



# Center for **Responsible** Appraisals & Valuations

Appraisal Compliance Paper:  
Residential Mortgage Originators,  
Securitizers, AMC's & The Mortgage  
Broker

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[www.responsibleappraisal.org](http://www.responsibleappraisal.org)

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## Center for Responsible Appraisals & Valuations

The National Community Reinvestment Coalition (NCRC) founded The Center for Responsible Appraisals and Valuations (The Center) after receiving a significant number of complaints from borrowers about overvalued appraisals.

For over a decade the residential real estate market has been at the mercy of improper and unlawful appraisal and valuation practices that have resulted in substantial over valuation of the collateral underlying trillions of dollars of housing loans. Despite the existence of Federal Laws (FIRREA) enacted to protect against such abuse the lending industry has, to some extent, become systematically engineered for over valuation.

Consumers have significantly overpaid for housing and all attendant closing costs and interest. The financial integrity of the system has been compromised.

Honest appraisers have had their businesses damaged or destroyed. Certain lenders and the entire secondary mortgage market have been defrauded out of billions of dollars. NCRC quickly discovered that appraisers are the least to blame for inflated appraisals. Lenders, mortgage brokers, real estate agents and title companies have been pressuring appraisers to inflate home values. Appraisers often have risked losing future business when they have not "hit" the price.

NCRC founded The Center to stop this practice. Representing borrowers, appraisers and responsible financial service providers, The Center's mission is

- To encourage mortgage finance professionals to sign our official code of conduct pledging to ensure fair and accurate appraisals for borrowers;
- To inform the public about those who have taken the code of conduct so borrowers can make more informed choices about mortgage finance professionals;
- To mediate differences between professionals about valuations, as well as file complaints on behalf of appraisers when they report pressure by lenders, brokers and others to inflate values or misrepresent a home's worth in some way.
- To advocate for effective public policy on a Federal and State Level.

## Prelude

We are in agreement that governmental attempts to stop unlawful pressure by lenders, real estate brokers and others have failed. Beyond the harm to consumers is the burden that over valuation has placed upon the financial system, as well as the harm to the appraisal industry itself. Industry groups, although well intentioned, do not have the mission or the clout to succeed with lenders, loan brokers and real estate brokers.

The Center for Responsible Appraisals and Valuations is committed to ending valuation abuses through education and the collaborative efforts of all industry participants. It has been our experience to date that not only do many professional appraisers want market reform, but so do many players who are concerned about overvaluation and its impact on the economy at a time of rising interest rates, increasing foreclosure and softening housing costs. THE Center has had enormous success in our preliminary discussions, especially with many of lenders, appraisal managers, and regulatory officials and policy makers, and expect the same regarding unlawful influence on appraisals and retaliation against appraisers who refuse to give in to the pressure from mortgage brokers.

The Center's mission is to make certain that lenders, loan brokers, real estate firms, secondary market buyers of loans and management firms are signatories to compliance agreements by which they agree:

1. Not to improperly pressure or retaliate against appraisers.
2. Implement best practices for FIRREA compliance.
3. Use almost exclusively, appraisers and management firms that have, by becoming Center signatories, agreed to compliance and participation in our dispute resolution mechanisms.
4. Celebrate informal alternative dispute resolution and/or arbitration when an appraiser complains of improper influence or retaliation, or where there is disagreement over a valuation result.

For more information and how you can participate please visit [www.responsibleappraisal.org](http://www.responsibleappraisal.org).

## Compliance Paper on Mortgage Brokers:

### PURPOSE:

This compliance paper is intended to provide a clear understanding of the duties and responsibilities management and each director of a lender must consider when performing their fiduciary duties involving real estate-related financial transactions, including the utilization of mortgage brokers.

The valuation professionals who serve on the Center's Partner's Council identified this issue for discussion, collaboration and as legislative and regulatory policy priority for the The Center. These professionals have repeatedly expressed concern about undue pressure from brokers and the fact that many honest appraisers have seen their businesses reduced or destroyed while others have had their integrity compromised in a situation that seems beyond their control. We are going to forcefully work to change this dynamic – and invite every appraisal and valuation professional to participate in The Center and work for change with us.

