

Testimony of
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Chief Executive Officer, Iowa Residential Appraisal Company
Des Moines, Iowa

On Behalf of the
Appraisal Institute
and the
American Society of Farm Managers and Rural Appraisers

Before Subcommittee on Housing and Transportation
Of the
Senate Committee on Banking, Housing, and Urban Affairs
On

"The Real Estate Appraisal Industry"

Presented by
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Chairman Allard and members of the Subcommittee, I am Alan Eugene Hummel, President of Iowa Residential Appraisal Company in Des Moines, Iowa, and Immediate Past President of the Appraisal Institute. I am pleased to be here today on behalf of the Appraisal Institute and the American Society of Farm Managers and Rural Appraisers, which together represent more than 20,000 real estate appraisers in the United States. Thank you for holding this hearing on the effectiveness of federal requirements established approximately 15 years ago that marked the beginning of federal involvement in state licensing and certification requirements for real estate appraisers in the United States.

Real estate appraisers play a strategic role in our country's real estate financing system. A professional appraiser's objectivity, training, experience and ethics are fundamental characteristics that help participants in residential and commercial real estate mortgage transactions assess the value of real estate and understand the risks involved in collateral lending. Trillions of dollars are invested in real estate in the United States, so it is of paramount importance that appraisers be qualified and adequately trained and have sufficient experience in the type of property under consideration. Also important is a system of enforcement with the authority to help ensure that appraisers are properly educated and experienced.

Both the appraisal profession in general and our professional organizations in particular have been directly impacted by the implementation of Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). We have serious concerns with how the law and subsequent regulation is affecting the profession. We are concerned with the quality of appraisals being used in our nation's mortgage financing system today. A fundamental goal of FIRREA was to raise the professionalism of appraisers involved in federally related real estate transactions; yet we have concluded that this goal has not been met. In fact, the result has been to promote a system that lessens the professionalism of appraisers rather than strengthens it. Having provided for only "minimum" qualification requirements and meager oversight authority, the implementation of FIRREA has failed to offer incentives to appraisers to seek additional training, education and experience. In addition, many state appraiser licensing boards and the federal oversight authority allow bad actors to remain in the system.

Competent and qualified real estate appraisers serve as a crucial safeguard in our banking system, but lax enforcement and ineffective federal oversight serve to diminish this safeguard. Thus, we are here to alert Congress that the system FIRREA envisioned is broken and needs to be fixed if we are to avoid a

financial crisis on the scale of the Savings and Loan disaster of the 1980s or the accounting scandals in the 1990s.

Appraiser Regulatory Structure

As you know, the Savings and Loan crisis of the 1980s led Congress to enact FIRREA. Title XI, the "Real Estate Appraisal Reform Amendments," was enacted to protect federal financial and public policy interests in real estate related transactions by requiring that real estate appraisals be performed by individuals with demonstrated competency in both education and experience. FIRREA mandated licensing or certification pursuant to national standards, but the resulting regulatory structure has become tangled and overly-complex. The system involves:

- Licensing and certification boards in all states and territories, each with differing interpretations of FIRREA as well as differing agendas and funding;
- Minimum qualifications criteria established by the Appraiser Qualifications Board of The Appraisal Foundation, a non-profit education organization;
- Appraisal standards (the *Uniform Standards of Professional Appraisal Practice*) established by the Appraisal Standards Board of The Appraisal Foundation; and
- Federal oversight by the Appraisal Subcommittee of the Federal Financial Institutions Examinations Council.

Unfortunately, FIRREA and its resulting complexity have adversely affected the appraisal profession and, in our view, put consumers, the states and the federal insurance funds at risk. Much of the complexity was identified by the General Accounting Office (GAO) in its investigation last year. We believe the problems are in four categories:

1. Lack of accountability
2. Ineffective and counter-productive state enforcement programs
3. Minimum qualifications and discouragement of professional development
4. Inadequate appraiser independence safeguards

The Multi-pronged System Lacks Accountability

Title XI created the Appraisal Subcommittee to oversee the activities of the states and many of the activities of The Appraisal Foundation. The Appraisal Subcommittee is essentially a junior subset of the Federal Financial Institutions Examinations Council. The Appraisal Subcommittee funds a portion of The Appraisal Foundation's expenses. Ironically, individual state certified and licensed appraisers fund the Appraisal Subcommittee operations through license fees collected by the states. Individual appraisers are assessed a \$25 annual fee passed through to the Appraisal Subcommittee, which has amassed a sizable reserve fund for no identified purpose.

