



Testimony presented on behalf of the

**Appraisal Institute
American Society of Appraisers
American Society of Farm Managers and Rural Appraisers
National Association of Independent Fee Appraisers**

**Before the Senate Committee on Banking
Subcommittee on Housing, Transportation and Community Development**

On

"Ending Mortgage Abuse: Safeguarding Homebuyers"

Presented by

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Joint Testimony Presented by
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Committee on Banking, Housing and Urban Affairs
United States Senate

Chairman Schumer, Ranking Member Crapo, and members of the Subcommittee on Housing, Transportation and Community Development, I am Alan E. Hummel, SRA, Senior Vice President and Chief Appraiser of Forsythe Appraisals, LLC in Minneapolis, Minnesota. I am the Chair of the Appraisal Institute's Government Relations Committee and Past President of the Appraisal Institute. Today, I am pleased to be here on behalf of the Appraisal Institute, American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, and the National Association of Independent Fee Appraisers, the four largest professional appraisal organizations in the United States, representing 30,000 real estate appraisers.

Thank you for the opportunity to testify before this subcommittee hearing on "Ending Mortgage Abuse: Safeguarding Homebuyers" addressing disorders in today's mortgage market. People have lost their homes to foreclosure, entire segments of the mortgage market have collapsed, and mortgage fraud has surged. Neighborhoods throughout the country have been devastated by mortgage lending abuse. The practices creating these problems must stop.

For years, professional real estate appraisers have been warning Congress about the endless schemes perpetrated on consumers and lenders by real-estate rogues, including some mortgage lenders, mortgage brokers, realty agents, title officials, and investors. Bad appraisers deserve blame, too. Too often, appraisers, either through incompetence or by turning a blind eye, facilitate bad mortgage loans. The entire real estate industry faces critical problems. We urge Congress to curb these abuses.

We believe that much of the mischief grows in the boundary dividing those segments of the real estate industry that are regulated from those that operate without effective oversight.

Real estate appraisers call your attention to three problem areas in this context:

- 1) Disparate oversight and regulation of mortgage brokers and mortgage lenders;
- 2) Systemic appraiser coercion, and
- 3) Weak regulation of real estate practitioners.

Let me describe these issues in more detail below, with suggestions for remedies.

Disparate oversight

Our organizations are deeply concerned with the disparity of oversight and regulation of the appraisal process in the mortgage market today. There are rules governing federally regulated financial institutions, but virtually none for all other mortgage originators in the marketplace. Greater appraisal problems spring up in the unregulated wilderness.

Pursuant to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), federally regulated financial institutions must maintain independent appraisal processes. Individuals within these institutions responsible for making final loan decisions are prohibited from playing a role in the appraisal management function. For example, a loan officer signing off on a loan decision cannot also be the person ordering and reviewing the appraisal. These rules attempt to enact an effective institutional “firewall” for appraisal independence.

After identifying widespread breakdowns in appraisal independence, lately federal bank examiners have been forced to issue guidelines reminding federally regulated institutions of their appraisal independence obligations, reemphasizing the need to maintain independent appraisal processes in mortgage transactions. The federal bank regulatory agencies are to be commended for identifying and addressing this issue. Yet our members still report problems with bank staff with a vested interest in a transaction controlling the appraisal process inappropriately. To work, the guidelines must be rigorously enforced.

Yet members find that such noncompliance isn't the biggest appraiser coercion problem. Different rules—or no rules at all—commonly govern entities under state jurisdiction, especially mortgage brokers and non-bank mortgage lenders. Except for the few states prohibiting appraiser coercion, intimidation, and bribery, we are not aware of any state-mandated appraisal management requirements for either non-bank mortgage lenders or mortgage brokers.

Today, unscrupulous lenders and brokers have a totally free shot at the appraisal. They can coerce, pressure, entice, or conspire with appraisers, virtually without consequences. As a result, many deem appraiser coercion the way to do business. Too many brokers and lenders unfortunately view the appraisal process as something to be manipulated.