Every federally insured financial institution is required to comply with regulations covering real estate appraisals and real estate lending standard. The regulations are Title XI of the Financial Institutions Reform, Recovery, and Enforcement act of 1989 (FIRREA) and Section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA).

FIRREA states that appraisals are to be written, performed in accordance with uniform standards by an individual whose competency has been demonstrated and whose professional conduct is subject to effective state supervision. FDICIA also require each regulated institution to adopt and maintain written real estate lending policies that are consistent with safe and sound banking practices and that reflect consideration of the real estate lending guidelines attached to the regulation. The real estate lending guidelines state that a real estate lending program should include an appropriate appraisal and evaluation program (hereafter Program).

The operative word is “what is an appropriate program”? All programs must meet the minimum standards, but they can be tailored to the institution's size and nature of their real estate-related financial activities. Each institution's board of directors is responsible to review, adopt and maintain policies and procedures that provide an effective real estate appraisal and evaluation program. The program should be approved at least annually.

Following are the individual standards and the regulators' expectations for achieving compliance with options a financial institution can consider to achieve compliance.

1. Establish selection criteria and procedures to evaluate and monitor the ongoing performance of individuals who perform appraisals or evaluations.

The competency paragraph of the appraisal regulation provides clear guidance to this issue. It states, "All staff and fee appraisers performing appraisals in connection with federally related transactions (FRTs) must be State certified or licensed, as appropriate.

However a State certified or licensed appraiser may not be considered competent solely by virtue of being certified or licensed. Any determination of competency shall be based upon the individual's experience and educational background as they relate to the particular appraisal assignment for which he or she is being considered."

It is incumbent upon the bank to have an initial selection process in place and an ongoing monitoring process also. Financial institutions frequently have an appraiser panel report that identifies which types of property and a dollar threshold level for using Appraiser Smith, Jones, or ..., etc.

2. Provide for the independence of the person ordering and performing appraisals or evaluations.

The appraiser independence paragraphs speak directly to this issue, but this is one area where many banks are not complying with the regulation. Except for financial institutions with independent appraisal departments, or credit risk staff dedicated to ordering and reviewing appraisals or funneling appraisal requests through an appraisal management company, lenders and their staffs continue to directly order appraisals.

*This is a violation of the appraisal regulation, which would require corrective action on the institution's part. Production personnel that receive remuneration for closed loans cannot directly order the appraisal or choose the appraisal management company that picks the appraiser.*

The regulation states:

Staff appraisers.

If an appraisal is prepared by a staff appraiser, that appraiser must be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in FRTs, and have no direct or indirect interest, financial or otherwise, in the property.

If the only qualified persons available to perform an appraisal are involved in the lending, investment, or collection functions of the regulated institution, the regulated institution shall take appropriate steps to ensure that the appraisers exercise independent judgment.

Such steps include, but are not limited to, prohibiting an individual from performing an appraisal in connection with FRTs in which the appraiser is otherwise involved and prohibiting directors and officers from participating in any vote or approval involving assets on which they performed an appraisal.

#### Fee appraisers:

If an appraisal is prepared by a fee appraiser, the appraiser shall be engaged directly by the regulated institution or its agent, and have no direct or indirect interest, financial or otherwise, in the property or the transaction.

In its October 28, 2003 interagency statement, the federal banking and thrift agencies reminded banks and bankers of the need for independence within their Programs. The agencies restated, "It is important to ensure that the Program is safeguarded from internal influence and interference from an institution's loan production staff. Individuals independent from the loan production area should oversee the selection of appraisers and individuals providing evaluation services." *A literal translation would be: Lenders are not allowed to order appraisals.*

They also stated that the statement *applies to all real estate-related financial transactions originated or purchased by a regulated institution for its own portfolio or as assets held for sale.*

The agencies made this statement because bankers regularly stated that the regulation applied only to commercial real estate credits. This is an inaccurate interpretation of the regulation. Title XI of FIRREA applies to all real estate-related financial transactions, including retail, capital markets transactions, and securitization and sales units.

