Report: Banker-Appraiser Task Force Review of Appraisal Issues in the Mortgage Lending Process

Introduction

The Banker-Appraiser Task Force brings attention to relevant questions and issues surrounding or emanating from the relationship between the lending segment and the appraisal arm of the real estate industry in the mortgage-lending arena. It is the intent of the members of the Banker-Appraiser Task Force that the following information and suggestions be used by the relevant entities to help resolve the issues and problems identified. The Banker-Appraiser Task Force thanks you for taking the time to read the results of our work. We sincerely hope that our efforts help form the framework for change. The Banker-Appraiser Task Force welcomes your input. Please forward your questions or comments to one of the co-chairmen, Lou Garone or Don Childears.

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The opinions in this document are the combined responses of the task force members and do not necessarily represent the views of the members' respective employers. Nothing said or implied by a member of the Banker-Appraiser Task Force can be construed to represent the views of all members of the Task Force, their employers, employees or sub-contractors.

Executive Summary

In summary, these questions focused on the lending and appraisal segments of the real estate industry. We subscribe to the principle that a major, if not the single most significant factor, of our country's economic strength lies in its real estate and the ability to buy and sell that real estate. Hand-in-hand with the ability to buy and sell is the ability to finance that real estate in the most prudent and secure manner possible.

The standard of measure for real estate is value. While there are several definitions of "value", at focus here is "market value" as established for lending purposes. Understanding value carries with it an absolute requirement of depth of knowledge regarding the various markets in which it must compete, a clear understanding of current and proposed uses along with adequately developed market analysis and highest and best use of land and improvements. This goes along with a thorough and complete understanding of the principles that set the framework for value, and the bundle of rights theory.

We hope the questions and responses provided a common thread linking real estate (the tangible property as developed and potential for redevelopment), its market (competitive area), potential for change (market analysis and highest and best use) and in-depth analysis of the market's interaction or reaction to a given property (conclusion of value). All these elements come together to enable the appraiser to give the lender an opinion of value that is reflective of the property and its financial security in addition to giving the lender the peace of mind that a good and safe lending decision can be reached.

Within these questions and answers is the foundational need for highly trained and experienced people on both sides of the industry, who understand risk and offsetting value. One also sees the need for recognizing a changing world relative to real estate and the measure of value. To accommodate the changing needs, we need uniformity in the regulatory rules/ guidelines along with consistency in application, a system to develop common knowledge among all practitioners, a method to encourage trainees from both sides of the industry along with measurable standards for supervisory functions as well as basic education hooked to the licensing segment of the appraisal process.

While this paper is focused on lending and the appraisal process it must be noted that the same set of elements apply for any circumstance where a conclusion of value is required.

Background and Methodology

Louis Garone, President of the Northern Colorado Association of Real Estate Appraisers, and Don Childears, President/CEO of the Colorado Bankers Association, spearheaded the Banker-Appraiser Task Force to address common appraisal related issues and concerns in the mortgage lending process. The study was launched following a December 2017 presentation by Childears to the Northern Colorado Association of Real Estate Appraisers (NCAREA). In his presentation, Childears identified several appraisal-related concerns within the mortgage lending process from the perspective of the banking industry. Following the presentation, Childears and Garone formed the Banker-Appraiser Task Force to discuss shared appraisal related concerns and issues.

Don Childears and Lou Garone co-chaired the task force, which was composed of a 10-member panel, equally divided between the banking and appraisal industries. The task force identified 24 issues as warranting further discussion. Each of the 24 issues was then assigned to a team (banker-appraiser pair) for further investigation and discussion. The task force reconvened several times to review the team-prepared responses for each of the 24 identified issues. The results revealed that some appraisal-related issues within the mortgage lending process work well while others are in need of change. The work of the task force concluded in October 2018.

Summary of the Task Force Discussions Items

The following list is intended to provide the reader with highlights of the questions and discussion results. You are encouraged to read the questions and responses in detail.

1. A professional opinion of value by a licensed or certified appraiser is necessary in a mortgage lending transaction. Task Force Item #1
2. Compliance with bank regulatory requirements in a dynamic environment is a challenge. Task Force Item #2
3. If an Appraisal Management Company (AMC) is utilized by a bank, there remains a need for a designated person at the bank to provide guidance to the AMC. Task Force Item #5
4. Given the intended use and intended users in a mortgage transaction, the appraisal results should be communicated as a single-point valuation. Task Force Item #7
5. Lending compliance can be problematic with complicated guidelines, conflicting criteria or requirements that do not conform to the appraisal assignment. Task Force Item #8
6. Some secondary market guidelines impose unrealistic constraints on the valuation and lending processes. Task Force Item #9
7. There is a lack of universal understanding of the appraisal process and results reporting techniques in the mortgage lending process. Task Force Item #10
8. Rate lock time constraints are a required component of the mortgage lending transaction, which can lead to pressure on the appraisal process. Task Force Item #11
9. Occasional and most often intermittent appraisal shortages may exist in specific locations but overall, there is no shortage of appraisers in all markets. Task Force Item #12
10. Appraisal fees may or may not be consistent with the time required to develop credible results. Task Force Item #13
11. Rural properties have the same appraisal standards, however they may benefit from differing appraisal requirements and thresholds and may be hampered by a shortage of appraisers. Task Force Item #14
12. Appraiser qualifications and/or expertise beyond basic licensing criteria are important and necessary. Task Force Item #15
13. Appraiser-trainees should be allowed to perform work including property inspections. Task Force Item #16
14. Significant roadblocks exist to appraiser trainee education, experience and mentorship programs. Task Force Item #17 and #18
15. The valuation analysis is important to the lending process, however the exact type of valuation analysis and subsequent review required depends on the details of the loan transaction. Task Force Item #19 and #20
16. There are numerous negative ramifications associated with an AMC in the mortgage lending process. Task Force Item #21
17. AMCs may fill a banking industry need for appraisal management services. Task Force Item #21 and #22
18. Automated valuation models (AVMs) have a limited role in the mortgage lending process. Task Force Item #23 and #24