We stand against such cynicism. Professional appraisers treasure their integrity and take great pride in upholding strong ethics as a critical part in the mortgage financing process. To preserve an independent appraisal process, we believe that this gaping hole must be closed.

Appraiser coercion

Appraiser pressure has received a great deal of media attention in recent months, and it was the subject of an independent study conducted earlier this year by the October Research Corporation. This study found that 90 percent of appraisers were pressured by mortgage brokers, lenders, realty agents, consumers and others to raise property valuations to enable deals to go through. This was nearly double the abuse findings of a similar study three years ago. Moreover, the survey found that 75 percent of appraisers reported “negative ramifications” if they did not cooperate, alter their appraisal, to provide an artificial valuation. The prime culprits of pressure, according to the survey, were mortgage brokers (71 percent), real estate agents/brokers (56 percent), consumers (35 percent), lenders (33 percent), and appraisal management companies (25 percent). Pressure comes from every direction. We must do everything we can to ensure an independent appraisal process in mortgage transactions. We cannot do that in a market half-regulated.

Pressure is especially strong when appraisals are delivered to parties whose compensation depends on getting people to the closing table to complete the sale and mortgage. If the loan doesn't close, these parties don't get paid. They do what they can to be sure they get paid.

Unfortunately, these parties with a vested interest in the transaction are often the same people managing the appraisal process within many financial institutions, and therein is a terrible conflict of interest. In this situation our members experience systemic problems with coercion. Appraisers are ordered to doctor their reports or else never see work from those parties again.

Coercion can be subtle or blatant. Some parties boldly demand overlooking material issues or conditions to make the appraisal arrive at the desired number - or else. Such direct threats typically occur over the phone or through an informal communication. And as a result, it is very difficult to document instances of inappropriate pressure on appraisers.

I have personally experienced such threats. On several occasions clients have told me that failing to comply with their wishes will result in my firm's not being paid or never receiving work from that institution in the future. In these cases, for not bowing to these pressures, I lost clients and was not paid for my services. I am one of many appraisers with this experience.

Our organizations are also concerned about the subtler practice of "blacklists" or "exclusionary appraiser lists," particularly when they are used as levers to pressure appraisers. It is one thing to maintain a list of reputable businesses to work with, or to maintain a list of firms to avoid as the result of poor performance; it is another to place an appraiser on an exclusionary list for no other reason than the appraiser failed to hit a predetermined value.

Subtle tactics may fall short of outright coercion, but the implication is the same. For instance, it is common for a client to ask an appraiser to remove details about the material condition of the property to avoid problems in the underwriting process. However, doing so would amount to a violation of appraiser ethical requirements. Just last week, I received the following email from a broker client:

Greetings,

I have a question on the following: "...with the exception of an area of the front porch flooring which decayed. According to the owner, the basement gets some dampness during storms through the newer area of the foundation..." Page 1 of 6.

Do you guys know Appraisals 101? This statement should never be on the report. Now we face a big problem with the lender here and this makes the customer very unhappy as well.

This decayed area, is this essential to notice? What if it was covered with a rug?

*I need to know what to do here. How can you help us get this in line? What is the exact problem? What is cost to cure?
Anything?*

Please respond ASAP.

Thanks.

I can assure members of the Committee that the cost to “cure” the decaying front porch flooring is a little more than the cost of an area rug to cover up the damage.

Weak or non-existent enforcement

Where there are few rules prohibiting appraiser coercion, little enforcement takes place. Outside of some diligent law enforcement officials and observant legislators who have recognized the importance of maintaining appraisal independence, we see very little enforcement occurring on these issues. For several years, our organizations have highlighted the importance of this issue on the state level, achieving some results.

For instance, the issue between 40-plus states and Ameriquest largely involved breakdowns in appraisal independence. Investigators found that, between 1999 and 2005, Ameriquest employees deceived thousands of consumers with high-pressure tactics to boost their monthly quotas and commissions. Consumers accused the company of engaging in unfair and deceptive lending practices such as misrepresenting the actual amount of interest, inflating their home appraisals, delaying funding of consumers' loans after closing and failing to clearly disclose fees or penalties associated with paying the loans off ahead of schedule.