#### Mortgage Brokers:

If a regulated institution buys the loan package from a broker, the broker, as an interested party, clearly cannot order, manage, influence, review or control the appraisal. As this would interfere with the normal functions performed by the broker, in "shopping the loan" for the borrower, it is necessary for the broker to place a qualified, independent intermediary between it and the appraisal function.

That intermediary, such as an appraisal management company or the credit policy staff appraisal management function of a lender, must be totally independent of the transaction. Thus, the utilization of any entity that has, or might have, an interest in the transaction would not be compliant.

If, for example, the appraisal management company was owned by a title or settlement services company, or by the parent company of such a title/settlement services company (and, thus, is an affiliate of the title or settlement services company), the broker would have to insure that the related title or settlement services company was not used on that transaction.

In recent mystery shops conducted at mortgage brokers by the National Community Reinvestment Coalition, in a surprising number of the fair lending tests the broker being audited represented to the shoppers that they knew appraisers who could ensure the origination because they "knew how to get value out of homes."

#### Payment for Valuation:

There is a question of the propriety and legality of a payment practice that, apparently, is often used by mortgage brokers and correspondent lenders, who then sell the loan to lender who purchases and, often resells the paper.

First, as we have duly noted, brokers and correspondent lenders, who do not (as would a lender) have appropriate credit quality staffs, actually order, choose, influence or manage appraisals or appraisers are violating FIRREA when that loan is sold or originated by or for a lender in a transaction that falls under FIRREA.

If, however, the broker or correspondent lender orders an appraisal through a totally independent "non interested party" to the transaction, such as the credit quality staff of the lender making or buying the loan, or an independent appraisal management company, the appraisal can be ordered by that credit staff or management company.

If the broker follows the proper guidelines they will retain the services of an independent credit quality staff of its "buying lender" or 3<sup>rd</sup> party company, as noted above, to order the appraisal for a lending transaction, however, in this scenario they then have the appraiser paid directly by the borrower via a check, generally at the time of the inspection portion of the appraisal. Here within lies the problem.

In regard to payment, under FIRREA and its guidelines, it is very clear that the borrower may not hire, retain or, as an interested party, influence the appraiser. Thus, it would seem from a cursory glance that this practice violates FIRREA? The question becomes one of both case law and inference. Obviously, if there

exists a contractual relationship between the borrower and the appraiser, FIRREA has been violated as the appraiser has obviously been retained by the borrower. Does the transference of a check between the borrower and the appraiser create what is known as "privity of contract" that creates the relationship proscribed by law?

It is possible for a nonparty to a contract to pay the consideration for another party without creating privity, where that is the intent of the parties. Thus, one could argue that the mere payment, in and of itself, does not create privity.

The greater problem, here, is in the instance that the borrower either "bounces" the check or refuses to pay with a credit card. Does the lender or 3<sup>rd</sup> party company remain responsible for the payment of consideration to the appraiser?

If the broker or lender takes, or their intention is to take, the position that they are not responsible for the payment to the appraiser, then an argument could be made that, in fact, the contract was, or must have been, between the borrower and the appraiser; thus violative of FIRREA.

To remedy this, the contract between the broker or correspondent lender and the final lender or 3<sup>rd</sup> Party company, and that between the appraiser and the final lender or 3<sup>rd</sup> party company should provide that the payment to the appraiser is not conditioned upon the completion of payment by the borrower.

The problem for the broker or lender, however, goes beyond this. If the appraiser is dependent upon the borrower to pay for the appraisal, then the borrower has a substantial modicum of influence on the appraiser. No interested party in the transaction can have such influence. The practice, thus, is flawed because of the potential influence the borrower has on the appraisal.

It is suggested that, in these instances, the borrower should direct payment to the broker or correspondent lender. Failing that, the borrower should direct payment to the final lender or the 3<sup>rd</sup> party company and not the appraiser.

