

Home Valuation Code of Conduct

Myths and Realities

The Home Valuation Code of Conduct (HVCC) was effective on May 1, 2009. As of that date, institutions that deliver loans to Fannie Mae or Freddie Mac must represent and warrant that the appraisals obtained adhere to the requirements found in the HVCC regarding appraisal management, ordering and review by lenders.

For more information on the HVCC, visit the following websites:

- Fannie Mae (HVCC and Frequently Asked Questions)
<https://www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/appcode/>
- Freddie Mac (HVCC and Frequently Asked Questions)
http://www.freddiemac.com/singlefamily/hvcc_faq.html
- Federal Housing Finance Agency
<http://www.fhfa.gov/webfiles/277/HVCC122308.pdf>

The release of the Home Valuation Code of Conduct has raised many questions on the part of lenders, appraisers, and others involved in mortgage lending activities. Lenders that sell loans to Fannie Mae or Freddie Mac are likely reviewing their internal appraisal operations, and some may have to retool or restructure their operations to achieve compliance.

Unfortunately, there is confusion and misinformation in the marketplace regarding HVCC compliance and appraisal policies in general, particularly in regard to use of third party vendor management firms. To help bring clarity to these issues, the information below is intended to identify some of the myths we have identified and state the reality. There will likely be additional questions on this issue in the coming weeks and months. For further information, please contact: insidethebeltway@appraisalinstitute.org.

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Home Valuation Code of Conduct – Myths and Realities

Updated: September 2, 2009

Myth: The HVCC requires lenders to use Appraisal Management Companies.

Reality: Use of appraisal management companies is not required under the Home Valuation Code of Conduct (HVCC). Lenders may engage appraisers directly without the use of third parties.

Myth: Mortgage sellers cannot achieve compliance without outsourcing the appraisal function.

Reality: Sellers may achieve compliance by establishing meaningful risk management practices, including separation between risk management (appraisal) and loan production. The Code requires that loan production staff not be involved in ordering the appraisal. This separation is currently required under existing federal bank regulation.

Myth: “Loan Correspondents” or “correspondent lenders” are the same as mortgage brokers and they too cannot order appraisals.

Reality: Unlike mortgage brokers, loan correspondents fund loans in their own name and, therefore, have “skin in the game.” They are allowed to order appraisals on loans sold to Fannie Mae and Freddie Mac like other sellers that fund loans in their own name or with their own funds. Mortgage brokers no longer will be able to engage real estate appraisers directly.

Myth: Sellers cannot maintain the appraisal function internally (as an in-house operation), without loan production involvement.

Reality: There are several ways in which sellers may staff appraisal functions internally without outsourcing the function to a third party, so long as they maintain separation between risk management functions and loan production staff. To achieve compliance the appraisal function should report to an individual or department outside of loan production. Some examples of eligible individuals or entities within institutions include, but are not limited to, the following:

- the risk management department,
- the credit department,
- the consumer lending department (with no loan production responsibilities),
- the compliance office, or
- the chief executive office.

For many institutions, the HVCC will not require any changes. However, whether the appraisal function is a fully staffed appraisal department or an individual assigned with the appraisal responsibility, the function can be maintained internally where the reporting line is to someone other than loan production (e.g., any of the entities listed above). Sellers also should make sure that their policies are in compliance with any applicable federal bank regulatory policies by contacting their appropriate bank regulatory agency.

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Myth: Loan Production staff is prohibited from communicating with appraisers.

Reality: Loan production staff may communicate with the appraisers, but they cannot be involved in selecting, retaining, recommending or influencing the selection of any appraiser for a particular appraisal assignment. Further, loan production staff cannot have any “substantive communications with an appraiser or appraisal management company relating to or having an impact on valuation, including ordering or managing an appraisal assignment.”

Myth: Outsourcing appraisal functions to an appraisal management company can reduce costs.

Reality: Given the diversity in the size and structure of lending institutions, it is difficult to conclude that outsourcing necessarily will reduce costs. Lenders incur costs for appraisal risk management whether done in-house or outsourced. Lenders should consider all the costs of compliance, including the costs associated with ensuring appraiser competence and appraisal quality, before making a decision to outsource their risk management functions.

Myth: Outsourcing appraisal management to a third party reduces lender risk.