In the settlement, Ameriquest denied all allegations but agreed to adhere to new standards to prevent what the states alleged were unfair and deceptive practices. Ameriquest had to overhaul its appraisal practices by removing branch offices and sales personnel from the appraiser selection process, by instituting an automated system to select appraisers from panels created in each state, by limiting the company's ability to get second opinions on appraisals, and by prohibiting Ameriquest employees from influencing appraisals.

In the past twelve months three states passed laws prohibiting brokers and lenders from pressuring appraisers to reach value. Last June, Ohio passed a law that prohibits a person or business from improperly influencing the judgment of an appraiser with respect to value. Following suit, the Attorney Generals of two other states, backed by our chapters, pushed for the passage of similar provisions. The Colorado legislature passed a bill that says no person shall improperly influence an appraiser, while Iowa passed a more extensive provision, banning appraiser coercion or attempted appraiser coercion. These laws join the list of state laws

protecting appraisers from undue pressure, in Arkansas, Kansas, North Carolina, Utah and West Virginia. Legislatures and public officials in other states are exploring similar actions.

The new Ohio predatory lending law has produced the recent indictments of 10 mortgage brokers, mortgage lenders and an appraisal management company, charged with improperly influencing the appraisal process. New York's attorney general is now investigating whether home appraisers were improperly pressured by mortgage brokers and lenders to inflate estimates, damaging the New York real estate market's integrity.

Outside of these cases, we are not aware of any administrative action taken by a state regulator of mortgage lenders, mortgage brokers or others involving improper influence over the appraisal process. However, this may change as the result of the recent laws passed in the last year, and several others currently pending in Michigan, California, and Florida.

Other problems

Other mortgage market problems certainly involve appraisals. State appraisal regulators indicate that identity theft of appraiser license information numbers has increased substantially. As many as 30 percent of complaints against appraisers pending in some state appraiser regulatory agencies involve it. This is consistent a recent report by the Financial Crimes Enforcement Network (FINCEN) that from 2004 to 2005 identity theft in mortgage fraud cases doubled.

It is also very difficult for non-bank personnel like appraisers to report instances of fraud. Suspicious Activity Reports (SAR) are available only to bank staff, and no such document exists for other parties to a transaction. Appraisers, as eyes and ears of lenders, would benefit by the development of a SAR for Non-lenders.

Solutions

Given the multitude of issues identified above, and others with an impact on abusive mortgage lending, we believe the solution requires a multi-faceted response by Congress and the entire real estate industry. All told, we believe that current mortgage lending abuses could be curtailed by the following actions:

- Establishing a single, legally defined and enforceable standard for all parties on appraiser coercion and appraisal independence;
- Enforcing the rules aggressively against bad actors throughout the real estate industry;
- Strengthening appraiser regulation; and
- Educating better all parties about the inter-related processes and issues.

Single Standard on Anti-Appraiser Coercion

We live in a world split between two different standards for appraisal independence and appraiser coercion. One segment is relatively robust, monitored by federal bank regulators; the other devoid of such protection, with alarming results.

By and large, we believe the federal bank regulatory agencies have it right. Their guidelines separate those ordering appraisals and managing the appraisal process from those signing off on final loan decisions. Whether these guidelines get enforced as rigorously as they should is one question, but overall, these regulatory agencies have identified the core issue and have established rules to address it.

