

SDW Best Practices Discussion Paper

Appraiser independence Issues From a Business Perspective

Appraiser independence has been the buzzword in the industry for some time now. Much of the problem within the lending industry has been blamed on the lack of it, lawsuits have been filed due to pressure around it, and laws have been written to protect it. Appraiser independence has been defined but there apparently there is still difficulty in recognizing it. This difficulty seems to run a wide range from the abusers who continually push the envelope with regard to demanding values to the overly sensitive appraisers who cry wolf at every turn.

Somewhere there is a middle ground where business needs should be met for all parties. And there are a multitude of questions that surround the issue that have not been resolved from a business standpoint.

- What are the responsibilities of all parties with regard to the property valuation?
- How does each party view their responsibilities?
- What are the conflicts for each?
- Who is the customer and what are their needs?
- What is the difference between appraiser pressure and a good client relationship?

The purpose of this SDW Best Practices paper is to examine these questions and address the business issues that surround the problem. Just as the appraiser has a need for protection from predatory practices, the lender also has a need for protection. He needs to protect his ability to work with the appraiser vendor in a reasonable business relationship.

Examining the Responsibilities

Each member of the valuation transaction sees the valuation conclusion in a different light. The question is where the responsibilities of each position lie. The originator (mortgage broker or loan agent) has a responsibility to supply his client (the borrower) with the best possible loan arrangement. Presumably that would be a loan with the most reasonable interest rate and terms that can be obtained for that borrower. That would include providing the borrower with a loan amount sufficient for whatever the stated purpose of the loan may be, if possible, but still within the borrower's ability to repay the loan without risk to himself or the lender. The violation here is that frequently the mortgage originator is driven to provide incorrect and/or fraudulent information to the lender in order to best accomplish providing the borrower with the highest possible loan amount regardless of ability to pay or accuracy of the information needed to accomplish this goal.

The lender has a responsibility to protect himself with regard to the risk level of the loan, making certain that the information supplied by the originator is accurate. The mortgage broker, being the lender's actual customer, has the right to expect from the lender a clear and concise response with regard to their willingness to fund the loan within the requirements specified (loan amount and terms). In terms of repeat business, the mortgage originator, not the borrower, will be the one to provide the lender with additional lending activity. However, the lender does not have a responsibility to give the mortgage broker what he wants if it is outside the risk tolerance that the lender is willing to accept. This risk level can be heightened either by credit or valuation concerns. The diversion here is that the lender may succumb to their own

pressure to obtain high lending volume goals, satisfy his client (the originator), or otherwise desire to make a particular loan with full knowledge that the information being supplied is inaccurate and aggressive.

The borrower has a responsibility to understand the process and the terms of the debt he is about to incur. As often as not, particularly in a refinance situation, the borrower is unaware of the negotiations or pressures that are part of the transaction behind the scenes.

The appraiser has the responsibility to provide the most accurate and reliable valuation and substantiating report that he is able to do within the expected parameters of the job. The report is expected to be well researched and documented. The responsibility of an appraiser who is providing an appraisal for lending purposes is primarily to protect the lender by providing accurate facts about the subject property and its environment so that an intelligent decision can be made with regard to risk.

Who is the Customer?

While it is fairly clear who the mortgage originator's customer is (the borrower) and who the lender's customer is (the mortgage broker as well as the borrower) appraisers seem to experience some confusion as to who their client is and how they can best be serviced. When it comes to appraiser pressure, here is where the conflict begins.

When there is a mortgage broker involved in the transaction, this is who is typically ordering the appraisal. At this point, any communication regarding the property, the borrower, and the loan are communicated between the mortgage broker and the appraiser. Once the appraiser has access to the property and the borrower, additional information may be provided, that was left out of the original order process – such as the loan amount needed, the borrowers estimate of value, and any additional information about the property that would only be evident upon inspection.

Everyone at this stage of the transaction knows that the appraisal will be delivered to the lender in order for the loan to be funded. But the borrower and the mortgage broker, even at this beginning point, may have differing views as to the appraiser's responsibility for the final product accuracy. The borrower frequently has paid for the appraisal already and expects to be able to control the process and outcome if not directly, at least by influencing the appraiser during the inspection process. Many borrowers feel that bank or lending appraisals are not really true valuations and are just a reflection of what the lender is looking for to make the loan. The problems in today's market only serve to support that opinion in the public eye.

The mortgage broker has a goal of closing the loan at the highest possible value, as that directly influences his compensation. He views the appraiser as his vendor because he is the one supplying the appraiser with continued orders. Unscrupulous brokers will use this to their advantage and take the opportunity to pressure the appraiser to supply the information that will best suit the deal. However, the mortgage broker is not the appraiser's actual client but is only acting as an agent for the lender when the appraisal is ordered. The ultimate responsibility that the appraiser has is not to make the deal work for the mortgage broker, but rather to provide accurate information to the lender so that a reliable risk decision can be made with regard to that particular loan.

