



June 12, 2008

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 Seventh Street, SW, Room 10276
Washington, DC 20410-0001

Re: [Docket No. FR-5180-P-01]
Real Estate Settlement Procedures Act (RESPA): Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs

Dear Secretary:

On behalf of the more than 35,000 members of our respective professional organizations, thank you for the opportunity to comment on the Department of Housing and Urban Development's proposed rule on the Real Estate Settlement Procedures Act (RESPA). We have reviewed information in the proposed rule, and we have several serious concerns. We urge HUD to completely withdraw the rule because of the negative impacts it will have on consumers. If HUD proceeds despite our concerns, we urge HUD to make the changes provided below to protect consumers.

Summary

Specifically, our concerns with the proposed rule center around six issues identified by our members:

- Allowing fees to be hidden or disguised from consumers;
- Charging some consumers more than actual costs through average cost pricing;
- Limiting recovery of everyday appraisal charges through the proposed 10 percent tolerance;
- Inappropriately intervening in an evolving and adaptive market by promoting volume discounts;
- Preventing small businesses from effectively competing in the marketplace; and
- Neglecting to recognize the importance of appraisal quality and service.

The recent subprime mortgage debacle was replete with unethical, convoluted tactics to fool the public and line pockets on every level. So many who were charged with protecting consumers were either asleep at the wheel or in on the deceit. One issue that is of critical importance to avoid instances like this in the future is to promote transparency as much as possible. We believe the proposed rule fails to promote transparency and is not in the best interests of consumers.

Our detailed comments are outlined below.

Allowing fees to be hidden or disguised from consumers

We support full and accurate disclosure of settlement service charges to consumers, as consumers deserve a transparent explanation of fees involved in real estate purchasing decisions. As a matter of principle, if an appraiser is paid \$350 to perform an appraisal, the actual fee should be disclosed to the consumer. It should not include so called, "up charges" or lender processing fees. We believe any other charges relating to the appraisal,

including appraisal management fees, should also be fully and transparently disclosed to consumers. Consumers deserve these basic protections with regard to appraisals and all other settlement services performed on mortgages.

Unfortunately, the proposed rule is deficient in this respect. Existing RESPA regulations and the proposed rule both fail to inform the consumer of (1) the actual charges paid for appraisal services, and (2) any charges paid for appraisal management services performed for the lender. For most mortgage lenders, the function of ordering, managing and reviewing independent appraisals had historically been an overhead expense allocated to processing of the loan. Unfortunately, today, that overhead cost is increasingly being shifted to the local appraisal service provider, and ultimately to the consumer, in a misleading manner.. It is increasingly common for local appraisers – those actually performing the appraisal assignment and subject to requirements of the Uniform Standards of Professional Appraisal Practice – to be paid only a small percentage of the actual appraisal fee charged to the consumer and presently reported on Line 803 of the HUD-1 as “appraisal fee”. As much as 60 percent of some “appraisal fees” charged to consumers today are actually being paid to appraisal management companies. Further, many lenders appear to have an ownership stake in appraisal management companies, whereby the management function is turned into a profit center for the lender. We hope that these companies are structured to comply with the RESPA requirements for affiliated business arrangements, but have not seen the appropriate disclosures surface in the marketplace. The result is that in many transactions, loan processing fees are misleadingly labeled as appraisal fees. We provide one example of this below:

<u>Scenario 1</u>		<u>Scenario 2</u>
Line 803 Appraisal	\$350.00	\$350.00
Typical fee to Appraiser \$350.00		
AMC business model		
Amount to AMC traditionally borne by lender as processing exp.	\$200.00	
Amount to Appraiser		\$150.00

This is unfortunate because consumers may believe they are receiving the services of experienced, full service appraisers, while the actual fees can only be achieved through the use of “boiler room” operations or low overhead appraisal companies which are much more likely to have less expertise, inadequate market data, resources, and the competence needed to provide credible analyses. Further, we believe there are widespread consumer abuses taking place today that may not comply with existing RESPA requirements. We believe lender imposition of appraisal management fees as a practice, which has gathered near universal acceptance, is merely a way for loan originators to assess a second lender processing fee through the appraisal process. We fear that these problems will only be exacerbated by adoption of the proposed rule in its current form. HUD has an existing policy against “up charges” of appraisal services. However, the courts have disagreed on HUD’s interpretation, which has allowed “up charging” practices to continue. Given the difficulty HUD has had enforcing the existing provisions, we question why it would propose to promote up charges practices any further by promulgating a proposed rule that would not require disclosure to the consumer of (1) the actual fees paid for the appraisal service and (2) delineation of the appraisal fees from any appraisal management services provided to lenders.