The following are three examples how institutions can achieve compliance with this aspect of the regulation. The Center has observed all examples in action. They all provide compliance under the law.

- Set up a section within the credit risk or credit policy area of the bank. Designate at least one person (and an alternate) to operate the Program (qualifying appraisers, maintaining the appraiser panel, selecting appraisers for assignments and reviewing their reports) under the oversight and supervision of the institution's credit risk management officer or the head of credit policy. The designated person(s) cannot have any involvement in the institution's lending, investment or collection functions. (A credit analyst or clerical support reporting to a loan officer is not an acceptable alternative.)

This structure will provide basic compliance when augmented with a qualified reviewer, who is not involved with lending, investment or collection functions.

- Set up an independent appraisal review department, staffed with State-certified appraisers (perhaps designated also), to operate the Program (qualifying appraisers, maintaining the appraiser panel, selecting appraisers for assignments and reviewing their reports) under the oversight and supervision of the institution's credit risk management officer or someone acting in a similar capacity. It is a common industry practice to refer to the head of this department as a Chief Appraiser. The Chief Appraiser cannot have any involvement in the institution's lending, investment or collection functions. The decision to staff an appraisal review department with qualified appraisers should be based on volume and complexity of the real estate loan portfolio. Financial institutions exceeding \$5 billion should consider the need for an in-house appraisal review department.
- The third option is to engage an appraisal management company and outsource your Program to them. They would operate the Program (qualifying appraisers, maintaining the appraiser panel, selecting appraisers for assignments and reviewing their reports) for you under your supervision. This structure requires a small staff of reviewers or third-party fee appraisers to review a percentage of the outsourced work from a quality control perspective.

#### Establish criteria for the contents of an evaluation.

In 1994, the agencies restated that an institution should establish prudent standards for the preparation of evaluations. At a minimum, an evaluation should:

- Be written.
- Include the preparer's name, address, and signature, and the effective date of the evaluation.
- Describe the real estate collateral, its condition, its current and projected use;
- Describe the source(s) of information used in the analysis.
- Describe the analysis and supporting information.
- Provide an estimate of the real estate's market value, with any limiting conditions.

The agencies further stated that an evaluation report should include calculations, supporting assumptions, and, if utilized, a discussion of comparable sales. Documentation should be sufficient to allow an institution to understand the analysis, assumptions, and conclusions.

The evaluation should provide an estimate of market value to assist the institution in assessing the soundness of the transaction. Best practices also require that as an institution engages in more complex real estate-related

financial transactions, or as its overall exposure increases, a more detailed evaluation should be performed. For example, an evaluation of an income-producing property should fully describe the current and expected use of the property and include an analysis of the property's rental income and expenses.

Provide for the receipt of the appraisal or evaluation report in a timely manner to facilitate the underwriting decision.

An institution's appraisal and evaluation program should establish effective internal controls and best practices, including the timely receipt of the report prior to the final credit decision.

Each report should receive at least an administrative/compliance review by an individual familiar with the agency's appraisal regulation, these guidelines, the real estate lending standards and the institution's program. This review can be part of the loan officer's credit analysis and be either a narrative report or a checklist. This review should be made a permanent part of the loan administration file.

An institution's appraisal and evaluation program should also include comprehensive technical analytical procedures that focus on more risky transactions, such as large-dollar credits, loans secured by complex or specialized properties, non-residential real estate construction loans or loans out of the institution's foot print.

These procedures should verify that the methods, assumptions and conclusions described in the report are reasonable, appropriate and fully-supported by the report. The person preparing this technical review must be independent of the transaction.

Assess the validity of existing appraisals or evaluations to support subsequent transactions.

In 1994 the agencies moved from a current appraisal being defined by a date, to a concept that embodied numerous factors that could render an appraisal valid to support a subsequent transaction (e.g., renewals or refinancings). This change resulted from knowledge acquired by the Comptroller of the Currency (OCC) during the late 80s and early 90s.