In-Depth Discussion of the Issues Addressed

1. When are appraisals necessary?

Generally, when an appraisal client (bankers, lenders, attorneys, and individuals) needs to make a financial decision on real estate and wants (or needs) assistance in reaching that decision, they may obtain a real estate appraisal. Whether buying, selling, lending, insuring, or determining how much to pay in taxes, having a professional opinion of value by a licensed or certified appraiser is useful.

When a federally regulated lender desires to make a loan, they refer to the Interagency Guidelines. In general, an appraisal is required at a transaction amount more than $250,000, though other exemptions and thresholds may apply. Refer to the FDIC website for further information.

2. What are viewed as significant roadblocks in the lending/valuation process from the banking perspective?

Compliance with bank regulatory requirements in a dynamic environment is a challenge. Specific concerns include: maintaining separation of the sales and appraisal departments; communication issues due to the separation of sales and appraisal, such as Appraisal Management Companies (AMCs); complying with complex regulatory requirements; and lack of educational resources or training relative to the appraisal and AMC processes.

3. How much dependency is placed on property value indications?

One hundred percent dependency is placed on the property value indication. The assumption is made that the value is reliable, without regard to the product type, which means evaluation and valuation report products are considered equal in their dependency.

4. Aside from the authorized appraisal-ordering entity or department, who should have direct contact with appraisers and why?

After the appraisal is ordered, there may be circumstances that necessitate communication between the appraiser and the lender's designated contact.

Loan originators? Rarely. The reason is that the lending process requires an independent valuation of the collateral and such communication can influence the valuation conclusion. Under certain circumstances, it may be necessary for some essential communication between originators and appraisers to better understand assignment conditions or the subject property. Additional questions regarding the date of appraisal appointment, expected delivery date, delays, or problems with the purchase contract and appraisal assumptions or methodology can be addressed. Appraisal values should not be discussed between the appraiser and loan production staff. That said, there should be someone who can step in as an intermediary (an AMC typically handles this for clients that use an AMC.)

Underwriters/Credit Risk Analysts? Yes, if the underwriters or analysts are qualified to review and understand appraisal theory and are not financially motivated by outcomes of the report or

underwriting process. The appraiser cannot determine whether or not an underwriter or other credit risk analyst is financially motivated; the underwriter or analyst must determine this and act accordingly.

5. How are Appraisal Management Companies (AMC) used in the lending process?

In some cases, the AMC can perform as a mediator for impartial communication and have procedures to review concerns or requests for reconsideration of value. Theoretically, AMCs are not opinion-based and not influential regarding appraisal results. Some banks assign duties of appraisal management/engagement to a loan processor or other assistant to the lending staff. The risk is that this person may be directly influenced in the loan process and an AMC can remove the burden of this situation where an employee is in a compromised position; the AMC can provide an impartial intermediary.

Still, there needs to be a designated person at the lending institution who provides guidance for the AMC; this person should at least be partially specific to this function and removed from the lending side.

6. Can the lending process be accommodated with value ranges?

The simple answer is no. Residential real estate loans require a set value point determination. Non-traditional appraisals may accept value range determinations, if agreed to in the engagement of the assignment. See question seven for additional information for further discussion.

7. Can underwriters assess risk and reconcile a loan amount from a range of value?

For regulated financial institutions such as banks, lending using a range of values is possible albeit \complex . Banks are bound by appraisal regulations for loans falling under the definition of a federally related transaction, and for consistency as well as safety and soundness reasons some of these guidelines spill over to loans below these transaction thresholds. Credit unions are bound by similar rules through their applicable regulator. Appraisal regulations and interagency guidelines address the use of multiple appraisals obtained for a transaction and dictate that the most credible value be utilized, rather than the highest value. This includes appraisals obtained from different sources, automated values obtained from different sources and a USPAP-compliant (Uniform Standards of Professional Appraisal Practice) opinion of value concluded by a second appraiser based on the review of the first appraisal, etc.

Further, the relevant federal (FIRREA) definition of market value includes: "…the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale…" This also implies that a specific value point be used in the lending decision and banks rely on the knowledge and experience of the appraiser to determine the most probable price.

Additionally, banks must balance customer service with fair lending issues, which can occur when similarly situated borrowers are treated differently. For instance, two different individuals each apply for a $300,000 loan to purchase a $400,000 home and have the same credit score/history, income, etc. However, one is offered more favorable loan terms, which creates the appearance

of a possible fair lending violation. Loans are priced and structured based on several factors, including a loan-to-value ratio, or the loan amount as a percentage of the collateral value. If the lender is presented with a value range of $370,000-390,000, the $300,000 loan would be somewhere between 77-81 percent loan to value. This seems like a small range, but the borrower with a higher loan to value ratio could be subject to a higher rate and fees as well as additional costs for private mortgage insurance. Private mortgage insurance (PMI) is a premium, most often paid by the borrower in addition to their monthly loan payment, with a loan originated over 80 percent loan to value. It may also be referred to as MI for FHA loans.