This concern is significantly heightened in importance with the March 3, 2008 release of the Home Value Protection Program and Co-operation Agreement between the Attorney General of New York and Fannie Mae

and Freddie Mac regarding appraisal ordering and management. Generally, the agreement requires lenders (those financing the loans) to order appraisals and handle the appraisal management process, among many other things. A "Home Valuation Protection Code" of Conduct required by the agreement establishes standards governing appraisal selection, solicitation, compensation, conflicts of interest and corporate independence, among other requirements. Fannie Mae and Freddie Mac have adopted the Code and will make appropriate changes to its Sellers-Servicers Guide to reflect the Code. Beginning January 1, 2009, Fannie Mae and Freddie Mac will require that lenders represent and warrant that appraisals prepared in connection with mortgage loans originated on or after that date that are delivered to Fannie Mae and Freddie Mac conform to the Code. One potential consequence of this agreement is that lenders may, in an attempt to appear to comply with appraisal independence, more frequently opt to use the services of appraisal management companies to manage the appraisal process. With that, the issue of misrepresenting the actual appraisal fees charged to consumers by burying them within a fee that includes an appraisal management fee will become more common. Consequently, accurate disclosure is even more important under this new business model.

However, we believe there are at least two solutions to these concerns, and a way for HUD to improve enforcement of its existing policy on "up charges." First, HUD could define appraisal management fees to be lender processing charges to be listed and disclosed to consumers on Line 801 of the proposed HUD-1 statement. Clearly defining appraisal management fees as lender processing fees would halt this practice and protect consumers from hidden charges.

We prefer the option above, but we support requiring two charges relating to appraisal services being disclosed to the consumer – (1) the actual amount paid to the appraiser and (2) the separate appraisal management fee, which is performed on behalf of the lender. Nothing more than a simple line itemization of these charges is required to address this concern, and we believe this can be easily accomplished by adding a box on Line 804 of the new HUD-1 statement as reflected below:

Draft HUD-1 Statement –

804a. <i>Appraisal fee to Appraisal company</i>	804b. <i>Appraisal Management fee to Appraisal Management Company</i>
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Further, we believe there is merit in providing a line itemization of the appraisal and management charges on the GFE. Under the proposed new GFE form, appraisal fees may be listed under Line 3, as follows:

Draft Good Faith Estimate –

Your Charges for All Other Settlement Services	
<p>3. Required services that we select These charges are for services we require to complete your settlement. We will choose the providers of these services.</p>	
<i>Service</i>	<i>Charge</i>
Appraisal and appraisal management	

We urge HUD to consider adopting one of the two changes suggested above should it attempt to publish a final rule.

Charging some consumers more than actual costs through average cost pricing

Unfortunately, the proposed rule encourages inflated charges to consumers. By allowing “average cost pricing” by loan originators, HUD is giving the green light to charge some consumers more than what was actually paid to the appraiser (settlement service provider) for the services conducted in the performance of the consumer’s loan. This is contrary to the goals of adequately informing consumers of settlement services charges, and we fear it will result in widespread consumer abuse.

For instance, under average cost pricing, loan originators may calculate an average for appraisal fees and assess the consumer based on this average. As an option to fully inspected appraisals, today it is common for lenders to utilize streamlined appraisal processes (drive-by appraisals) or evaluations (automated valuation models) on many loans, particularly for those applicants with above average credit and on homes with common features and characteristics (tract homes). Oftentimes, the fees for conducting a streamlined appraisal or an evaluation are well below the average fully inspected appraisal costs. Yet, if these services are performed, and the consumer is charged the overall average, they will be assessed a higher fee than the actual cost of the appraisal services performed on their loan. Our members tell us this practice of utilizing a streamlined appraisal, yet charging full appraisal fees is already a problem under the existing RESPA rules today, and we believe this problem will be exacerbated if the proposed rule is implemented.

