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K&L Gates Webinar Series

New Appraisal Requirements Affect Lenders and AMCs

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Background

- Washington today is all about Risk Management
- Increased scrutiny and over regulation
- New laws mean greater and greater Accountability, Responsibility, and Liability for lenders and their agents
- Pendulum has swung 180°
  - RESPA reform
  - TILA rules
  - FHA requirements
  - State enforcement
  - Dodd-Frank Act

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Today's Session

1. HVCC, AIR, and appraisal independence standards
2. "Customary and reasonable" appraisal rates
3. Standards for "higher-risk" mortgages
4. AMC registration
5. Other miscellaneous changes

Appraisal Independence – Background

- Where did it begin?
  - Aftermath of mortgage meltdown – questions regarding inflated appraisals
- March 2008 Settlement
  - New York Attorney General, Federal Housing Finance Agency, Fannie Mae, and Freddie Mac
- Appraisal Code of Conduct

Appraisal Independence – HVCC

- May 1, 2009
  - Applicable to all conventional loans sold to Fannie Mae and Freddie Mac
- Prohibited undue influence on appraisers
- Restrictions on ordering appraisals and communicating with appraisers
  - No mortgage brokers or other third parties
  - No loan officers or other members of loan production staff

Appraisal Independence – TILA

- October 1, 2009
  - Federal Reserve Board amendments to TILA
- Applied to consumer-purpose, closed-end loans secured by a consumer’s principal dwelling
- Prohibited undue influence on appraisers
  - 5 examples of prohibited activity
  - 6 examples of permissible activity

Appraisal Independence – FHA Loans

- January 1, 2010
  - HUD Mortgagee Letter 2009-28
- Prohibited improper influence on appraisers
- Restrictions on ordering appraisals and communicating with appraisers
  - No mortgage brokers or other third parties
  - No loan officers or other members of loan production staff

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Appraisal Independence – Fannie Mae/Freddie Mac

- The HVCC by any other name is still the HVCC
  - Sunset required by Dodd-Frank Act
- Fannie Mae and Freddie Mac introduce Appraiser Independence Requirements (AIR)
  - Effective October 15, 2010
- Substantially the same as HVCC

AIR vs. HVCC

- Same examples of prohibited coercive practices
  - Limitations on ordering second appraisals gets separate treatment in AIR
- Borrower still required to receive copy of appraisal
  - AIR clarifies that waiver of three-day requirement must be obtained at least three days prior to closing
- Same prohibition on mortgage brokers selecting, retaining, or paying for appraisals

AIR vs. HVCC (cont'd)

- Same prohibition on loan production staff selecting and communicating with appraiser
- Same requirement that lender employees selecting appraisers be appropriately trained and qualified
- Still allows use of appraisals prepared by in-house appraisers or appraisers affiliated with lender

AIR vs. HVCC (cont'd)

- Removes explicit requirement regarding written notice for removal of an appraiser
- Loosens conditions on use of an appraisal prepared for a different lender
- Removes requirements related to external audits, Independent Valuation Protection Institute, and reporting of violations to Fannie Mae and Freddie Mac

AIR vs. HVCC (cont'd)

- Removes "small bank" exemption
- Removes explicit 10% quality control sample and Fannie Mae and Freddie Mac reporting requirement
  - Lenders are still expected to review appraisals as part of their quality control efforts

Appraisal Independence – Dodd-Frank Act

- New Section 129E of TILA
  - Federal Reserve Board interim final regulations implement new requirements
  - Replaces prior Board regulations

- Applies to:
  - Extension of consumer credit secured by consumer's principal dwelling (including HELOCs)
  - "Valuations," which includes BPOs (not AVMs)
  - Creditors and persons that provide settlement services

Appraisal Independence – Dodd-Frank Act (cont'd)