Not only is the interest of the lender meant to be served, but if the lender feels that the appraiser is providing inaccurate reports, they will no longer accept future work from that appraiser. The mortgage broker will have no problem moving on

to another appraiser to provide the valuation reports he will need in the future, The appraiser, by misunderstanding who the actual client is, not only sacrifices the work he is providing that individual mortgage broker (as he is now on the lender's "do not use" list) but also other brokers who will be reluctant or unable to use him due to his appraisals being considered unacceptable in the lending community.

If the inaccurate valuation reports somehow pass through the initial loan process, they may easily be picked up in the secondary market review, which can cause an even broader blacklisting of an appraiser's work. This is the dilemma that the appraiser faces by not understanding who the client is and how they can best be served.

What is This Thing Called Pressure?

There seems to be unilateral agreement, at least on the appraisers' side, that the appraiser is an innocent party to the pressure he receives. It is either the broker or the lender who is the "bad guy" attempting to coerce the appraiser into reporting a value that is outside the range that the appraiser considers reasonable. The pressure can also take the form of attempting to force the appraiser to report information about the property, comparables, or neighborhood that is misleading or downright inaccurate in order to have the appraisal fall within the guidelines presumed to be acceptable with the lender and/or secondary market.

There are times when the pressure would appear to be clear. As an example, if there is a direct threat made to the appraiser with regard to bill payment, future business or some other related negative activity. But where is this line to be drawn? And who is the ultimate "decider" with regard to the report changes being unacceptable. One would think the best judge would be the appraiser. But that is evidently not always the case.

The Fine Line of Doing Business

Many lenders and mortgage brokers complain that they are unable to work effectively with the appraisers providing the valuation services because the appraiser does not understand the difference between pressure and client business relationships. As with any business, the parties to a transaction need to work effectively together in order to establish and maintain a good working relationship. In the instance of property valuation this balance is not always understood.

It is a fact that frequently, whether through incompetence, lack of training or experience, or inability to understand how business is done, appraisers are offended and react uncooperatively when any discussion of the appraisal value (or other items contained in the report) is sought. Many lenders, AMCs, and others on the receiving end of the appraisal report feel that they are unable to communicate with their appraiser vendors due to this specific issue.

There are a variety of opinions as to why this may be the case. However the bottom line is that many times the appraisal vendor manager is unable to reconcile questions that they may have or additional information they have received. The appraiser feels that any discussion with the lender is a form of appraiser pressure and should be avoided. The situation in many cases has gone from concern about pressure to one of avoiding any discussion about the report received. While this may eliminate time spent by the appraiser on a report already completed, it may also eliminate him from the lenders' approval list as they find they are unable to work with a vendor who will not willingly enter into a legitimate business discussion.

The ability to work with a client to provide good customer service has not changed in definition over time. The lender

receiving a report needs the information to analyze the amount of risk being taken with a given loan. In order to understand that risk with regard to the collateral property, the lender hires a professional appraiser to provide the relevant information. There is much information to be found on the appraisal report besides the bottom line value. Description of the neighborhood, analysis of the overall market, condition of the property, and use of comparables are all important factors in mitigating risk. This information is provided on the report so that the user can understand the valuation process as it relates to a particular property. It would not be unusual or out of line for a lender to call the appraiser with a question to ensure that understanding.

For example, when an appraisal value comes in lower than expected, the borrower is frequently able to supply additional information such as comparable sales in the immediate neighborhood. If these sales are not mentioned in the report and would, on the surface, appear to be relevant, it would not be improper for a lender to ask the appraiser if that sales data was considered in the process. As a matter of course, if there were sales that appear to be applicable and for some legitimate reason were not used by the appraiser, it would have been appropriate for the appraiser to discuss this in the comments section of the report.

Often appraisers are so focused on completing the form report, that they do not take the time to supply narrative that fills in the gaps and serves to truly supply a stand alone report. The lender client is hiring the appraiser to provide a credible report that can be used not just for the initial loan decision but also provided to investors to substantiate the loan package for investor purchase. Anyone in the process should be able to pick up the appraisal document and understand what the appraiser's thought process was and how the valuation conclusion was reached. If that process is not clear to the reader, there is a legitimate reason to call the appraiser with questions. This is not appraiser pressure, but a customer service that should be supplied to the client.

Estimated Value – Business Practice or Appraiser Pressure

Much has been made of the practice of supplying the appraiser with the estimate of value. It has been construed (correctly in some instances) that it is a form of pressure that the lender uses to communicate to the appraiser the property value he is expected to provide. But has this been and is it always the case? Are there solid business reasons for providing this information? Many would argue that there are.

As an example, all appraisers agree that the subject value is a range rather than a pinpoint number. If the property value needed to make the deal "go" is within that range, is it incorrect for the appraiser to provide that number to the lender? Can any appraiser be correct in their value within a small percentage? Doesn't the definition of market value include a meeting of the minds of the buyer and seller which is an arbitrary number within a small percentage as well?