This is an extremely important issue because quality and expertise are critical components of the appraisal service. The price the consumer pays for an appraisal is in direct correlation with the quality level of the service. For instance, there is a standard title insurance policy which is used by almost all service providers and serves as an industry standard. And title rates are regulated by the states. Therefore, it is relatively easy to arrive at an average price for title services. Appraisal services, in contrast, are performed at various levels of assignment conditions, levels of inspection, levels of analysis, and levels of reporting. If all of the levels of appraisal services are grouped together in computing the average, this will be misleading to the consumer and provide an incentive for the lender to order the lowest level of service and charge the consumer a higher average.

At a minimum, any average cost pricing should require averaging for the level of appraisal services provided. For example, a fully inspected Form 1004 Uniform Residential Appraisal Report (URAR) for a single family residence, typically the most robust appraisal service provided today, might have an area average based on typical fees of \$325, \$350, and \$375, resulting in an area average of \$350. In contrast, a Form 2055 Exterior Only “drive-by” appraisal average might be based on typical fees of \$275, \$300, and \$325, resulting in an average of \$300. It would be patently unfair to charge a consumer \$350 for a full appraisal, knowing that the lender may order a drive by appraisal for \$275. Going further, we live in an age where there are lesser, non-regulated collateral assessment products that fall short of actual “appraisals,” such as automated valuation models (AVMs) and “broker price opinions”, which can cost as low as \$25. Therefore, advancing a regulatory system whereby lenders are incentivized to order the lowest service available and charge the consumer a higher average is ripe for abuse.

Additionally, we believe HUD should reconsider the appropriateness of using the “appraisal” line of the HUD-1 to disclose these lesser collateral assessment products. This is misleading consumers to believe they have received the highest level of service available from a licensed and regulated appraisal service provider, when this would not be the case.

We see some justification for using average cost pricing for establishing settlement service charges estimates listed on the Good Faith Estimate (GFE). However, when it comes to actual costs incurred by consumers, we believe it is far better policy to require full disclosure to consumers for payment of actual services performed on their loan. For this reason, we strongly urge HUD to allow average cost pricing for establishing estimates on the GFE only and prohibit their use, under all circumstances, on the proposed new HUD-1 statement.

Further, we strongly believe that any average cost prices for appraisal services allowed by HUD should not be less than current marketplace fees as determined by an independent source conducting research on appraisal fees which can be updated on a regular basis. This method would help avoid the conflict of interest of allowing loan originators or their agents (appraisal management companies, who oftentimes dictate lower fees to appraisers) from low-balling the average costs for appraisals supplied in the GFE and HUD-1 and shifting fee income to appraisal management companies or lenders. Conversely, loan originators or their agents might inflate those fees above costs in areas where appraisers are in short supply. One reliable and respected resource is the market survey of the Veterans Administration (VA) and its Appraisal Fee Panel. VA Regional Loan Centers conduct surveys of local appraisers to help determine market rates for appraisal services to be paid for VA guaranteed loans. These surveys are widely available, and we view them as the most trustworthy source of market rate information on appraisal fees. We urge HUD to establish a floor utilizing this or a similar reputable schedule for average cost pricing for any appraisal services in connection with this rule if HUD pursues average cost pricing.

Limiting recovery of everyday appraisal charges through the proposed 10 percent tolerance

We are also deeply concerned about the requirement for a 10 percent limitation on settlement cost increases as they relate to appraisal services. Through this restriction, loan originators could not increase their own charges from those stated on the GFE by more than 10 percent absent “unforeseeable circumstances.” We do understand that one “unforeseeable circumstance” is the need for a second appraisal. In addition, while we can appreciate the intent of this provision (attempting to decrease costs for consumers), we believe this requirement will inadvertently and unnecessarily restrict the ability for appraisers to charge market prices for their services. For instance, travel times for distant assignments are traditionally charged, as well as increased fees for changes in the scope of work not divulged during the initial order phase. And, it is common practice among reputable lenders and appraisers to upgrade initial appraisal orders from lesser products such as a Form 2055 drive-by to a fully inspected Form 1004 when the initial inspection indicates additional complexity.