Taking all of the above information into consideration, the likely result is a loan based on either the mid-point or the bottom of the value range. This approach is the moderate to conservative way for a lender to utilize a consistent determination from a range of values, and therefore minimize potential fair lending issues.

Additionally, some lenders utilize multiple appraisal reports obtained from different appraisers. In this case, the lender identifies the most credible report upon which to rely for the lending decision, which can be somewhat subjective if all reports obtained are credible. This further complicates the concept of utilizing a range of values and reconciling to a single value point for the loan structure and terms.

Ultimately, the bank needs a written policy to determine which value to use in the lending decision. This determination itself could be completed by an underwriter/risk analyst presuming that person is independent from the loan production staff. Community banks may not have the resources to ensure the underwriter is independent from the loan production staff, which presents the opportunity for a conflict of interest.

Overall, there could be potential negative consequences for borrowers, especially consumers, if a range of values is presented in an appraisal for a lending decision. The appraiser, as an independent third party, is relied upon for the opinion of value and is typically the most qualified party to select the value as a point in the range.

Market value is defined as the most probable price not a range of probable prices. The single point opinion of value recognizes the inherent definition of market value. In addition, sale transactions are for a single price which typically evolves from a range through negotiation. In this way, the appraisal mirrors the actions of the buyers and sellers and the specifics of the contract. There is clarity in a single-point opinion of value, which can then be used to determine the other lending thresholds. If the appraisal included a range of values then the downstream lending thresholds would also be expressed as a range of values complicating the process of risk analysis. To best identify the value point conclusion you rely on an appraiser for a single-point analysis/opinion.

8. Is lending compliance problematic resulting from multiple regulatory and secondary market agency rules, reps, and warrants?

As far as appraisers are concerned, the lender provides guidelines and criteria which resolve the issue for the appraiser on a case-by-case basis. This can be problematic when the guidelines/criteria that are supplied conflict, are overly complicated, or do not conform to the assignment. For example, lenders sometimes supply rules for Colorado that are based on California guidelines; i.e.: asking the appraiser to appraise to a double-strapped water heater requirement in a state that does not experience earthquakes and has no related local codes.

From the lender's perspective, developing an internal appraisal policy that complies with the requirements of all governing laws and that meets secondary market investor requirements is a challenge. Commercial appraisal rules are infinitely more logical and efficient to administer than residential requirements. There are many overlays that must be considered for residential lending that are simply not present for commercial real estate (CRE). The streamlined efficiencies for CRE valuations are most evident in the example of USPAP requirements for CRE being deemed acceptable by the Small Business Administration, a division of the federal government, for small business lending. This alignment of requirements clearly does not exist with residential appraisal requirements and is most evident in a review of secondary market requirements which are stricter than standard appraisal regulations for loans kept in the bank's portfolio.

Federal Housing Administration (FHA), Fannie Mae (FNMA), Freddie Mac (FHLB), Veterans Administration (VA) and any other secondary market requirements should be examined against USPAP and the interagency guidelines to identify inconsistencies. Eliminating conflicting or onerous rules would reduce the regulatory burden and result in a more streamlined, efficient process that would support accurate and meaningful appraisal reports.

9. How do secondary market criteria (e.g. FNMA guidelines) impose unrealistic constraints on the valuation/lending process?

While secondary market guidelines impose constraints, most guidelines are intended to protect the general public as well as the entity providing the funds. Secondary market guidelines are important but not understood by every appraiser or lending institution because of the various interpretations and added lender-specific requirements from one assignment to the next or from one lending institution to the next. In some cases the constraints imposed by secondary market criteria can stop a loan in its tracks or hold up the sale of a package of loans to investors until corrections can be made. When there is a lack of understanding about the intent behind a guideline, it can get confused such that a simple statement (or lack thereof) can stop a loan. Appraisers, real estate professionals and lenders need to have a good understanding of guidelines' intent. Of equal importance is the clear and consistent application of guidelines in the review process.

An example: a tri-level with security bars on the lower level windows that do not have quick-release. While FNMA doesn't allow this in rooms that are labeled for sleeping (bedrooms), a seasoned appraiser knows how to work with secondary market criteria and may designate this room as a "study" (with full disclosure), such that the appraisal will not raise red flags and the loan can be completed. A room defined as a "habitable" space can be labeled in many different fashions and can be labeled differently than the current use. To be labeled a bedroom, a room should have egress as defined by the appropriate building code such as the International Residential Code (IRC). Sleeping rooms must have a window of adequate size and ability for a person to escape or for a rescue person, wearing a backpack, to gain access. . The IRC has specific criteria for the size of the window opening and states it "must be operable without keys, tools, or special knowledge." Clearly, without the ability to quick-release the bars, this room does not qualify as a sleeping space. By its very nature, without legal egress, this room cannot be defined as a sleeping area/bedroom. By designating this room as a study, the room holds its value as a finished room – but sleeping room criteria should not be applied. The current use of the room does not necessarily dictate the way an appraiser labels a room.