Effective Oversight of the Appraisal Subcommittee

We are concerned with the lack of oversight for the Appraisal Subcommittee. By and large, the Appraisal Subcommittee is operating in an insulated environment without any practical accountability measures.

Providing federal oversight over an activity traditionally regulated by the states (licensing), the Appraisal Subcommittee is a hybrid federal agency that has conducted much of its business in the dark and with no direct input from the appraisal profession. The Appraisal Subcommittee board is composed of staff bank examiners and program staff from the five federal financial institution regulators and one from the Department of Housing and Urban Development. It meets quarterly in Washington, but does not allow for public access or participation to their activities and meetings.

The Appraisal Subcommittee staff performs audits of state appraiser boards on a three-year rotation cycle, and works with state boards on Title XI compliance. The Appraisal Subcommittee posts some of the results of its audits on its website and a portion of this information is released in its Annual Report to Congress. Section 1103 of Title XI requires the Appraisal Subcommittee to issue an annual report to Congress no later than January 31 of the following year. The report itself historically has been little more than a financial statement, containing sparse information on the audits that were conducted with few compliance statistics. In addition, it is now nearly April and the 2003 Annual Report apparently has yet to be issued to Congress. Similar delays have occurred the past, like last year when the 2002 Annual Report was not issued until April 16.

Appraisal Subcommittee Oversight of States

Not only are the Appraisal Subcommittee's operations insular, but their powers are also impotent. Recommendations from the Appraisal Subcommittee are routinely disregarded by state appraisal boards, contributing to a cycle of ineffective enforcement. The only *real* power the Appraisal Subcommittee has over state appraisal boards is the authority to "decertify" a state if it is found to be out of conformance with Title XI. This specific power has generally become known as the "atomic bomb," because if it were to be invoked, virtually all mortgage lending in that state would cease. The Appraisal Subcommittee has never used this power, although it has threatened to do so. Such an unrealistic threat is an ineffective way to promote sound processes in the states.

According to the latest annual report issued by the Appraisal Subcommittee, a full 43 percent of the state appraisal regulatory agencies reviewed in 2002 either failed to resolve complaints against real estate appraisers expeditiously or were inconsistent in applying disciplinary sanctions; failed to pursue all alleged violations of the Uniform Standards of Professional Appraisal Practice; or did not adequately document enforcement-related files. In addition, one state failed to forward disciplinary actions to the Appraisal Subcommittee, which is required by Title XI and Appraisal Subcommittee Policy Statement 9. The fact that so many state appraisal boards failed to resolve complaints against appraisers in an expeditious manner is deeply troubling.

Examples of state appraisal board actions that have occurred without consequence from the Appraisal Subcommittee include:

- Hundreds of appraisers in Oklahoma who failed to meet the minimum requirements for licensing and certification were "grandfathered" under a new licensing law passed by the Oklahoma Legislature and endorsed by the Oklahoma Real Estate Appraiser Board Division;

- Failure of the New York Division of Licensing Services to revoke an appraiser's license following a guilty plea for "filing false documents," leading to two years probation and more than \$100,000 in fines and restitutions, because his certification would "not involve unreasonable risk to the safety and welfare of the general public."¹
- Complaints against appraisers in multiple states that have gone unresolved up to 8 years.