The drafters of the proposed rule are encouraged to recognize the reality that, contrary to uninformed common perception, appraisal costs can vary widely, depending on the property type, time devoted to research, travel time, and a host of other factors that determine appraisal pricing. While appraisers are restricted from charging contingent fees, their prices do vary depending on the assignment and the level of due diligence, time, identification of the appraisal problem, and effort involved.

For instance, a waterfront property is vastly different than a tract home in a subdivision, and through that, access to comparable sale data may vary. Oftentimes, appraisers must travel to neighboring communities to access public data to find comparable sales information. Unfortunately, we doubt this would qualify as an “unforeseeable circumstance,” which are defined under the proposed rule as 1) acts of God, war, disaster, etc., or 2) circumstances that could not have reasonably been foreseen at the time of the GFE application that are particular to the transaction and that result in increased costs. The complexity of the assignment, in most cases, cannot be reasonably foreseen at the time of the GFE application, because the appraiser has yet to even be engaged to

perform the appraisal. We see this as placing severe and unnecessary restrictions on appraisers, and we urge HUD to modify its definition of “unforeseeable circumstance” to account for everyday occurrences like the one explained above.

We urge HUD to increase transparency and add language as follows:

“In Sec. 3500.2 in the definition of unforeseeable circumstances after “the need for a second appraisal” add

...*“extraordinary appraisal” charges, consisting of actual costs, expenses for time, and mileage and assignment complexity which exceed normal allocations in the average area appraisal fee.*”

We recommend that if HUD adopts the 10 percent tolerance, it should provide a specific exception for “extraordinary appraisals” beyond, for example, the Veterans Administration market survey norm. “Extraordinary appraisals” will recover actual costs, which will be explicitly detailed in the final charges for the consumer and other parties. It will be very easy for consumers as well as HUD, if the Agency was to examine these charges, to verify, or dispute their accuracy.

Inappropriately intervening in an evolving and adaptive market by promoting volume based discounts

We do not believe it is appropriate for HUD to encourage volume based discounts for appraisal services. Such actions are contractual market-based decisions between loan originators and large settlement service providers and must be balanced with other public policy issues and concerns, including potential declines in quality and the availability of providers that come as result of volume agreements. Further, volume based discounts are already negotiated in the marketplace today. There is no need for HUD to mandate in a rule a development that is already occurring in the private sector. The fact that volume based discounts are developing in the marketplace through a variety of mechanisms, including technology based solutions, is also a key indicator that technology may solve many of the problems that HUD has identified, and will benefit the consumer. In fact, a Federal rule memorializing current models may actually hinder development of technologies that provide new solutions.

As stated, volume based discounting occurs regularly in the marketplace today. Under the current requirements of Section 8(a) of RESPA, discounts should be passed on to the consumer. We understand that the proposed rule continues to require that no more than the reduced price is charged to the borrower and disclosed on the HUD-1-1A. However, the volume relationship is typically negotiated between lenders and appraisal management companies, which may process thousands of assignments per month. Yet, currently in the marketplace, the discount is taken from the portion of the fee paid to the local small business appraisal provider and not from the appraisal management company fee. There is no guarantee that the discount will find its way to the consumer without transparent disclosure of the split between the local appraiser and the national appraisal management company on a revised HUD-1. Given concerns about appraisal quality and appraiser independence, we believe it is unwise for HUD to effectively attempt to “nationalize” the appraisal industry, which is largely based on small local cottage industry service providers. While volume pricing may work for title services or overnight shipping, reputable, quality driven, local, small business appraisal providers simply cannot operate their businesses under this model and are being driven from the market.

Since appraisal services are based on small local business participation where cost can vary significantly from locale to locale, we believe it is more appropriate for HUD to allow the market to dictate developments in this area without government interference. We believe that under the current market model, services are supplied in rural

areas, as well as urban areas where HUD has made concerted revitalization efforts. Therefore, this current business model should be retained. Furthermore, allowing volume based discounts directly contradicts the latest mortgage industry reform which has focused on the elimination of conflict of interest between parties and improved transparency as evident by the New York Attorney General's Credit Agency Reform Agreement announced June 5th, 2008.

Preventing small businesses from effectively competing in the marketplace

HUD contends that the rule will not have a significant impact on small appraisal businesses because, since appraisals are locally provided services, small firms are just as competitive as larger ones.