With that in mind, appropriate labeling can change the way an appraisal is used/accepted by the client. Another example of this is non-conforming bedrooms in a basement that have windows too small for egress. Appraisers can label these as “bonus” rooms, “study/office,” “hobby,” etc. Labeling the room as a bedroom can cause liability issues if the room does not technically qualify, i.e.: have legal egress.

While guidelines are designed to protect the loan package and reduce risk, in some cases appraisal analyses and reports can be restrained depending on how a guideline interpretation is applied. Individual lenders interpret these guidelines differently and impose particular and sometimes unreasonable constraints upon the appraiser, per their interpretation of the guideline. When the client (lender) requirements are so specific that they put words into the appraiser’s mouth and script actual verbiage that must be included in the appraisal report, this causes difficulties and can result in multiple requests for revision. It is more often the lender’s supplementary requirements, designed to meet the FNMA guidelines, which distort the intent of FNMA’s guidelines and create confusion and frustration.

Lastly, the lender overlay on secondary market loans that a certified appraiser inspects every residential property is also perceived to have a limiting impact on the industry, due to the practical constraints it places on the use of apprentices. This restriction prohibits a trainee from completing inspections alone, even if the trainer deems them capable. That limits the usefulness or cost effectiveness of taking on an apprentice (see question 16) and the overall availability now and in the future of appraisers. Additional information is contained in the FNMAE Selling Guide.

10. Is there universal understanding of the appraisal process? If not, can it be accommodated or fixed?

There is no universal understanding of the residential appraisal process, the information contained in an appraisal report or valuation methodologies used by appraisers among loan officers, real estate professionals or borrowers. This lack of understanding results in an inordinate amount of time spent on unsupported disputes of valuations, resulting in an inefficient use of time for all parties involved. Evidence of this is the 162 complaints received by the Department of Regulatory Agencies of the State of Colorado in 2017 from which 56.6 percent were dismissed and only 30 percent were referred to the Real Estate Appraisal Board for further action.

Additionally, appraisers do not generally have a full understanding of the constraints under which lenders are working due to the prohibition of communication directly between lenders and appraisers, first prohibited by the 2009 Home Valuation Code of Conduct (HVCC) and further limited by the appraiser independence requirement (AIR) mandated by the Dodd-Frank Act.

While required independence in appraisal engagements and reviews was needed due to the unscrupulous acts of some lenders pressuring appraisers to provide higher valuations, the unintended consequence is a widening knowledge gap among lenders and borrowers in regard to comprehending appraisal reports. This matter can and should be addressed with a two-prong approach. First, efforts need to be made to address and eliminate the discrepancies in the rules governing appraisals from all regulatory bodies and the secondary market. Secondly, the issue should be addressed by requiring annual continuing education training for all Nationwide Multistate Licensing System/Registry (NMLS) lenders/loan originators, lending staff, realtors and title company representatives. In banking, annual training is utilized for almost all other regulated topics and appraisal standards should be included in this circuit.

Lastly, the appraisal industry and lending industry should collaborate further to promote public awareness about conscientious lending and property valuations.

11. Can loan "rate lock" time constraints be extended to allow for adequate credible analysis?

Simply put, no, it is not feasible. This is a contractual agreement. Lenders need to be aware of time constraints and order the appraisal in a timely manner or be prepared to pay a higher fee for expedited service. Regardless of the fee structure, complex properties may require additional time to adequately complete.

12. Is there a shortage of appraisers?

While shortages may be occasionally identified in specific locations, given our capitalistic society, we assume that where there is a lack of appraisers, appraisal fees will be higher. It is simple economics. Denver and Seattle have high appraisal fees. Does this mean these locations have a lack of appraisers? The surprising answer is no; – these locations have more appraisers than Nebraska and Oklahoma. Is there a shortage of appraisers in rural America? Yes, and there are examples of this in Colorado and Wyoming, small mountain towns and farming/rural communities. The rural area appraiser shortage is further exacerbated by the lack of a quality national database for comparable properties and some states' non-disclosure rules. The lack of real-time, reliable data continues to be a problem both in urban and rural communities and is especially palpable when valuing an income-producing property.

However, in general the shortage of appraisers in rural areas is not much different today than it was 20 years ago. Recently federal law was changed through S. 2155 to allow an exception to the appraisal requirement in rural areas for a home under a $400,000 transaction amount in certain circumstances. This should provide some relief to problems with appraisal availability and timeliness in rural areas.

Economics have changed over the past 20 years. Fees were stagnant for many years while the cost of living increased tenfold. However, in just the past three years, appraisal fees have increased significantly in some markets. This came as a shock to lenders and real estate brokers accustomed to the unreasonably low fee structure caused by the stagnation and desperation of appraisers trying to stay in business during difficult economic times.

The automatic reaction was to assume that the powers of supply and demand were in force. The increase in appraisal fees has been misinterpreted to indicate a lack of appraisers to meet a higher demand for services – a "shortage."

The perceived shortage is due, in part, to the client's approach to the appraisal industry and process for selecting appraisers; mainly resistance to increasing appraisal fees and lengthier turn times. Clients continue to select appraisers based on unrealistic expectations. They are price shopping and selecting appraisers based on the fee paid and/or turn time, rather than on the quality of the appraisal product they receive from the appraiser. Many markets still have a significant number of inexperienced appraisers delivering reports for lenders – who are willing to work for the lowest fee and within shorter turn-around time. Therefore, a large portion of these low-cost and speedy appraisals are delivered to clients and are not lender or secondary market compliant, requiring numerous requests for revisions. On December 11, 2017, Don Childears,

president and CEO of the Colorado Bankers Association, was the guest speaker at the meeting of the Northern Colorado Association of Real Estate Appraisers. Mr. Childears spoke about the large percentage of appraisal issues bankers see on a regular basis – requiring revisions that significantly delay the loan process. These delays make large impacts on the banks' ability to write loans. To paraphrase his presentation, "When banks can't write timely loans, properties fall off the market and customers are the real victims when there are delays."