Inadequate Structure and Regulatory Slights of Hand

In practice, FIRREA has weighed heavily on the development of appraisal practices in non-federally related transactions, such as appraisal consulting and market analysis. When states implemented their FIRREA requirements for state licensing and certification, many of them wrote their laws to include *all* appraisal services performed in their state. These so called "mandatory" states require appraisals to be performed by licensed or certified appraisers and in conformance with the *Uniform Standards of Professional Appraisal Practice*. However, even in so called "voluntary" states, where non-licensed or certified appraisers are allowed to "appraise" property, a de facto requirement to be licensed and certified exists. As a result, transactions outside of traditional mortgage lending are effectively being dictated by policies written and enforced by bank examiners (the Appraisal Subcommittee). We believe the Appraisal Subcommittee should have a more diverse membership since it will likely continue to impact practitioners delivering a wide range of appraisal and valuation assignments.

Finally, when implementing FIRREA, the five federal financial institution regulators failed to take the licensing and certification requirement seriously. Through regulation the law was effectively modified to exempt nearly 90 percent of all transactions in the residential mortgage market from being appraised by licensed and certified appraisers. As originally contemplated, all transactions greater than \$15,000 would be required to be appraised by a licensed and certified appraiser, but with a regulatory slight of hand the threshold was raised to \$250,000 before a licensed or certified appraiser was required. As a result, a significant portion of the real estate valuation work throughout the country takes place in the form of "evaluations," or "broker price opinions" (BPOs), or through "competitive market analysis" (CMA) reports. In many cases, evaluations are done by staff of organizations that have a vested interest in a real estate transaction. This negates the benefit of having an independent third party involved in the real estate transaction, while omission of a licensing or certification requirement for properties under \$250,000 creates a disruptive gap in the enforcement of appraisal standards.

Ineffective and Counter-Productive State Enforcement

While there are many dedicated individuals on state appraiser boards, many times their ability to carry out their charge is compromised due to lack of funding or administrative support. Too often, complaints against real estate appraisers in states are not reviewed by state appraiser boards, leading to a lack of disciplinary action against poorly performing appraisers. Some state boards have been known to spend inordinate time and research and collect fines for inconsequential offenses, leaving little time for enforcement of major issues.

Concerns with state enforcement agencies include:

¹ Christian Murray, "Appraising the Appraisers," *Newsday*, August 9, 2002.

- Failure to review complaints in a timely manner or review them at all
- Failure to apply appraisal review procedures consistently
- Failure to proscribe disciplinary action against appraisers for poor performance
- Failure to provide adequate resources to investigate complaints as licensing fees are often commingled with the state's general fund and not used for oversight purposes as intended.

Neglectful Supervision and Administration

Since Title XI was enacted, it has been difficult to achieve necessary consistency among the states for enforcement of both standards and certification requirements. Whether through a lack of resources or a lack of will by those charged with providing oversight, the current system allows some unscrupulous and unqualified appraisers to continue practicing and has little or no recourse for their actions. In fact, some of these very appraisers have been linked to mortgage fraud schemes throughout the country.

For example, within the last year, a real estate appraiser in New York was found guilty and convicted of a felony for grossly inflating appraisals. His state license was revoked, and he served a jail sentence for one year. Upon his release, he challenged the state appellate court to be re-granted his license. The court overturned the ruling of license revocation, determining that he had served his time sufficiently and that he must return to becoming a "beneficial member of society." Amazingly, this fraudulent appraiser charged with participating in numerous land scam schemes is now a practicing appraiser--sanctioned--in New York.

New York is not alone in handling such cases carelessly, as a similar case was brought to light last month in Maryland. In June 2003, an appraiser who pled guilty to appraisal fraud admitted that the government lost between \$500,000 and \$800,000 due to his actions. In the fall, he applied to renew his license. On the online application, he answered "no" to the question of whether or not he had ever been convicted of a felony. According to his attorney, he "honestly" answered no, because in the federal system, one is not convicted until sentenced, and the appraiser was not sentenced until last month, in February. Thus the Maryland Commission of Real Estate Appraisers and Home Inspectors renewed his license last October for another three years. A spokesperson for the Maryland Commission said to the Baltimore Sun, "all we have to go by is the honesty of the licensee. We are not required to perform background checks; moreover, the financial and personnel resources are not available at this time."²

