

## **Appraisal Pressure: Toward a Workable Solution**

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During the last year, the problems in the real estate market have brought increased attention to the issue of appraisal values and the impact that improper pressure could have on the market. More than a dozen states have new laws to address the issue of appraisal independence (AI). All of the federal banking regulators have issued specific guidelines about it. The appraisal industry has lobbied Congress about it for years, and there are now proposals in Congress for new federal laws to regulate the issue.

An objective discussion of AI and appraiser pressure is needed to put it in perspective, and to develop clear, unambiguous solutions. The industry and the public deserve a workable set of rules that will be understood by all parties and have the desired result with as few unexpected consequences as possible. It will not help the problem if we overreact, or adopt vague standards that will complicate the situation further.

### **TAVMA As A Forum for the AI Issue**

TAVMA has a unique perspective on the AI issue since many of its members are appraisal management companies (AMCs) and large appraisal shops. TAVMA has followed the issue closely for years and proposed a workable solution as early as 2004. Further, we need to engage in the dialogue now, as Congress adopts new laws to address the AI issue.

This article will seek to: (1) Define the AI problem and review the current state laws that address it; and (2) Propose a workable solution and statutory proposal that could resolve the issue at both the state and federal levels. TAVMA is uniquely positioned to describe the problem, since its member companies manage millions of appraisals every year and are on the "front lines" of the issue every day. In fact, TAVMA believes that AMCs are part of the solution and can provide a critical firewall function for any new AI rules that may be required by legislation or regulation.

A second article in the next Newsletter will update TAVMA members on the status of the current federal AI proposals, as well as the recent "Code of Conduct" that has been adopted by the Government Sponsored Enterprises (GSEs, Fannie Mae and Freddie Mac.) Both the federal and GSE proposals are controversial, and the GSE Code was adopted literally as this article went to print.

### **The AI Problem**

Appraiser pressure is not a new problem. It was a key consideration in the adoption of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) and the Uniform Standards of Professional Appraisal Practice (USPAP), intended to address the savings and loan

crisis of the '80s and then used in the New England real estate meltdown of the '90s. Therefore, it is clear that the real estate industry and its regulators are still struggling to develop effective solutions to halt this longstanding problem.

The adoption of FIRREA and USPAP made the state appraisal boards responsible for licensing and regulating appraisers. USPAP contains guidelines and ethical standards that were meant to assure that appraisers performed objective, unbiased opinions of value. However, the state boards only have jurisdiction over the appraisers themselves, not the other parties involved with RE transactions. During the last 20+ years, it has been the appraiser's duty to avoid conflicts and resist improper pressure for pre-determined values. However, during the last five years, appraisers have increasingly complained to their state boards and state legislators about the pressure they are under, and many states have responded with new laws to address the issue.

### **A. The Interested Parties**

The first complicating factor in the AI issue is the number of "interested parties" involved with all purchase/sale transactions. There are three basic groups or sets of interested parties in most RE transactions - the borrower (consumer); RE agents and/or brokers (sales); and lenders and mortgage brokers (lenders and loan agents). Finally, the appraiser is needed as an "uninterested" professional to confirm the underlying value for the lender to underwrite the loan. Technically, although often forgotten, FIRREA provides that the appraiser's only "client" is the lender in loan-related transactions.

All of the interested parties want the value for the deal "to work," so the transaction can go forward. However, the appraiser must maintain objectivity and provide an unbiased opinion of value. Although the other participants have their own interests at stake, in the final analysis, the "go/no-go" decision is often made by the appraiser. So, there is an inherent tension between the appraiser and all of the other parties to the transaction. In a rising-value market, this usually does not present the same kind of trouble as can occur in declining markets.

### **B. Pressure in Rising vs. Declining Markets**

Every property seller wants his or her property to be valued as highly as possible - that's human nature. Even during upward-trending markets, sellers are often disappointed that the appraisal did not "come in" quite as high as they had hoped. But, such value differences are usually resolved, the parties come to an agreement, and the transaction closes.

Unfortunately, during declining markets, a "disappointing" appraisal value can have serious adverse consequences for all of the interested parties in a real estate sales scenario. Each of them feels pressure about the value; the seller may be found to be "underwater" on his mortgage, and unable to simply pay-it-off by selling; the real estate agent/broker will not make their fee if the deal fails, and will worry about the growing impact that RE devaluation will have on their local markets; and the mortgage broker and/or lender will not be able to receive a commission, or make a loan, respectively. Only the buyer can benefit in such a declining market scenario.