All parties involved in the appraisal ordering process should have minimum requirements regarding its management, including a ban on appraiser coercion, intimidation and bribery. We support the following actions:

- The Federal Reserve, in their current efforts to establish a definition of “abusive lending practices,” should include an anti-appraiser coercion requirement applying to all parties in a real estate transaction. We encouraged the Federal Reserve to do such in their public hearing held on June 15, 2007;
- Development of state appraisal independence guidelines similar to those established by the federal bank regulators. This would be similar to the recent efforts by the Conference of State Bank Supervisors, which developed guidelines on nontraditional mortgage loan products for their member institutions.
- Federal licensing or registration requirements, including a minimum standard for appraisal management and anti-appraiser coercion. This would be an extension of

the state laws recently passed in Ohio, Colorado, and Iowa, which impose an anti-appraiser coercion requirements on mortgage lenders or mortgage brokers; and

- Accountability measures for those with the privilege of ordering and reviewing appraisals, or so called, "Lender/Broker Accountability."

These measures can crack down decisively on appraiser coercion.

Lender accountability provisions, a version of which is included in the Borrower's Protection Act, S. 1299, are important. Among other improvements, this provision would impose good faith and fair dealing requirements on mortgage originators with regard to the appraisal process.

As an overall policy, we recommend that Congress be as consistent as possible to established policy by the federal government. The Department of Housing and Urban Development has relevant rules. In 2005, the Federal Housing Administration issued Mortgage Letter 2005-06, entitled, "Lender Accountability for Appraisals." With this policy, FHA established a standard of accountability to which lenders, sponsor lenders, and loan correspondent lenders are held that is the same as the standard used to impose civil money penalties for program violations. That standard is one of knowing (actual knowledge) or having reason to know. In other words, if lenders knew, or should have known about a deficient appraisal, they are held accountable by FHA. We encourage the Subcommittee to review this policy and enact policies consistent with this standard.

We also believe the prohibited practices section of S. 1299 could be strengthened along the lines of the recently enacted states law prohibiting appraiser coercion. Such laws prohibit legally recognized and enforceable terms such as coercion, intimidation, extortion, and bribery of appraisers. In addition, given the increased propensity of appraiser identity theft, we suggest that penalties against stealing the identity of an appraiser be added here as well.

Bonding Requirement Implications

Troubled as we are with appropriate regulatory improvements, our organizations are concerned with the de facto bond requirement for residential real estate appraisers contained within the bill. It would require appraisers to carry a qualifying bond for no less than 1 percent of

the aggregate value of all homes appraised by a home appraiser in the preceding year. In many ways, the typical aggregate appraisal value would require a bond—essentially a line of credit—of over \$1.5 million. According to estimates provided to our organizations, this would result in \$10,000 to \$40,000 in annual out-of-pocket expenses per appraiser. Since 98 percent of real estate appraisal firms are small businesses, the cost would either be passed on to consumers or drive many appraisers to simply leave the profession altogether. Consumers simply can't afford it.

Appraisers already face significant federal and state regulation. Congress requires them to be licensed or certified by state appraisal boards. They are required to pay annual appraiser licensing fees, and they are subject to state appraiser licensing laws, which include the Uniform Standards of Professional Appraisal Practice (USPAP). These standards carry the force of law, and many appraisers lose their licenses every year as the result of USPAP violations or other transgressions.

Several additional federal statutes can apply to appraisers. They certify to this with every home appraisal they prepare, specifically, when signing an appraisal report on any of the standard appraisal report forms. For instance, Certification #25 of the Uniform Residential Appraisal Report form, which is the flagship appraisal form for single-family appraisals, mandated by Fannie Mae and Freddie Mac, requires the appraiser to certify to the following:

“Any intentional or negligent misrepresentation(s) contained in this appraisal report may result in civil liability and/or criminal penalties including, but not limited to, fine or imprisonment or both under the provisions of Title 18, United States Code, Section 1001, et seq., or similar state laws.”

We urge that the bonding provision of S. 1299 be removed.

Aggressive Enforcement of Mortgage Fraud

Federal bank regulators and law enforcement officials need more resources to conduct enforcement activities. With SAR filings climbing through the roof, these agencies are overwhelmed with cases. Our members report that many agencies are turning down legitimate fraud referrals because they can't afford to pursue them.