Deficiencies with state appraisal complaint systems were noted in the GAO Report, most notably in relation to a government sponsored enterprise (GSE) that recently began making referrals of poor appraisals to state appraiser boards. Eight hundred and sixty referrals were made to 45 different state regulatory agencies between August 2001 and August 2002. Officials from the GSE commented to the GAO that they had been dissatisfied with some state decisions on punitive actions and with the lack of feedback on actions that had actually been taken. The officials added that some states do not penalize

² John B. O'Donnell, "Real Estate Appraiser Faces Sentencing in Property Flipping Plot; Man Still Holds License Despite Pleading Guilty," *Baltimore Sun*, February 27, 2004.

appraisers for multiple violations if the appraisers have already been disciplined or do not tell complainants what action was taken. The officials reported that they have observed a lack of consistent and effective investigation and enforcement by some of the states. As an example, they noted that some states appeared to perform meaningful investigations and took appropriate actions while other states appeared unwilling to investigate similar cases with comparable support and documentation.

While FIRREA's complexity is causing problems with state enforcement, it is also placing a significant burden on appraisers working in more than one state. For example, a member of the Appraisal Institute from Virginia recently applied for a license in the State of Indiana. This individual is currently certified in Virginia, Maryland, New Jersey, West Virginia, Ohio and Tennessee. After submitting the lengthy documentation on education and experience, the appraiser was notified that his application was to be tabled for six months due to his education not meeting their standards. This individual has taken virtually all of the courses offered by the Appraisal Institute and regularly teaches advanced curriculum courses across the country and in other countries.

Appraisers are paying a heavy price for redundant licenses while being denied others because of the bureaucratic nightmare created by FIRREA. A substantial percentage of real estate appraisers in this country are asked to perform real estate appraisal assignments that are not in their home state. This was not a major problem prior to the enactment of FIRREA; however, with its implementation each state must now take appropriate measures to facilitate the work of out-of-state appraisers who do business in multiple states. Our organizations believe that there are two appropriate methods for handling inter-state appraisal work. The first method, "Temporary Practice," is mandated by Title XI, but unfortunately this fact was overlooked by many states and this provision of Title XI has not as yet been properly implemented throughout the country.

The second method, "Reciprocity," is not mandated by Title XI but in most cases will provide the maximum benefit to the public with the least amount of difficulty for the state regulators. In many parts of the country, the geographic areas for an appraiser's day-to-day business may lie within two or three states. In such cases, the "temporary practice" provisions are not appropriate to handle the appraiser's out-of-state business and the appraiser may be forced to become licensed or certified in two or more states. This means that several states may be required to administer the same process over and over again with no demonstrable benefit. In this situation, reciprocity agreements make a great deal of sense because they avoid duplication of effort and, in doing so, lessen the administrative burden on each of the various states involved and the appraiser. To date, 12 jurisdictions have no reciprocal agreements in place, and those that do are not universal between all states. Virtually no new reciprocal agreements have been drafted since the early 1990s.

Minimum Qualifications and Discouragement of Professional Development

An important goal of FIRREA was to ensure that appraisals are performed by competent appraisers. However, in practice, FIRREA has had the opposite effect because it stresses minimum qualifications. This emphasis has severely curtailed the continuing development of a true appraisal profession.

This is explained well by users of appraisal services, who are in the best position to speak to changes in quality of appraisal services since the passage of FIRREA. In a poll conducted recently by the Appraisal Institute of significant users of appraisal services³, 50 percent responded that the quality of appraisal services and appraisal reporting has declined, whereas only 28 percent said appraisal services and reporting have improved. This is consistent with discussions our organizations have had with users of appraisal services for the past several years.

As we reflect upon FIRREA, it is clear that the requirements for licensing and certification were set too low. Unfortunately, many clients see the possession of a license to be the only necessary qualification and stop short of fully considering the issue of competency for a particular appraisal. Likewise, many appraisers feel it is enough merely to meet the minimum requirements. What the FIRREA legislation missed is recognition that attaining the minimum level of education and experience for a license or certification does not necessarily qualify the licensee as competent to appraise.

