



September 15, 2011

The Honorable Edward J. DeMarco
Acting Director
Federal Housing Finance Agency
1700 G. Street, NW
4th Floor
Washington, DC 20552

Dear Director DeMarco:

On behalf of the 30,000 members of our respective professional organizations, please accept these comments on the Federal Housing Finance Agency's ("FHFA") Request for Information (RFI) on the Real Estate-Owned ("REO") asset disposition programs of Fannie Mae and Freddie Mac and the Federal Housing Administration ("FHA").

We applaud your agency for soliciting comments from industry stakeholders to gather ideas on how to address an extremely complicated issue. Many real estate markets are highly volatile and face significant challenges ahead given high concentrations of foreclosures and/or delinquencies. While an argument can be made that the faster markets are allowed to "clear," the faster an economic recovery may occur, it is our general view that there is merit to alternative measures that seek to mitigate market declines in a thoughtful and well-managed way.

Here, the "right" answer will be market specific. There may be communities in which rentals makes sense; others where outright sales would be best for everyone; and others where the best possible outcome is demolition. In any event, federal agencies, and those working with them, need real estate experts, like professionally designated real estate appraisers, to advise them which is which.

We have three general comment areas:

1. We believe market value appraisals should be mandatory for all REO;
2. If a rental program is established, we believe qualified appraisers are the best source for estimating market rents;
3. Contracting firms involved with valuation should have in-house appraisal expertise and pay appraisers on a "cost-plus" basis, where management and review are charged separately from actual appraisal performance.

Market value

First, our organizations believe any program designed to facilitate the disposition of REO properties requires credible and independent opinions of *market value*. Market value helps establish several baselines, ranging from financial reporting to asset management and disposition. Specifically, we believe it is critical that appraisals be performed by *qualified appraisers* -- who meet professional competency requirements -- and conduct their appraisals in accordance with the Uniform Standards of Professional Appraisal Practice.

Here, federal agency policy varies far more than it should. While FHA and the federal bank regulators require appraisals when a loan is taken into REO¹, the policies of Freddie Mac and Fannie Mae unnecessarily diverge. It is our understanding that Fannie Mae obtains at least one appraisal and a Broker Price Opinion (BPO) for its REO; however, we do not believe Freddie Mac obtains any appraisals and bases its REO decisions on two BPOs and an internal automated valuation model². We believe these policies should be made more consistent, with, at a minimum, at least one appraisal obtained from a qualified appraiser.

Further, we caution against exclusive use of BPOs in REO for several reasons. First, BPOs may not necessarily report market value. Rather, because of biases in the listing and sales process, BPOs may often report something more akin to “liquidation” value, or “quick sale” value, in some markets. This is partly because no enforceable standards exist for BPOs, but also because the notion of an “independent” BPO is a misnomer. By law, agents and brokers are required to advocate for their clients. Here, appraisers provide something a broker or agent cannot – objectivity and independence. This is critically important given there is a fiduciary responsibility to obtain maximum value in foreclosure sales to help protect neighborhoods a downward spiraling real estate market from properties being “dumped” on the market.

Lastly, we believe lenders, loan services and federal agencies are vastly underutilizing the services of real estate appraisers today. For instance, while market value is essential, appraisers can also provide liquidation value opinions to give asset managers a greater sense of market dynamics and assist in asset disposition. One appraisal from a qualified appraiser with a scope of work to deliver market value and liquidation value is far more efficient to ordering several BPOs. The Appraisal Institute has developed a Liquidation Value addendum which is available in various appraisal software packages today³. Further, many are not aware that appraisal standards have been modified in recent years to give greater flexibility to appraisal development and reporting. “Phased” appraisal assignments, where an original appraisal is performed and “updates” are prepared on a reoccurring basis throughout disposition, are an underutilized approach to the property management and asset disposition process. While many small financial institutions have adopted such procedures today, large, national operations generally have not. All of these services can be provided by qualified appraisers on a cost-effective basis and address distressed asset management issues facing banks and agencies today.

Establishing Market Rent

In some markets, renting REO properties may be preferred to wholesale liquidation. However, any rental program must be properly structured, managed and overseen to protect all parties involved. Property management requirements will be critical to avoid degradation of the condition of rental properties.

If a rental program is established, we believe the agencies should establish “market rent” utilizing the expertise of highly qualified appraisers. Given the need to balance affordable housing concerns with property management in the public trust, establishment of market rents will help build confidence in such a program and protect renters and asset managers from unnecessary questions and complications about fees and fiduciary responsibility.

Developing conclusions of market rent is common in real estate appraisal; such opinions are most often required as part of the income capitalization approach valuation technique, but are frequently required for independent use such as in HUD Section 8 housing subsidy programs and lease negotiations. Our

¹ See *HUD Handbook 4150.2*, available at <http://www.kirchmeyer.com/HUDManual.pdf> and *Other Real Estate Owned*, available at <http://www.occ.treas.gov/topics/credit/commercial-credit/other-real-estate-owned.html> and

² Berry, K. 2011, September 8. “Freddie Mae: No Fire-Sales of Foreclosed Homes.” *American Banker*. Available at http://www.americanbanker.com/issues/176_175/freddie-mac-discounts-foreclosed-homes-1041992-1.html

³ Available at <http://www.appraisalinstitute.org/education/downloads/Form801.03.pdf>

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organizations have long been a leader in educating appraisers on the income capitalization approach method, and it is one we instruct our members to use with rental properties. It also has a strong foundation in agency policy. FHA and the GSE's require appraisers to conduct a rent study and determine market rents and estimate operating expenses on every non-owner occupied property that is insured or sold⁴. In sum, appraisers are well equipped to deliver market rent services, and such services have a strong presence in pre-existing agency policy. Our organizations stand ready to assist in this endeavor.

Contracting Firm Qualifications

The RFI seeks input on the qualifications of contracting firms relating to appraisal and valuation. Given the scope of the issues involved, we strongly believe any firm should have in-house appraisal expertise, demonstrated best by professional designations conferred by nationally recognized appraisal organizations.

Also, we strongly believe that the appraisal services described above and envisioned by the RFI require use of highly qualified appraisers. Your agency is grappling with complex appraisal problems. Asset managers should be instructed to seek out high quality appraisal service providers. To accomplish this goal, we recommend asset management and appraisal management firms should be structured to procure appraisals on a "cost-plus" basis, where appraisal and appraisal management are billed separately. Today, co-mingling of appraisal and appraisal management is common; however, we are deeply concerned about the impacts such models have on appraisal quality. As such, use of "cost-plus" appraisal firms managed or directed by professionally designated appraisers is highly encouraged.

Thank you for your consideration and we would be happy to arrange a meeting and discuss this with you in person. Please call Bill Garber, Director of Government Relations for the Appraisal Institute, at 202-292-5586 or bgarger@appraisalinstitute.org, or Brian Rodgers, Manager of Government Relations, at (202) 298-5597 or brodgers@appraisalinstitute.org should you have any questions.

Sincerely,

Appraisal Institute
American Society of Farm Managers and Rural Appraisers

⁴ For example, Fannie Mae requires lenders use Form 1007 to obtain the market rent for a conventional single-family investment property from the appraiser. Available at <https://www.efanniemae.com/sf/formsdocs/forms/1007.jsp>