During this time period, national banks were required to have all classified real estate credits reappraised annually. What the OCC learned was that market values had stabilized year after year and that national banks were spending money unnecessarily. The OCC stopped this practice.

What are the criteria an institution should consider when determining the validity of an existing appraisal to support a subsequent transaction:

- Condition of the property and the marketplace relative to the original appraisal and the nature of the subsequent transaction,
- The passage of time,
- The volatility within the local market for comparable properties,
- The availability of financing,
- The supply of competing properties,
- Improvements to, or the lack of maintenance to the subject and competing properties,
- Changes in zoning, current or proposed, and
- Environmental issues.

Each institution must document their informational sources and analyses used to conclude that an existing appraisal is valid for a subsequent transaction.

- Establish criteria for obtaining appraisals or evaluations for transactions that are otherwise exempt from the agencies' appraisal regulations.

Management should identify those prudent situations when they will order an appraisal even if it is not required by law. For example, appraisals might be ordered for portfolio monitoring and risk management purposes, even though additional financing is not being considered.

- Establish internal controls that promote compliance with these program standards.

The single, most important internal control is the independence of the institution's appraisal management practice from the loan production areas of each institution. This includes the selection of appraisers and the ordering of appraisals by someone not involved in loan production whether it is directly or through an independent third-party.

Technical reviews should be performed by qualified state-certified or state-licensed appraisers not involved in loan production. All reviews must be documented.

Administrative reviews can be conducted by any qualified individual within the institution.

Someone within the institution should be knowledgeable about the requirements of the appraisal regulation and the real estate lending standards and assure the institution that the appraisals and evaluations received comply with the regulations and regulatory guidance.

## Best Practices & The Role of The Center:

The mission of the Center, which has been incorporated as a tax exempt charitable trade association is to represent the interests of responsible market players committed to independent and fair valuation practices with regulators, legislators and the public. The Center celebrates the use of appraisers and corporations who have agreed to the Center code of conduct, so that the public can be aware of professionals and corporations who have affirmed their desire to provide accurate, compliant and fair appraisals and valuations. Further, appraisers and lenders who have been harmed by those who have unlawfully influenced appraisals and retaliated against those who stood up to them will now have an inexpensive and fast means of obtaining fair treatment.

The Center is currently inviting the largest lenders in the U.S. as well as well as the appraisal industry to enter into compliance agreements and to partner with us to change the market dynamic. It is our hope and expectation that over the next year, thousands of appraisers and hundreds of lenders will become signatories, and with that, the problem posed by improper valuation practices will be far better policed and controlled. Those lenders, appraisers, real estate firms and others who refuse to become signatories will be at a market disadvantage when it comes to business with consumers who care about safety, accuracy and compliance. They will also have to face the authorities when a complaint is made about them from a signatory. Our lawyers will, unless the respondent submits to the resolution process, turn bona fide complaints into the appropriate regulatory institutions and will hold them accountable to take appropriate action.

Thus, the center will focus its activities on fulfilling the promise of the Codes of Conduct for each industry signatory that insures independent and responsible valuation practices by lenders, appraisers, appraisal management firms, the secondary market, real estate professionals, mortgage brokers and other businesses involved in the sale and finance of residential real estate

## IMPLEMENTATION

The American Dream of homeownership and the soundness of the mortgage marketplace are at risk due to the lack of responsible lending. To address the bad practices existing in the lending marketplace today, NCRC founded the Center for Responsible Appraisals and Valuations (THE CENTER). The purpose of the Center is to bring the home valuation abuse to an end.

## CODE OF CONDUCT

The Center for Responsible Appraisals and Valuations has created a national Code of Conduct for all industry participants to follow once becoming Signatory

Members of the new Center. In order to curtail the valuation abuse that has become a major form of predatory lending, each Signatory agrees to comply with the guidelines of FIRREA as well as all other local, state, and federal rules and regulations.