- Prohibits:
  - Coercive behavior to influence independent judgment of appraiser
  - Misstatement of the value of the property
- Enumerates 5 examples of prohibited activities:
  - Influence resulting in maximum or minimum value
  - Conditioning future orders on targeted value
  - Withholding or threatening to withhold payment unless target value returned
  - Excluding appraiser from future work unless target value returned
  - Conditioning appraiser's compensation on closing of transaction

Appraisal Independence – Dodd-Frank Act (cont'd)

- Enumerates examples of activities that do not violate appraisal independence standards:
  - Asking appraiser to consider additional property information, provide further detail, or correct errors
  - Obtaining a second appraisal and using the more reliable one
  - Withholding appraiser compensation for breach of contract or substandard performance
  - Taking action permitted by federal or state law

Customary and Reasonable Fees

- Unexpectedly and perhaps inexplicably the new TILA rules impose strict compensation requirements on lenders and their agents (i.e., AMCs)
- Lenders required to pay appraisers "customary and reasonable" fees for their services
- Unexpected and inexplicable because the requirement is not that consumers be charged fair fees – but that lenders make sure appraisers get paid a reasonable amount for their services

Customary and Reasonable Fees (cont'd)

- Lenders and their agents must compensate "fee appraisers" at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised

- Evidence of a fee's reasonableness ***may*** be established by objective third-party surveys, but these surveys must exclude assignments ordered by known AMCs

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Customary and Reasonable Fees (cont'd)

- FRB concludes that the marketplace should be the primary determiner of the value of "appraisal services"
  - FRB relied on HUD Mortgage Letter (ML 2009-28)
- Consistent with that premise, under the Rule, a creditor:
  - can negotiate with an appraiser a rate for an assignment in good faith; and
  - can communicate to an appraiser rates submitted by other appraisers for that assignment.

Customary and Reasonable Fees (cont'd)

- The Rule: "In any covered transaction, the creditor and its agents shall compensate a fee appraiser for performing appraisal services at a rate that is customary and reasonable for comparable appraisal services performed in the geographic market of the property being appraised."

- FRB Rule provides two rebuttable presumptions of compliance.

FRB Rule Key Terms for Customary and Reasonable:

- Covered Transaction – Same as appraisal independence, but applies only to appraisals
- Agents – Determined by applicable law. AMCs are agents; a fee appraiser is not an agent of the lender
- Fee Appraiser – (1) state licensed/certified individual not an employee of lender/AMC; or (2) appraisal company
- Appraiser Services – Limited to the services required to perform an appraisal
- Geographic Market – Market area
- AMCs – same as FIRREA but no exemption for smaller AMCs

First Presumption of Compliance

- Amount reasonably related to *recent* rates (within 1 year) paid for comparable services performed in the geographic market. Adjustment based on 6 factors:
  - Type of property
  - Scope of work
  - Turnaround time
  - Fee appraiser’s qualifications, experience, and work quality; and
- No anticompetitive behavior (price fixing; market allocation; acts of monopolization or other antitrust laws)

Alternate Presumption of Compliance

- Rely on information about rates that:
  - Is based on objective third-party information (schedules, studies or surveys);
  - Is based on recent rates (1 year) paid to a sample of providers of appraisal services in a geographic market or the fee schedules of those providers; and
  - Such fee schedules, studies or surveys exclude compensation paid to fee appraisers for appraisals ordered by AMCs.

No Presumption of Compliance Based on Fee Appraiser Certification

- Document signed by appraiser indicating "agreed" rate is "customary and reasonable" does not create a presumption of compliance
  - Need objective factors
- Volume-based discounts not prohibited, so long as compensation is customary and reasonable
  - Further guidance needed?