An unfortunate fact within the industry is that the collateral value must be a specified number rather than a value range. Most agree that acceptance of a range within a certain percentage would make everyone's lives easier. An obvious solution, given that a pinpoint number is required from the appraiser, would be that the lender make a risk level business decision on the amount of the loan using a specified range around the value of the subject. However, this decision has another set of business implications.

The secondary market does not provide for the lender to take on that kind of flexibility. If the loan to value ratio is high or the lender has documented a change in the appraised value within the review process, secondary market pricing for that

makes the corrections on the report rather than making changes in underwriting or loan review. Therefore, when the lender has additional information to be considered about the property and appraisal, it is necessary for him to be able to contact the appraiser to have that data considered.

Can Education and Professionalism Address the Problem

In many countries around the world, appraisers are highly educated and are required to have backgrounds in related occupations such as accounting or engineering. The reports and information produced for the loan process is substantial and highly respected as a professional report product. This is typically not the case in the US. Education levels for appraisers have only recently been raised, with many of the industry courses at a substandard level and geared to help the student pass the test rather than actually learn the material. Mentorship in the industry is at an all time low, with some appraisal firms actually being criticized for taking on trainees to produce reports under the supervision of a senior member of the firm.

An extensive education may not be necessary to produce the standard residential appraisal report for lending purposes. But what the education may help to provide in this situation is a better understanding of the business needs of the client rather than assuming that any discussion is an attempt at pressure. Education does not guarantee professionalism, but is a key ingredient. A broader view of the lending process will provide a willingness to consider additional information or documentation to substantiate the process that was used. Many professionals that supply reports to their clients expect to spend time with them to discuss the process and conclusions. While the appraisers are not necessarily as highly paid for their finished product, it is not unreasonable to assume that a percentage of those reports will require some additional conversation to complete the transaction. Asking for additional information is not value pressure.

To expect the client to always take the report at face value with no question or discussion is unreasonable in any profession. If an appraiser is able to understand why the questions are being asked (as in understanding the bigger picture of the loan process) it should be a reasonable service to the client to participate. Just as appraisers do not want to be considered a peer to those who consistently hit the target numbers, lenders are not all predatory in their behavior.

What is the Lender's Solution?

Choosing an appraiser based merely on turn times and accuracy does not necessarily fulfill all client needs. The lender must be able to choose a vendor who will also be willing to engage in a working relationship that will help his client do business in a responsible manner. As in any business relationship, the supplier can provide the minimum required to get the job done or go the extra mile to provide the level of customer service above and beyond the competition.

With the above goal in mind, the following should be considered in the appraisal management process:

- ***Choose the appraiser panel with the broader business goals in mind.*** Vendor managers should consider the most professional services that they can find. That professionalism should include the ability to work with the client to obtain information to make risk based decisions. The long-term solution to appraisal issues is to create a stronger pool with more high quality appraisers.
- ***Cut down on the existing panel to use the appraisers who "get it right" the first time.*** Every time an appraiser needs to be contacted for anything after the appraisal is delivered, it should be noted. Measure how many times each appraiser has to be contacted for any reason.

- **Scrub the panel on a regular basis.** Continue to design the appraiser panel with the business relationship goals in mind. Upgrade the panel to focus on the appraisers that are the most professional as well as the most accurate. Review GSE fee panel lists on a regular basis to eliminate appraiser who are reported to produce low quality reports. These are the appraisers who will require the most communication in the long run.
- **Log everything in to document the file.** Make sure that whatever is sent to the appraiser is recorded so that the re-contacting is defensible rather than appearing to be pressuring for value
- **Document the entire process for future reference.** Documented processes are easier to defend and enforce and will provide good reference for regulators. Operationally, a well-documented process is easier to understand and will manage the expectations of all parties in the transaction.
- **Put processes in place to manage the valuation issues.** Provide a specific means for sales or the borrower to submit additional information with regard to the value. Design forms to be used when additional data is submitted that answers some of the pertinent questions. Put internal review staff at the entry gate to ensure that additional data is truly relevant to the appraisal. Provide an organized method for the appraiser to work with the additional data and respond to its relevancy. If appraisers respect the process and feel that any additional information has been reviewed before being sent over, then appraisers will be more willing to respond.

Conclusion

Predatory lending continues to be an issue in mortgage lending despite the press and government attention being focused on mortgage fraud nationally. If lenders and appraisers can establish a business relationship that is built on respect for professionalism and trust that the lender is seeking the most accurate valuation to mitigate risk of, then the best of both groups will be successful doing business with each other.

Lenders must be able to take a defensive position with regard to this situation. Internal appraisal groups should be able to use the best appraisers possible to protect both the integrity of the loans being made as well as protecting the organization from false claims of appraiser pressure. At the same time, the internal appraisal group must be in the position to keep the appraiser independent from the lending process so that they can do their job to the best of their ability as well as to the expectations of the client.

Setting up a well-designed and documented operation can effectively cover all the bases and provide clear direction both internally and outside the organization. Communication of the system and clarity of purpose is essential for success in these tumultuous times.

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