The negative impacts of a low or "cut" value in refinance transactions can be just as painful. As described currently in mainstream media, borrowers in declining markets are often unable to refinance out of adjustable-rate mortgages, or to cash-out any equity from their home, because,

for the first time in almost a decade, there isn't any equity in the property. As values faltered, and foreclosures began to rise in number, all of the parties to almost every transaction became acutely aware of the critical valuation decision. The appraised value became the key, and all eyes focused on the appraiser.

### **C. The Appraiser's Role Has Not Changed**

The appraiser is required to play an objective and uninterested role in the process. Unfortunately, during both the last period of rapid value increases and the current falling values and prices in many markets, appraisers have said that they are under increased pressure from all parties to the transaction. Recent industry surveys by October Research have confirmed this feeling among the appraisers. (Such surveys also confirm the important role that AMCs can play in managing the whole appraisal process and the AI issue specifically.)

However, it is important to note that the basic role of the appraiser as a non-interested, objective part of the RE process has not changed. The pressure upon them may have increased, but they must, to borrow a sporting phrase, "hold-the-line." Unfortunately, it has come to the point that appraisers often feel that any communication about the value is a form of improper pressure. This problem was recently addressed in a report by the Mortgage Bankers Association of America, "Appraiser Independence: Issues from a Business Perspective" (February 2008).

Therefore, it is clear that some additional guidelines are needed to more clearly address the problem. The existing rules should not be replaced, but strengthened as narrowly and objectively as possible to protect appraisers from truly improper pressure. In the final analysis, appraisers themselves must continue to make the final decisions under USPAP about the nature of the influence upon them and their value opinion.

In sum, the AI problem is not new and has been controlled by USPAP and Federal guidance for years. Improper pressure upon appraisers must be more clearly defined and prohibited. The line between appropriate communications with the interested parties and improper pressure must be drawn, so that appraisers can continue to perform their critical function in an appropriate way. New, objective definitions are needed to clearly identify and address the problem.

### **The State Law Response**

There are now at least fourteen (14) states that have laws addressing the AI issue and there are numerous new proposals being made as this article goes to print. TAVMA has tried to keep up with the various proposals, and has maintained a Survey of State AI Laws located at [http://www.tavma.org/images/tavma\\_state%20ai%20laws\\_102407.pdf](http://www.tavma.org/images/tavma_state%20ai%20laws_102407.pdf). (Note: It is maintained by volunteers and the proposals have changed and keep coming, so it should be viewed as an information tool rather than a formal compliance guide.)

One of the earliest states to address the AI issue was Arkansas, which adopted the following provisions in 2006 in the language of bills relating to guidelines for mortgage lending: "... a licensee may not fail to promptly pay for services..., (or) influence or attempt to influence through coercion, extortion or bribery the development, reporting, result or review of a real estate appraisal sought in connection with a mortgage loan ( AR HB 424 / SB 272)."

Many states have adopted similar proposals, with some adding extra defining words or restrictions upon behavior that could be pressure. Unfortunately, some states have adopted more subjective language that allows an appraiser to decide whether s/he "felt" pressured. Examples of such unworkable, subjective wording include "intimidate" and "threaten." However, California recently adopted SB 223 which follows the Arkansas model and provides a set of objective standards by prohibiting any "coercion, bribery or extortion." All other descriptive or subjective words tend to be covered by and to fall under those three, broadly defined terms. Further, those three words (coercion, bribery, extortion) define criminal behavior, are found in all state criminal codes, and have clearly defined meanings under existing state laws. The use of pre-existing and already defined terms is helpful to assure that everyone knows what they mean. That is very different than trying to define how and when someone has been intimidated, or threatened.

The state models are instructive because they were the first to recognize the problem "in the trenches." State efforts to adopt new laws have provided a valuable starting point and testing forum to evaluate the language and options available to address AI. A recent proposal in South Carolina is instructive. HB 4596 would include all of the interested parties to a real estate transaction as subject to the new law. It would ban "coercion, bribery and extortion" as improper pressure, but added "blacklisting, boycott, intimidation and threat" as newly defined offenses as well as "comp checking." It would make such offenses an unfair trade practice under SC state law.