Seasoned, competent appraisers that produce credible appraisal reports seldom see requests for revisions. The majority of them apply the necessary effort to develop a credible report the first time, which involves more of the appraiser's time and pulls from his/her experience level. Additional time spent developing an appraisal simply costs more as a matter of economics. Appraisers who produce reliable reports and do not charge Customary and Reasonable (C&R) fees have a short life-span in this industry due to the expense associated with running an appraisal business; they can make more money for less effort in another industry. Likewise, appraisers who produce non-credible appraisals and charge minimal fees also struggle in this industry for a variety of reasons, one of which is the delay caused to lenders by their lack of quality. Making boiler plate statements, cloning prior jobs and bypassing quality reviews will speed up the turn-time, but will also increase the amount of revision requests which will eventually make the final turn-time much longer. By changing the process of appraiser selection, the client can substantially decrease the amount of delays caused by poor appraisals. Paying an appropriate fee for a quality appraisal today will eliminate many of the future difficulties lenders are seeing in the appraisal process and limit substantial delays that victimize lenders and home buyers.

Conversely, what has decreased is the amount of seasoned master appraisers producing credible reports. Over the past 6-8 years, the demand for credible (quality) appraisals has increased, yet the number of clients willing to pay for them has not kept pace with this increase. This dynamic has given way to an appearance of an appraiser shortage because clients are not sending appraisal orders to appraisers that charge for the time spent. The low cost/fast turn-time appraiser is getting the majority of the orders and has an overloaded schedule.

Lenders have been warned about non-credible appraisals and are putting more attention on receiving *good* appraisal reports. This push for a higher quality appraisal product comes from increased legislation and requirements imposed by the secondary and investor markets which hold the lender accountable. As a matter of time economics, a quality appraisal takes longer to develop and that simply costs more.

To summarize; most markets have adequate numbers of appraisers and trainees are entering the market on a daily basis. However, there aren't enough clients paying the C&R costs associated with seasoned master appraisers that can produce quality credible appraisals that meet today's appraisal requirements the first time. Many clients are steering away from competent appraisers in exchange for low cost and quick turn-times resulting in a low-quality appraisal product and adding significant delays to the loan process when this low-quality appraisal is not lender or secondary market compliant.

An additional downstream issue that needs to be considered is the impact on the lender when a loan goes bad, which can come in the form of direct foreclosure, secondary market buy back requests, or in very significant circumstances when an entire portfolio is denied or sent back to the initiating lender.

The solution? Lenders can consider changes to the “lender – appraiser” dynamic and the appraiser selection process to focus on developing lasting relationships with seasoned master appraisers to fulfill their needs today and help develop seasoned master appraisers in the future.

13. Are appraisal fees consistent with the time required to develop credible conclusions?

Fees and time are both important, but there is typically an inverse relationship. For a faster delivery of a credible report, a higher fee is typically charged. For certain institutions, a market-based fee is paid to appraisers while other institutions pay a “low” fee in conjunction with a “fast” turn time. In a field where so much is derived from supply and demand, it is an appraiser’s business decision whether to accept that fee and turn time, or revise their business model.

That being said, in certain markets and for certain clients, there is anecdotal evidence that fees are being driven down. For appraisers who work with Appraisal Management Companies (AMCs), a portion of the fee paid by the lender is due to the AMC. This may not be readily apparent in fee surveys unless the net fee is also disclosed. Whether the effective decreased fees are driven by market forces or by working with AMCs, the result may be that the appraiser would need to complete a greater number of reports per day to sustain their business, resulting in a potential “rush” to complete one report and move on to the next. As a result, the quality of the end report and/or complete compliance with USPAP may be in question.

The Appraisal Qualifications Board recently adopted revised licensing requirements which reduced certain education and experience hour requirements. That is outside the scope of this question, however it is worth noting that ongoing education requirements must be considered as they take up an appraiser’s time that would otherwise be spent on appraisal assignments. That is not to say that continuing education is not important, rather it is to call attention to further time and cost constraints on appraisers when they undertake license and designation mandated continuing education.

Based on a cursory study for this task force, a typical appraisal - one that is not a complex assignment - takes nearly a full workday to complete. Factors such as a rush order, additional analysis required for a complex assignment, etc. require work beyond the normal workday. In a manner consistent with overtime pay, rush fees and the like are assessed when applicable. Professional appraisers do not reduce the quality of work in order to speed up the delivery of the report. Instead, they utilize their personal time to complete the work so as to produce credible assignment results within the delivery time frame for the assignment.

Ultimately, appraisal fees may or may not be consistent with the time required to develop credible results. An appraiser is obligated to produce a report with credible results, regardless of the fee paid or the time to complete the assignment. It is a business decision for the appraiser to accept or reject the assignment.