We dispute this conclusion. Appraisal firms are typically very small business. At the height of the real estate boom in 2006, over 72 percent of appraisal firms employed fewer than 10 people. Nearly half of all firms employed fewer than four. We expect, with the declining real estate economy, and the need to layoff non essential personnel, these firms are now even smaller.

Volume discounts and average cost pricing may well reduce the prices that appraisers are able to charge. If small appraisal companies and sole proprietors are unable to recover the cost of providing their services, there is no rationale for remaining in the business. Particularly in rural areas, where actual transportation costs will be above the average there will be a shortage of qualified, available, appraisers, without the changes we recommend above. Adoption of the current rule could have the result of "redlining" rural areas because it will not be cost effective to provide services in certain areas of the country.

In fact, in attempting to analyze the effects on small appraisal business, HUD tries to "have it both ways." In describing the current market and potential effects, HUD notes that appraisals are locally provided services, and are therefore competitive. On the other hand, the agency also notes, that the local orientation could change over time because of automated valuation models (AVMs). By fostering the development of AVM's, the rule could effectively precipitate nationalization of the settlement services industry. Contending that these technological advances will take place in any case, and that the rule does not have an exacerbating effect fails to recognize that the cumulative effects of the failure to separate the appraisal fee and the AVM fee, the exception for volume discounts, average cost pricing, and a rule that effectively promotes the use of AVMs will exponentially increase a trend at a time when the marketplace is undergoing dramatic adjustments. These market adjustments will not be completed within the time period of the next two years, and they will undoubtedly have a proportionately negative impact on small service providers.

Neglecting to recognize the importance of appraisal quality and service

Finally, the economic assumptions used by HUD in the Section on Economic Analysis are patently flawed and incorrect. The economic analysis notes that based on "average third-party fees" 17.7 percent of the "savings cost" of third party fees will come from the appraisals. We believe that if these "savings costs" are achieved, it will be at the detriment of the availability and quality of service to the consumer.

The economic analysis also references reports that competitive pressure under tolerances, discounting, and average cost pricing will lead to pressure on all costs. In fact, the report notes that variability in appraisal prices was noted by Timothy Schools, who heads National Commerce Financial Corp.'s vendor management subsidiary. His company found that appraisals ordered by 10 different employees at one of its bank branches ranged in cost from \$150 to \$350 -- all from the same appraiser. Schools was noting the purported advantages of more

centralized ordering of third party services. However, as we have noted above, the actual cost of an appraisal may vary widely depending on the time, effort, and direct costs attributable to the appraisal. Consequently, while Mr. Schools, by centralizing the ordering of a portion of its settlement services, found \$7 million a year in savings from improved efficiency and negotiated discounts, this may well have been at the expense of quality of appraisals, and thus the quality of mortgage loans which were originated.

Therefore, these proposed changes cannot have come at a worse time. The industry, like the mortgage market, is in a sea change. Many appraisals are now often ordered late in the final underwriting process of the real estate origination and settlement process.

While appraisal fees traditionally were collected at application and placed in escrow. Increasingly, lenders are not collecting appraisal fees upfront but (for competitive reasons are collecting the fees at closing if and when a closing occurs). Consequently, appraisers are not paid for work in those transactions. In other instances, the volume of work is also decreasing because appraisals are now portable. There are loans that don't close with one lender but do with another, and the original property appraisal is used. The point being made is that the economic analysis appears to presume that there is an appraisal expense in the initial underwriting phase, which we believe is flawed.

Conclusion

Again, as noted above the recent subprime mortgage debacle was replete with unethical, convoluted tactics to fool the public and line pockets on every level. So many who were charged with protecting consumers were either asleep at the wheel or in on the deceit. One issue that is of critical importance to avoid instances like this in the future is to take transparency as far as possible. We believe the proposed rule fails to promote transparency and is not in the best interests of consumers. For these reasons, we urge HUD to completely withdraw the rule. If HUD issues it despite our objections, the modifications described above are essential.

We appreciate the opportunity to comment. We would be happy to meet with you or your staff to discuss these concerns in more detail. Please contact Bill Garber, Director of Government and External Relations at 202-298-5586, bgarber@appraisalinstitute.org if you have any questions.

Sincerely,

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