There are several provisions of the STOP FRAUD Act, S.1266 that we suggest could be helpful in addressing mortgage fraud, including establishment of a central database of mortgage professional licensees, funding for enforcement, and resources for appraiser oversight by state appraiser regulatory agencies.

In addition, the federal bank regulators through the bank examination process must enforce existing regulations relating to appraisal independence. We urge the federal bank regulators to emphasize wherever possible the importance of appraisal independence, as they did in their recent statement on nontraditional mortgage loans. So far, however they have failed to follow suit in the draft statement on subprime mortgage lending.

Strengthen Appraiser Regulation

The appraiser regulatory structure currently suffers from significant weaknesses. Title XI of FIRREA needs to be updated, because it maintains day-to-day oversight over real estate appraisers. Yet its shortcomings actually are contributing to appraiser involvement in mortgage fraud. Federal and state appraiser regulators lack adequate tools and resources to properly oversee appraiser licensing and enforcement. Consequently, complaints against appraisers often languish unresolved before state appraisal boards, with virtually no ramifications.

Title XI of FIRREA addressed the weaknesses identified in 1989 regarding real property appraisals used in connection with federally related transactions. Prior to FIRREA, only a smattering of states regulated appraisals and the appraisers who performed them, and poor quality appraisals contributed to the numerous bank and savings and loan failures during that time. Title XI sought to address this situation, creating a unique appraisal oversight structure that involves private, state and federal entities. The Appraisal Subcommittee is part of that structure.

The most recent Annual Report of the Appraisal Subcommittee, the federal appraiser regulator, finds that more than 60 percent of the state appraiser regulatory agencies failed to uphold their 2006 enforcement responsibilities. Fourteen of the 23 states audited by the Appraisal Subcommittee did not resolve complaints expeditiously or did not adequately document enforcement files. Unfortunately, the Appraisal Subcommittee offered only a cursory summary of

these important points. Enforcement at the state regulatory level is vital to the success of the appraisal regulatory program.

Despite its brevity, the report appears to support the structural changes to Title XI that our organizations continue to advocate. In fact, we believe this report is evidence that the existing appraiser regulatory structure, including the Appraisal Subcommittee and the state appraiser regulatory agencies, needs to be enhanced in order to conduct meaningful oversight of licensed and certified appraisers. For several years, our organizations have called on Congress to enact reforms to Title XI to provide resources to state appraisal boards to support enforcement activities, increase the regulatory authority of the Appraisal Subcommittee over state appraisal boards, mandate public disclosure of the results of all field reviews of state appraiser regulatory agencies, and encourage use of professionally designated appraisers.

Education & Best Practices

The industry as a whole must improve communication and understanding among the components of real estate financing. Lenders and brokers ordering appraisals should understand basic appraisal processes, while appraisers should understand how their work product is being used by lenders and brokers and for underwriting purposes. Consumers deserve to have a full understanding of the documents they are signing. They should know whether multiple appraisals were performed for their loan, and why they were ordered. We support more resources being applied to consumer education about the mortgage process.

We are circulating an industry-wide statement of “best practices” on real estate appraisals and mortgage lending, which we believe is crucial to educate all parties involved about the importance of an independent appraisal process. We hope we can work with our industry partners to jointly develop and adopt such a statement for all major participants involved in the mortgage lending appraisal process.

Finally, we would be remiss if we did not point out that many of the problems associated with bad loans could be avoided if competent appraisers were retained to begin with. Of course, people determined to commit mortgage fraud will find ways to accomplish their schemes; yet it is important to emphasize that reputable parties can avoid problems much more effectively and

efficiently by incorporating mitigation techniques. One way to accomplish this is by hiring a competent appraiser.

Appraiser competency should not bow to cost and turn-around time. The federal bank regulators have attempted to emphasize this in recent years, but we face an uphill battle if participants continue to view the appraisal process as they do. We ask Congress to encourage reputable parties to seek out professional appraisers, including appraisers who hold designations from professional appraisal organizations like ours, in addition to any minimum credentials required by law.

Thank you.