14. Should rural properties be under different appraisal requirements or standards?

Requirements and standards are not synonymous. In appraisal practice, standards are viewed as published rules and guidelines established by entities of authority. Foundational to all levels of licensing is the Uniform Standards of Professional Appraisal Practice (USPAP). USPAP is established through process by the Appraisal Standards Board (ASB) of The Appraisal

Foundation (TAF). Enforcement of USPAP is through the state regulatory bodies for licensed appraiser and various professional organizations for their members. Requirements deal with needs or necessity and are demanded or obligatory, are in addition to the standards and imposed by the client. For an appraisal, the standards for rural properties must be consistent with urban or suburban properties while requirements may differ by client, location, or even property type depending upon the client and their overlays. Rural markets generally have limited lenders and limited appraisers, as well as limited market data. Rural properties have specific marketable features, requiring specific techniques such as utilizing properties that would serve as a purchase alternative to the subject property. Information is usually more limited and turn times are lengthier as a result of fewer appraisers, distance between the subject and sales and limited data, all of which can add to the turn time when compared to metropolitan assignments. So, should the requirements be different for rural properties? Yes, depending on the client's needs. Should the standards for an acceptable appraisal be different? No, as the standards are established by an authority, not the client.

Finding qualified appraisers for rural properties is a recurring problem, with no easy solutions and is not unique to the appraisal profession. As an example, rural areas have limited access to doctors and many other services. Recently, however, there have been some exemptions put in place to help with the overall problem of rural property appraisals, one example of which is S 2155.

15. Are appraiser qualifications and/or expertise beyond basic licensing criteria important or necessary?

Very little has changed in the core/basic classes that teach real estate/appraisal theory because the classes were developed to address the core base of knowledge promulgated by the Appraisal Qualifications Board (AQB) of The Appraisal Foundation (TAF). This was to codify appraisal theory that had been applied for decades prior to the advent of appraiser licensing. The core principles of appraisal practice remain unchanged despite the evolving real estate and lending industries. Regulations are among the factors that have caused these industries to change drastically in the past decade, and in the decades before.

Economic shifts have imposed significant pressure on the balance of supply, demand and absorption. Those changes are complex and have led to equally significant changes in the buying, selling and financing part of the industry. The real estate transaction has evolved and become heavily regulated, detail oriented (finite in scope) and client specific. The industry is reliant on the appraisal (asset/collateral) as a component of the loan decision. While the basic data required for a standard appraisal has not significantly changed, the supporting documentation and explanation has multiplied in content. These added requirements can be interpreted differently by different institutions, but are most commonly experienced with secondary market lending and state regulatory agency requirements. The appraiser is intended to be the unbiased third party to the lending transaction.

Basic licensing is simply that – basic. The nuances of writing the appraisal, understanding complex properties and adhering to client specific guidelines are not taught in basic appraisal classes. Appraiser trainees, fresh out of these basic licensing classes, may have never visited a subject property, never written any part of the 1004 URAR report and never been exposed to secondary market guidelines. These experiences are necessary to develop knowledgeable appraisers.

The model of licensing formerly included a lengthier mentor period during which trainees received hands-on education to compliment classroom learning. Recently the AQB rolled back the requirements and cut this mentor period in half. Many appraisers spent several more years working with their mentor than what the minimum guidelines dictate. Most seasoned appraisers agree that two years under a mentor are not enough to branch out independently; however, the economic reality is such that a mentorship period beyond two years may not be feasible. The new requirements (lowering the mentorship by 50 percent) will likely result in under-trained appraisers. Understanding the appraisal theory, while important, is not a substitute for appraisal practice and experience.

It can take years for an appraiser to be exposed to the complexities of any given market and that understanding is an ongoing process of learning throughout an appraiser's career. In one year, an appraisal trainee may not acquire or receive the adequate exposure necessary to develop credible results. A master appraiser will be able to write a credible report that will meet client requirements, secondary market guidelines and reflect the true conditions of the market, but a novice appraiser who has met only the minimum licensing criteria likely may not. Adequately presented inappropriate data and analysis may not be identified by the underwriter. Another report of the same property with the correct data and analysis results in a credible appraisal, accurately identifying the collateral risk of the loan.

16. Under what conditions should appraiser trainees be allowed to prepare work for lending?

Under current appraiser and bank requirements, some banks will allow external trainees to perform assignments, under the supervision of a trusted appraisal vendor. Some, but not all, financial institutions allow trainees to inspect the property alone and the supervising appraiser is required to sign the report with the trainee. This is typically allowed when the supervising appraiser has received prior permission from the bank and may have signed a separate agreement stating that they are responsible for assignments completed by their trainee.

This process is more easily administered by a lender with an approved appraisal panel. By comparison, an Appraisal Management Company may not have the same relationship and knowledge of a specific appraiser's work as compared to a lender with a panel. It is not impossible for this program to be developed with an AMC, however, due to the degree of separation, lenders may not be as comfortable with and willing to accept these reports.

As a possible solution, trainee appraisers could be allowed to prepare work for lending institutions under the direct supervision of a senior appraiser, regardless of the complexity of the assignment. The decision to involve the trainee and to what extent could be left to the supervising appraiser as long as the results are credible and the lender has the same reliability and recourse for errors. Consistent with other licensed professions, the trainer determines the appropriate amount of supervision for each trainee on a case-by-case basis. The problem is, how does the industry enforce compliance with a rule or obligation of direct supervision?