Reality: Federal bank regulatory agencies have cautioned against reliance on third-party relationships by reaffirming that such relationships may significantly *increase* a bank’s risk profile, notably its strategic, reputation, compliance and transaction risks¹. According to federal banking guidelines, “Increased risk most often arises from poor planning, oversight and control on the part of the bank and inferior performance or service on the part of the third party, and may result in legal costs or loss of business. To control these risks, management and the board must exercise appropriate due diligence prior to entering the third-party relationship and effective oversight and controls afterward.”

***NEW!!* Myth: Appraisers must complete appraisal assignments in compliance with the HVCC, or present a certificate to lenders or appraisal management companies certifying that the appraisal was prepared in compliance with the HVCC.**

Reality: The responsibility to ensure compliance with the HVCC for all loans intended for sale to Fannie Mae or Freddie Mac rests with the lender (Section VIII of the HVCC). There is nothing in the HVCC that requires appraisers to take any “pre-engagement” actions to ensure that their business is “HVCC Compliant”. The appraiser’s only responsibility is to ensure that each appraisal performed for the lender or AMC is performed in accordance with the Uniform Standards of Professional Appraisal Practice.

It is possible, however, that a lender or an AMC may ask an appraiser to certify that the lender or AMC acted in good faith to comply with the provisions of the HVCC in its dealings with the appraiser on a specific appraisal assignment. For example, a lender or an AMC may ask the appraiser to certify that the lender or the AMC did not improperly influence, or attempt to improperly influence, the outcome of an appraisal by doing any of the things prohibited by Section 1(B) of the Code. However, there is nothing in the HVCC that specifically requires or prohibits lenders from obtaining these assurances from an appraiser.

¹ OCC Guidance Cautions National Banks on Third Party Relationships. (2001, November 2). Office of the Comptroller of the Currency, United States Department of the Treasury. Available at <http://www.occ.treas.gov/ftp/bulletin/2001-47.txt>

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Myth: Use of third party vendors ensures the use of competent appraisers.

Reality: Lenders traditionally have been responsible for ensuring the competency of the appraisers and reliability of the appraisals they use for credit decisions. However, the competency of an appraiser is not measured by scoring compliance with seller servicer guidelines. Processing appraisal orders is a separate function that does not specifically include a review of competency. The function of competency review is best performed by individuals with significant education in appraisal standards and theory.

Further, institutions should consider any potential reductions in quality that might result from outsourcing the appraisal function. To this point, federal bank regulatory agencies recently reminded institutions to consider an appraiser's competency for any given appraisal assignment.²

Myth: The licensing of an appraiser ensures his or her competency.

Reality: Licensing does not necessarily ensure the competency of an appraiser. The Fannie Mae and Freddie Mac Selling Guides require lenders to review the appraiser's education and experience. Specifically, the Fannie Mae Selling Guides state:

*"A lender must not assume—simply based on the fact that an appraiser is state-licensed or state-certified—that the appraiser is qualified and knowledgeable about a market area or is aware of the appropriate market data sources for the area and will be able to obtain access to them. If an appraiser is not knowledgeable about a particular location, is not experienced in appraising a particular type of property, or is not familiar with (or does not have access to) the appropriate data sources, a lender should not give the appraiser assignments in that market area or for that particular type of property."*³

Myth: The HVCC requires that lenders and appraisal management companies utilize rotational panels in making appraisal assignments.

Reality: The HVCC does not require the use of a rotational list of approved appraisers by lenders and appraisal management companies. Appraisers should not be selected for an assignment just because they are "next on the list." Further, lenders are under no obligation to expand the number of appraisers on their appraiser panels as a result of the HVCC. Instead, lenders and AMCs should select the appraiser on their panel that is most qualified and competent to complete the specific assignment. According to Freddie Mac Bulletin 2009-18, "Appraisers must be familiar with the local market in which the property is located, must be competent to appraise the subject property, and must have access to the data sources necessary to develop a credible appraisal." The Freddie Mac Bulletin further states that "Some markets or properties may require that the appraiser have access to non-traditional data sources in order to provide the Seller with a credible appraisal. In such cases, the Seller should ensure that the appraiser has access to the necessary market data to support any conclusions about the market." Lastly, Freddie Mac states that "Sellers should consider membership in a professional appraisal organization as a qualification criterion", but that it should not be the only factor used in selecting an appraiser for an assignment.

