute at 202-298-5583, dkelly@appraisalinstitute.org or Ted Baker, Executive Vice President, American Society of Appraisers at 703-733-2109, tbaker@appraisers.org.