Many (if not most) lenders do not have their own in-house appraisal panels, managed by a regional appraisal department or similar structure. As a result, they may not be familiar with the appraisers who complete work for their organization within a given geographical area. Lending organizations that do not rely on AMCs to provide appraisal services know their panel of appraisers, the quality of work produced and the reliability/character of the person completing or supervising the work.

One possible solution would be to establish a regional appraisal department within the bank if one does not exist. A Regional Appraisal Department can be created and operated in compliance with federal banking regulations and provide some control over the panel of appraisers. A Chief Appraiser may head the in-bank regional appraisal department as a bank employee, competent manager and an experienced appraiser qualified to review the work of other appraisers. This person would work with the independent fee appraisers, corporate management, and the underwriting team to ensure compliance with regulations and the delivery of credible assignment results appropriate to the organization's structure. Fees and appraisal processing systems would be in the domain of the Chief Appraiser as would be creating and maintaining the approved appraiser list, applicable appraisal review (which may include the use of scoring models developed for agencies such as FNMA), and handling requests for reconsideration of value. Aside from the Chief Appraiser, the panel of appraisers need not be employees of the bank and could be a panel of independent fee appraisers.

Another option is to mandate an internal "eyes-on" review of appraisals signed by a trainee appraiser. Yet another option is the creation of a special licensure level or certification for supervising appraisers through the Appraisal Qualification Board. Following adequate training, the supervising appraiser's license could be flagged with an additional designation.

In closing, caution needs to be exercised in this arena. It is tempting to reduce costs via the use of a trainee appraiser, however, if it is done at the expense of credible assignment results then the risk may not be worth the reward. As we have learned from the past, not all supervising appraisers are diligent in their review and correction of trainee work resulting in the delivery of questionable appraisal results and findings.

In order to prevent a repeat of past mistakes in regard to the quality of work completed by a trainee appraiser, the supervising appraiser should be required to complete more than a signed affidavit. In the past, becoming a trainer appraiser was viewed as being too easy by many and appeared to be a method to substantially increase profits, with minimal input or oversight. The previous trainer-trainee process does not appear to include enough safeguards, if any, for the quality of work performed, and limitations on the number of trainees per mentor.

17. What are the roadblocks to appraiser trainee education, experience and securing mentors?

Being licensed by the state is the first road block for most trainees. Then, there is substantial cost for the education, experience, equipment, insurance and license. A significant barrier is gaining adequate appraisal experience to become a licensed appraiser. To gain the experience, a trainee must obtain a mentor supervisory appraiser to provide guidance, review and verification. Typically, the trainee does not have an income stream or a client he or she can rely upon to get the experience. Therefore, the supervisory appraiser must supply the work. In some cases, the supervisory appraiser will train an appraiser only to see them become a competitor or the trainee is forced to relocate.

Appraisal Management Companies are not the answer, as they are typically providing assignment and delivery functions, not training appraisers for field work. Prior to licensing in the early 1990s, appraisers gained experience from a family member or friend, or obtained a staff appraiser position from a mortgage company or bank. Under current conditions, there are very few staff positions for trainees leaving association with senior (mentor) appraisers as the primary remaining

viable option. One additional avenue to experience is through county assessor offices, however, it must be noted that the mass appraisal process is significantly different than the typical processes used for lending purposes, not to mention the number of county offices that have trainee positions are also very limited.

Just as important, it is unknown if securing mentors will become easier or more difficult amid recently relaxed secondary education requirements and vastly reduced work experience standards.

18. What can banks do to assist with appraiser trainee education and experience?

While the concern of appraiser shortages is currently an issue of perception with the exclusion of rural areas, bank staff involved in the appraisal areas recognize that there may be a potential future shortage of appraisers as senior appraisers retire and sufficient mentors cannot be found.

Banks can assist with appraiser trainee education and experience in several ways. One way is to implement an internal licensing program for staff interested in pursuing the appraisal profession. Although there are additional risks to a bank associated with bringing such a program in-house, there are banks researching and implementing programs at various levels. This is typically through a combination of hours spent performing USPAP-compliant report development and review.

This would assume that a regional appraisal department, or similar structure, would be maintained within the bank. In-house appraisers were commonly relied upon in the past. Over the years, as expenses grew, these departments were closed and the services they provided were contracted to third-party organizations and/or independent fee appraisers. Bringing a Chief Appraiser or similar role back into the banking structure may serve as a strong path to allowing known appraisers to train others. This person or persons would be required to provide oversight and management of the approved appraisers and potentially an internal mentor/trainee program.

As mentioned above, banks can also allow external trainees to perform assignments, under the supervision of a trusted appraisal vendor and with prior permission. In our experience, this provides the trainee valuable experience in working with a lender client.

19. What types of loans (residential or commercial) are beyond the need for appraisals?

There are carve-outs specified in federal appraisal regulations noted in FIRREA and the resulting Interagency Guidelines as well as the recent changes adopted in April, 2018 and these were changed recently with alterations to both the definition of a federally related transaction and the allowable appraisal exemptions under these rules. Although there were outliers on both sides of the argument, the consensus was that the thresholds agreed upon by the agencies are appropriate. In all cases, the valuation is supposed to be commensurate with the risk and the bank/lender must have a policy to address these aspects.

Under appraisal regulations for banks, a lesser scope valuation constituting an evaluation is allowed up to a loan amount of $250,000 for most residential loans. This provides flexibility for smaller-dollar loans, which may also be lower-risk if they are at a low loan to value and senior lien position.