While our professional organizations maintain high standards and strict codes of ethics and effective peer review, less than 40 percent of all licensed and certified appraisers choose to be affiliated with such organizations. Currently, there are approximately 80,000 licensed and certified appraisers in the United States; out of this total, approximately 50,000 appraisers do not belong to professional appraisal organizations.

Those appraisers that have only met state licensing and certification requirements tend to be less experienced and qualified than appraisers with professional designations; 84 percent of users of appraisal services say this is the case. Ironically, after FIRREA was passed, our organizations saw appraisers retreat from professional organizations, as the federal government dictated that minimum levels were all that were necessary to perform appraisals in federally related transactions. As an example, in the case of the Appraisal Institute, from the early to late 1990s, membership dropped from over 35,000 members to slightly more than 16,000 members. The Appraisal Institute was not alone in this troubling circumstance.

Particularly problematic is a bizarre discrimination provision formulated against designated appraisers contained in Section 1122 of FIRREA, the "Anti-Discrimination" clause. This section states:

"Criteria established by the Federal financial institutions regulatory agencies...for appraiser qualifications in addition to State certification or licensing shall not exclude a certified or licensed appraiser for consideration for an assignment solely by virtue of membership or lack of membership in any particular appraisal organization."

In this case, the mischaracterized "discrimination clause" of FIRREA actually promotes discrimination against appraisers who have practiced appraisal for years and have achieved the highest credentials the industry offers. This section of FIRREA has been read to mean one need not be a member of a professional organization to be an appraiser. While this statement may be true, making such a statement

³ "Appraisal Quality Post-FIRREA," A Survey of the Appraisal Institute's 2000-2004 Client Advisory Committee Members, March 21, 2004.

is much like saying that consumers seeking medical care should not seek board-certified physicians or that a school prefers to hire people with GEDs over those with PhDs. Fundamentally, it fails to recognize the intense work and diligence that thousands of professional appraisers have put into earning and maintaining their status as the most competent and experienced appraisers in the profession. The public and the real estate community should be aware that there are professional organizations that confer designations to appraisers who have advanced themselves significantly beyond the minimum requirements of FIRREA.

For decades it has been the professional organization and societies that have developed and maintained the basic principles and methodologies used by today's practitioners. Without professional organizations, the fundamental body of knowledge of real estate valuation would not exist. To dismiss this segment of the lifeblood of the profession is a grave oversight with serious repercussions.

Inadequate Appraiser Independence Safeguards.

While FIRREA did provide for some separation between real estate appraisal and loan production inside financial institutions, FIRREA failed to adequately address the issue of appraiser independence. Although federal agencies issued the Interagency Appraisal and Evaluation Guidelines in 1994, recent bank examinations have indicated that this separation is failing to curb pressure to coax real estate deals along by influencing the independent judgment of appraisers. In October 2003, the five financial institution regulators issued an interagency statement reminding financial institutions that the 1994 Guidelines require that borrowers and loan production staff to not exert influence over the selection of appraisers. However, our members report that this is a regular occurrence. In fact, some financial institutions, mortgage brokers and others require a pre-determined value to be met by an appraiser in order to receive future assignments from that institution. Such comments are often backed up by threats of coercion and non-payment for services. FIRREA was established to avoid such circumstances, yet they are occurring every day under its purview.

There are relatively few options that appraisers have when confronted by inappropriate client pressure:

- First, the appraiser could turn down the assignment, or just say no. Many appraisers do this; however, given the dilution of the licensed appraiser market, our members report that it is likely that a financial institution will find an appraiser who is willing to bend to their request.
- Second, the appraiser could tell the individual ordering the appraisal that national uniform standards and state and federal law require appraisers to perform assignments ethically and competently and that they would like to discuss and resolve any remaining concerns or issues. Appraisers and clients have such conversations on a regular basis, but appraisers are oftentimes faced with having to meet a predetermined value. This is particularly the case with many mortgage brokers and others whose compensation is driven by production.
- Third, the appraiser could report the activity to the appropriate enforcement authority. However, when doing so, the appraiser would have to ensure it was sent to the proper agency. Complaints against national banks would have to be sent to the Office of the Comptroller of the Currency; credit unions to the National Credit Union Administration, etc. Many parties, such as some

mortgage brokers, are completely outside of a regulatory system. In these cases, the appraiser is simply forced to lose a client.