² 2006 Revisions to the Uniform Standards of Professional Appraisal Practice. (2006, June 22). OCC, FRB, FDIC, OTS, NCUA. Available at <http://www.occ.treas.gov/ftp/bulletin/2006-27a.pdf>

³ Knowledge and Experience Requirements. (2003, August 24). Fannie Mae Single Family Selling Guide, XI, 101.02. Available at www.efanniemae.com

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Myth: Real estate brokers and agents are prohibited from communicating with appraisers even if they have no direct interest in a specific sale.

Reality: Real estate agents and brokers, both those directly involved in a transaction and others that are contacted by an appraiser, provide information to an appraiser that is invaluable to the appraiser in developing an accurate and reliable opinion of value. This includes information related to closed and pending sales, terms & conditions of sale, etc. Without this information, an appraiser has a much more difficult time developing an accurate and reliable opinion of value. Agents and brokers, including those that have a direct interest in a transaction, are permitted to communicate with an appraiser and to provide additional information to an appraiser, so long as the communication and information is done in a way that is not intended to influence the outcome of the appraisal.

Myth: Every person on a lender’s staff, all third parties (i.e., AMCs) authorized by the lender, and other persons/entities directly involved in the transaction are prohibited from communicating with an appraiser.

Reality: The lender’s staff, the staff of an authorized third party, and any other party in the transaction may communicate with an appraiser to correct factual errors in an appraisal report. Further, anyone who is not part of the lender’s loan production staff or who is not compensated on a commission basis upon the completion of a loan, or anyone who does not report to any officer of the lender not independent of the loan production staff or process may communicate with an appraiser. Appraisers are also permitted to receive other market information for consideration in the analysis, such as closed and pending sales, terms & conditions of sale from real estate agents, home builders, home inspectors, and other third parties. These entities may communicate with an appraiser so long as the information provided by the party is presented in a way that is not seeking to influence the appraisal results.

Myth: Professional appraisal designations cannot be used when evaluating the qualifications, education and experience of an appraiser.

Reality: The Fannie Mae Selling Guides state that designations may be helpful in evaluating an appraiser's qualifications, particularly when the designation is from a nationally recognized organization. Specifically, the Fannie Mae Selling Guide states:

“Professional appraisal designations can be helpful to the lender in evaluating an appraiser’s qualifications, particularly when the designation is from a nationally recognized organization that has formal experience, education, and ethics requirements that are strongly administered. If the lender considers an appraisal designation in its evaluation, it should be familiar with the appraisal organization’s specific requirements to ensure that the designation is evaluated appropriately.”⁴

In addition, Freddie Mac Bulletin 2009-18 includes consideration of membership in a professional appraisal organization as a “best practice” in evaluating appraiser qualifications.

⁴ Selection of Appraisers. (2002, June 30). Fannie Mae Single Family Selling Guide, XI, 101. Available at www.efanniemae.com

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Myth: “Comp checks” which are prohibited under the HVCC without an engaged appraisal assignment are the only way to determine if there is sufficient value in the collateral before proceeding with a loan application.

Reality: Lenders often want to know if there is sufficient value in the collateral before proceeding with a loan application. To determine this in the past, lenders and brokers would request “comp checks” of the appraiser. The HVCC bars lenders from ordering “comp checks” without engaging an appraiser in an appraisal assignment.

Lenders may engage appraisers in appraisal assignments that involve a scope of work that is significantly narrow. For example, the appraiser could provide an answer to the question “is the property worth at least \$XX” or “is it within a certain range,” rather than a single point value estimate? This still would be an appraisal; the appraiser would need to complete the necessary research and analysis to answer such a question, and would have to document that analysis properly. Alternatively, the appraiser could be engaged in a consulting assignment to provide raw data to the client to help with their analysis.

***NEW!!* Myth: The HVCC applies to all mortgage situations, including commercial appraisal engagements.**

Reality: The Home Valuation Code of Conduct applies to lenders selling 1-4 single family loans to Fannie Mae or Freddie Mac. It has no applicability to commercial mortgage appraisals.

Final Note: The HVCC is intended to promote independence in the appraisal process and, thus, help ensure that appraisers and the appraisal process may be relied upon as part of sound underwriting for financial institutions.

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