For most commercial real estate loans, a lesser scope valuation constituting an evaluation is allowed up to a loan amount of $500,000. Some banks have adopted this higher threshold, which was previously also at $250,000. Again, this provides some flexibility for lower-dollar loans. Commercial real estate is inherently more complex than residential real estate and should require a greater level of analysis compared to residential real estate. That being said, certain property types are readily valued by a single value approach and a full appraisal is above the necessary analysis to properly underwrite the loan.

There are also exemptions for properties taken as an abundance of caution and for business-purpose loans secured by real estate but for which income from the real estate is not the source of repayment. The business threshold is $1,000,000, and up to that amount a qualifying loan could be originated with an evaluation rather than an appraisal. An example of this would be an operating line of credit for a liquor store. The bank would rely on the income of the business from the sale of inventory to repay the loan, but when a business is distressed the inventory can "disappear." If the business qualifies for the line (with the inventory as collateral) but the bank takes a lien on real estate as secondary collateral, the bank can rely on an evaluation for loan amounts up to $1,000,000.

There is general agreement on the notion that the valuation analysis is important to the lending process. An appraisal provides a value-added service and a component of the risk management process. The exact type of valuation analysis and subsequent review required depends on the details of the loan transaction, which are inclusive of the value of the property or changes therein, the loan to value ratio, credit scores, debt-to-income ratios, cash flow analysis, etc. Because of the interdependency of lending institutions, among institutions and with the economy in general, there is a need for federal oversight and regulation. While not every rule and regulation is applicable to every lending transaction, national consistency and reliability with regard to risk management serve to strengthen the industry overall.

20. Should different appraisal criteria or requirements apply for portfolio loans?

The only recommended change for portfolio lending is to allow the criteria for using evaluations instead of appraisals to be governed by property type instead of a maximum loan amount. The definition of a "non-complex" residential property is defined by regulators and allows for the use of evaluations or limited-scope reports for properties that qualify, even if the loan amount exceeds $250,000. This change would allow local lenders to use their understanding of their markets to make decisions based on the overall risk of a credit transaction in a more expedient manner. This does not preclude the lender from obtaining an appraisal when an evaluation would otherwise be allowed, based either on the lender's policies or when other risk factors are present.

Evaluations are available in varying forms, from an AVM to a report similar to a restricted appraisal. In some cases, evaluations are prepared with a similar level of detail to a full appraisal report but may not be prepared by a credentialed appraiser. The type of evaluation and scope of work should be commensurate with the level of risk associated with the loan transaction. For instance, as noted in Question 24, AVMs can be relied upon when collateral risk is low to minimal in a stable or appreciating market, where the neighborhood is homogeneous and the subject property is conforming.

21. What are the pros and cons of AMC relationships?

Not all AMCs are alike but in general:
AMC Pros

- Coverage with speed
- Knowledgeable engagement process and point of contact
- Impartial review options
- Can equate to greater workflow for registered appraisers – more banks
- Relief of lender pressure
- Monitoring appraiser's work and revisions
- Encourages thought-out, concise communication that can be less emotional
- Set of required data to facilitate an order and eliminate or lessen delays and changes in scope of assignment

AMC Cons

- Less than vested interest in quality product
- Complex assignments not being assigned to competent appraisers
- All communication has an additional layer / loss of personal interaction
- Confusing for appraisers / avoided by appraisers that are able to get other work
- Ongoing bidding process and pressure driving fees down
- Fee schedules
- Erodes bank appraiser panels that become AMC panels only
- Limited vetting process to add appraisers
- Lack of support and decision-making capabilities
- Time intensive, given the layers involved
- Lack of quality control, or box-checking only
- Adding guidelines or requirements that are not client-specific

22. Should banks reinstitute appraisal departments or functions as a tool for process and quality control?

If order volume is sufficient to do this, then yes. However, it may not be cost effective for small banks. In many cases, having one coordinator along with a platform for ordering would be cost effective and allow an employee of the bank with a vested interest in compliance and obtaining quality reports to be in control of processing appraisal orders.

It has become increasingly necessary to have detailed policy or specific personnel who can consider when certain products (appraisal vs. evaluation) are appropriate given loan amount, risk and regulatory restrictions.

Recommendations – Bank clients need to educate AMC vendors in clear terms regarding who is responsible for what tasks and approvals. Education is advised for smaller community banks regarding shared services for appraisal processing.

23. How much reliance can be placed on automated valuation models?

It depends upon the size of the relevant market sample – the more reliable data available, the more accurate the automated valuation model, in most cases. Since AVMs can range from

being fairly reliable to totally unreliable, AVMs alone should not be viewed as the only source for valuation conclusions. Additionally, quality control testing is critical to the reliability of AVMs as with any evaluation or valuation product.

24. Under what conditions can regression analysis or other automated models take the place of eyes on the property, experience, and judgment?

- Low allocated loan amount
- Known market conditions
- Large enough market sample to be reliable

AVMs can be useful when there is low to minimal collateral risk in a stable or appreciating market, where the neighborhood is homogeneous and the subject property is conforming. Even then, adverse conditions, unaccounted for in AVMs, can affect the marketability and collateral strength or risk. The risk with AVMs has always been that properties with fair to poor condition will be valued at a higher than market value position and properties in good to excellent condition will be under-evaluated, even when model matches are utilized in the data set. This is generally the result of the presumption of “average” in terms of quality and condition.

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