Although definitions for the above, new terms are provided, they will not be able to clarify the personal, subjective issues that often arise when an appraiser "feels" intimidated. Or, when an appraiser has performed poorly by objective criteria in related to value issues, and is placed on a "watch list," that action should not be assumed to be improper. However, some of the SC proposal has merit and, hopefully, it can be amended to eliminate the unworkable, subjective language and focus upon the clear prohibition of improper coercion, bribery or extortion. As of the time of this article, it appears that the bill has died in committee in the SC General Assembly. TAVMA will coordinate future discussions with the sponsors and other interested parties to arrive at a more workable alternative.

A similar bill is now pending in Hawaii, and there are numerous other states that have already adopted new, subjective AI language, referenced above. Unfortunately, there has been no coordination of the state AI proposals, and they contain many different definitions and solutions to the AI problem. After considering all of the options developed in the "laboratory" of state legislatures, TAVMA believes that the AR and CA models provide the best, most workable proposals.

### **TAVMA's Position**

As we stated in a letter to Representative Paul Kanjorski last November, in commenting upon the federal AI proposals contained in H.R. 3837: TAVMA has worked diligently to advance a uniform definition of what constitutes improper client pressure on appraisers. Several states, most recently California, have adopted language within appraisal legislation that defines illegal client pressure in this way: "No person shall knowingly bribe, coerce, or extort a certificate holder or licensee for the purpose of corrupting or improperly influencing the independent judgment of the certificate holder or licensee. However, this section shall not prohibit a lender,

mortgage banker or mortgage broker from asking the appraiser to do one or more of the following: (1) consider additional, appropriate property information, (2) provide further detail, substantiation or explanation for the appraiser's value conclusion, or (3) correct errors in the appraisal report."

TAVMA believes that the use of the legally defined terms bribe, coerce, and extort is far preferable to overly subjective words like intimidate, instruct, compensate or influence that can undermine the effectiveness of state anti-pressure statutes. TAVMA believes that its position on appraiser independence and inappropriate client pressure is the most common-sense and legally enforceable position on the issue. Moreover, we are convinced that the appraisal management industry is uniquely positioned to keep the appraiser and client at arms-length.

Since writing that letter, the increasing proposals for state AI laws have continued to demonstrate the national nature of the problem, which calls for a federal solution. H.R. 3837 is still pending in Congress, and TAVMA members should stay informed about this important issue. Whatever is adopted during 2008 could drastically change the way that appraisal work is conducted throughout the country.

### **Conclusion**

When FIRREA and USPAP were adopted, the individual appraiser was required to carry the ethical burden of avoiding pressure and resisting any influence that might affect an objective appraisal. Now, state legislatures have increasingly decided that more regulation is needed to assure that appraisers are protected from improper pressure. TAVMA believes that an objective federal response is needed as soon as possible, and that AMCs should play an important role in the overall solution. Perhaps AMCs should employ more licensed, staff appraisers to assure that AI issues are a higher priority. AMCs could also offer another service to address the AI problem: AMCs should create AI Hotlines or call-in numbers for appraisers to complain about improper pressure. This type of value-added service does not require legislation to implement, and would be a logical new service to add to the AMC business model.

During the last year, and for the next two years at least, most observers of the RE industry expect a significant increase in the number of foreclosures. Delinquency and default rates are moving higher, and RE values continue to soften. Just as there has been "pressure" felt by the appraisers, our elected officials at both the state and federal levels are being lobbied heavily for sweeping reforms and consumer assistance programs. Unfortunately, this type of crisis mentality can lead to overreaction and short-sighted solutions with unintended consequences for the longer term. Whatever wording is finally chosen, it must be clear and understood the same way by all who read it: the wording must be chosen carefully to eliminate ambiguity. Personal or subjective "feelings" and interpretations must be avoided to be workable.

TAVMA urges Congress to take a step-back from the current rush to solutions. As described previously herein, there are workable solutions to the AI problem, but there are others that go too far and could create untenable requirements for the RE and mortgage lending industries. We urge Congress to have the GAO study the problem and for a rational discussion of the objective standards that will be needed to resolve the AI issue. It is clear that only a federal solution will be able to effectively address the AI problem, with preemption, so that inconsistent state laws will

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not create a "Balkanized," patchwork effect. Federal law and regulations have always formed the backbone for issues of national scope and for the appraisal industry in particular.

Finally, TAVMA believes that the AMC business model is actually a part of the solution. AMCs acting as a "middle manager" between the parties involved in the appraisal process should be able to provide a guarantee of separation and control over the appraisal pressure issues. AMCs may be the only way to effectively control the parties, the ordering process and the appraiser's ability to avoid pressure and deliver an impartial appraisal.

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