Customary and Reasonable Fees – Challenges

- First presumption vs. second presumption of compliance
- Wholesale vs. retail appraisal rates
- Communication needed between lenders and AMCs

Other Appraisal Independence Provisions – Conflict of Interest

- Dodd-Frank Act and FRB interim rules prohibit an appraiser or AMC from having a direct or indirect interest in the property
- No express ban on using appraisals ordered by mortgage brokers

- Not a conflict of interest:
  - Persons employed by lenders or AMCs affiliated with lenders
  - Providing additional settlement services
  - Provides a "safe harbor" if firewalls and other safeguards are in place

Other Appraisal Independence Provisions – Mandatory Reporting of Appraiser Misconduct

- Creditor or other settlement service providers having a **reasonable basis** to believe appraiser is not complying with USPAP or applicable laws, or is engaging in unethical or unprofessional conduct in violation of state or federal law, ***must refer the matter*** to the applicable state appraiser agency

- Mandatory reporting only if noncompliance likely affects value

Other Appraisal Independence Provisions – No Extension of Credit

- Creditors prohibited from closing loan unless lender uses reasonable diligence to determine that appraisal does not materially misstate or misrepresent value

- Creditor acts with reasonable diligence if credit is extended based on another valuation

Civil Penalties

- Section 129E sets forth substantial civil penalties for violations of customary and reasonable fee restrictions:
  - $10,000 per day that violation continues (first violation)
  - $20,000 per day that violation continues (subsequent violation)
- Civil penalties are in addition to other enforcement provisions referenced in Section 130 of TILA

Other TILA Provisions – Higher-Risk Mortgages

- A creditor may not make a higher-risk mortgage without obtaining a written appraisal conducted by a certified or licensed appraiser that has conducted a physical property visit **of the interior**.

What Is a Higher-Risk Mortgage?

- Higher-risk mortgages are mortgages that are not "qualified mortgages" and have an APR that exceeds the APOR by:
  - 1.5 percent – for first-lien conforming loans
  - 2.5 percent – for first-lien jumbo loans
  - 3.5 percent – for second liens

Higher-Risk Mortgage

- Requirement for second appraisal in potential flipping scenario
  - Second appraisal must include an analysis of the difference in sale prices, changes in market conditions, and any improvements made between current sale date and previous sale date
  - The cost of the second appraisal cannot be charged to the applicant

AMC Minimum Standards

- Federal regulators to establish minimum requirements to be applied by a state in AMC registration, including that the AMC:
  - Be subject to supervision by state appraiser boards;
  - Verify that only licensed or certified appraisers are used for federally related transactions;
  - Require that appraisals comply with the USPAP and TILA's appraisal independence standards.
- Minimum requirements also apply to AMCs that are bank subsidiaries, but state registration not required

AMC Registration

- Two registration tracks: one for those AMCs subject to federal supervision and one subject to state supervision

- Size Requirement
  - Must oversee network or panel of more than 15 certified or licensed appraisers in a state, or at least 25 nationally, within a given year

AMC Registration

- States may establish their own additional AMC requirements
- AMCs will be subject to annual registration fee ($25 per appraiser)
- Federal agencies must first finalize rules establishing minimum requirements
  - States then will have 3 years to implement a regulatory scheme

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RESPA Disclosure

- The HUD-1 may disclose both:
  - the fee paid directly to the appraiser by the appraisal management company; and
  - the administrative fee charged by the appraisal management company

ECOA Amendment

- Copy of any and all written appraisals and valuations must be sent to borrower no later than 3 days before closing, whether or not loan is approved or application withdrawn
  - Three day requirement may be waived
- No charge may be assessed for providing copy
- At application, must notify applicant in writing of right to receive copy of each written appraisal and valuation

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Conclusion

1. Appraisal independence standards have been extended beyond HVCC and the reach of Fannie Mae and Freddie Mac
2. Lenders and their agents will now be accountable for making sure appraisers are paid a customary and reasonable fee
3. AMCs gear up for national registration and 50 state regulations
4. Comments on the Fed's October 28 Interim Rule due on or before December 27
5. The appraisal landscape is changing rapidly, don't get caught short – and don't expect this to be the last word on appraisal reform

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QUESTIONS AND ANSWERS