In some cases, bank examinations have uncovered unscrupulous activities. Oftentimes, the activities go unchecked and unreported. A particular problem appears to revolve around the fact that those who have a vested interest in the closing of the deal are ordering the appraisals. The 1994 Interagency Guidelines and the 2003 Interagency Statement call for a separation of loan production and credit analysis. However, full separation has never been realized, particularly in the areas of mortgage lending and brokerage. We believe that this is an inherent weakness of FIRREA that should be addressed immediately.

Legislative Recommendations

The Appraisal Institute urges Congress to explore the following suggestions as a starting point for addressing current deficiencies. These suggestions emphasize improving state appraisal board complaint processes, inserting accountability measures over the Appraisal Subcommittee and promoting consumer awareness and professionalism. Consider:

1. Requiring the Appraisal Subcommittee to report to Congress annually their assessment of the effectiveness of each state's enforcement processes as part of their Annual Report, including results of all audits performed that year and a performance rating for all state appraisal boards.
2. Requiring adequate funding for state appraisal boards for disciplinary functions enforced by the Appraisal Subcommittee.
3. Modifying the makeup of the Appraisal Subcommittee to reflect broader representation, including an industry advisory council.
4. Requiring the Appraisal Subcommittee to issue guidance to states addressing common deficiencies.
5. Requiring the Appraisal Subcommittee to conduct public meetings.
6. Requiring the Appraisal Subcommittee to consult and interview industry participants when conducting field reviews of state appraisal board operations.
7. Requiring the Appraisal Subcommittee to share information from the National Registry with other federal agencies, including the Federal Bureau of Investigation for anti-fraud purposes.
8. Requiring the head of the Appraisal Subcommittee be confirmed by the United States Senate.
9. Ensuring accountability of the Appraisal Subcommittee, and only then, providing it with authority to sanction consistent with its responsibility to monitor the activities of state appraisal boards.

10. Granting the Appraisal Subcommittee authority for reciprocity of qualifications among licensing jurisdictions.
11. Extending authority to the Appraisal Subcommittee for uniform temporary practice among licensing jurisdictions.
12. Recognizing and encouraging the use of designated appraisers with qualifications beyond merely licensed and certified.
13. Providing penalties for engaging in appraiser coercion and creating adequate resources for appraisers to report instances of such.
14. Encouraging state appraiser boards to recruit the best qualified candidates to participate on board activities, regardless of membership in professional appraisal organizations.
15. Requiring all regulated financial institutions to retain copies of all appraisals in loan files, even appraisals that are NOT used in the decision to lend.

Concluding Remarks

There is an immediate need to find solutions to deficiencies in the system and our organizations are committed to assisting you in this effort. We look forward to working with you to identify solutions to solve the problems associated with the current appraiser regulatory structure. Please contact Don Kelly, Vice President of Public Affairs, Appraisal Institute, at 202-298-5583, dkelly@appraisalinstitute.org

About the Appraisal Institute and American Society of Farm Managers and Rural Appraisers

The Appraisal Institute is the acknowledged worldwide leader in residential and commercial real estate appraisal education, research, publishing and professional membership designation programs. Its extensive curriculum of courses and specialty seminars provides a well-rounded education in valuation methodology for both the novice and seasoned practitioner. Members of the Appraisal Institute form a network of highly qualified professionals throughout the United States and abroad. They are identified by their experience in and knowledge of real estate valuation and by their adherence to a strictly enforced *Code of Professional Ethics and Standards of Professional Appraisal Practice*.

The American Society of Farm Managers and Rural Appraisers is an international organization recognized as the leader in rural valuation and farm management. The ASFMRA provides extensive professional education with basic and specialized classes in these fields. A professional designation is only achieved after years of experience, education and a demonstrated ability in all aspects of rural property valuation or management.