Each Signatory agrees to do their part in effectively putting a stop to Improper Influence. Any act that will have the result of creating a valuation that is anything other than the most truthful and accurate reflection of fair market value is considered to be Improper Influence.

Once becoming an Center Signatory, lenders, mortgage brokers, real estate brokers and management firms agree to the Code of Conduct and to the Alternative Dispute Resolution (ADR) process that has been designed through the American Arbitration Association (AAA). This method offers Signatories that have been wronged, the opportunity to file a complaint through an efficient cost effective process on line. Mediators and Arbitrators will be of assistance in the settlement of disputes if the Signatory chooses this method. However, if online arbitration is not effective, the parties can elect to participate in formal arbitration process pursuant to the commercial guidelines of the AAA.

## SUGGESTED MEMBERSHIPS

Every participant in the lending industry is encouraged to become a member of the Center.

### APPRAISERS & STAFF APPRAISERS

For over a decade many appraisers have had their businesses harmed by real estate valuation abuses in the mortgage marketplace and have had no dispute resolution mechanisms. For the first time, as a result of the Center for Responsible Appraisals and Valuations (THE Center) an appraiser will have the clout of a major consumer group behind their complaints of improper influence of valuation results or improper retaliation by a lender or management firm when an appraiser refuses to alter such a result.

To participate, an appraiser enters into a voluntary agreement to comply with the Center Code of Conduct. All appraisers within the firm will be required to comply with the Uniform Standards of Professional Appraisal Practice (USPAP). The appraiser agrees to notify the Center (on a confidential basis) of any attempted improper influence or improper retaliation by anyone against him or her. The appraiser agrees to participate in the Alternative Dispute Resolution (ADR) process by which disagreements with lenders or others are to be handled.

### LENDERS & MORTGAGE BROKERS

In today's competitive environment some lenders have attempted to "influence valuations" and cease using appraisers and management companies that refuse

to create overly aggressive valuations. The impending liability for mortgage brokers, where it can be proven they knowingly influenced a valuation, is similar to that faced regarding all aspects of predatory lending. Through its review process, The Center offers lenders and mortgage brokers the ability to compel a review of what is believed to be an incorrect appraisal and file claims against those that retaliated against them for refusing to improperly influence the valuation process.

## SECONDARY MARKET

The secondary mortgage market, including the Government Service Enterprises, buyers insurers and rating agencies have, perhaps, the largest single stake in the problems caused by over valuation of collateral. It is the intention of the THE CENTER to convene a national conference of Secondary Market participants to develop methods by which they can assist the The Center in creating an environment of safe, sound and compliant mortgage lending. Examples of these methods would include: greater audit and review standards for loans sold and purchased in the secondary market, more effective pre purchase review methods and standards, and earlier and greater enforcement of representation and warranties.

## MANAGEMENT FIRMS

Within the lending and valuation industries, management companies have played a major role in the creation of compliant and accurate valuations and appraisals. As Management Companies have positioned themselves as the outsourcers of the valuation process for lenders, it has been assumed, often incorrectly, that they are a force for independent, accurate and compliant appraisals and valuations, simply put, some are such a force and others are not. As Management Companies proclaim themselves to be compliant outsourcers of a function that is regulated, they themselves are generally not subject to such regulation, thus, must qualify for Signatory status in a manner that goes well beyond the standards set for lenders.

## REAL ESTATE BROKERS

For decades, far too many real estate agents, have requested that lenders obtain valuations that supported the purchase price arrived at between seller and buyer. Many good and honest agents believe that, "what ever a seller and buyer agree" must constitute fair market value. There are many reasons this is not true, first and foremost FIRREA, which dictates that valuations are made by independent appraisers who have been appropriately certified by the states in which they practice and are totally independent of the transaction. Liability could be involved where it can be proven that a real estate agent knowingly influenced a valuation result that was materially inaccurate.

For more information about the Center for Responsible Appraisals and Valuation or to become a member, please visit [www.responsibleappraisal.org](http://www.responsibleappraisal.org) or call us at 866-244-9706.



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